INTERNATIONAL MONETARY FUND

IMF Country Report No. 20/24

REPUBLIC OF NORTH MACEDONIA

January 2020

2019 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR NORTH MACEDONIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2019 Article IV consultation with North Macedonia, the following documents have been released and are included in this package:

- A **Press Release** on the staff report that concluded the Article IV consultation with North Macedonia.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse of time basis, following discussions that ended on November 15, 2019, with the officials of North Macedonia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 23, 2019.
- An **Informational Annex** prepared by the IMF staff.
- Two **Staff Supplements** updating information on recent developments.

The document listed below will be separately released.

- Selected Issues Paper

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 20/17
FOR IMMEDIATE RELEASE
January 27, 2020

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700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2019 Article IV Consultation with the Republic of North Macedonia

On January 22, 2020, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of North Macedonia and considered and endorsed the staff appraisal without a meeting.[1,2]

Economic activity is strong. Real GDP growth is estimated to have strengthened to 3.2 percent in 2019, supported by buoyant private consumption and a rebound in investment. Export growth remained high despite the slowdown in key trading partners, while imports were boosted by the solid domestic demand. Helped by sizeable inflows from remittances, the current account deficit was modest. Inflation, which is mainly driven by euro area inflation and food and energy prices, was low.

The overall fiscal deficit is expected to have remained below 2 percent of GDP in 2019, keeping public debt broadly stable. Capital spending increased markedly from 2018 but continues to be below budgeted amounts, despite the country's investment needs.

Credit growth is solid, and non-performing loans remain relatively low. Against the background of low inflation, solid deposit growth, and favorable foreign exchange market developments, the National Bank of the Republic of North Macedonia has continued to accumulate international reserves and further cut its policy rate in January 2020, keeping monetary policy accommodative.

Executive Board Assessment

In concluding the Article IV consultation with the Republic of North Macedonia, Executive Directors endorsed the staff's appraisal as follows:

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

After a protracted political crisis, the economy has entered a period of solid growth and stability. Over the recent years, the authorities have reviewed the reform momentum, with crucial institutional and governance reforms and efforts to make public finances more sustainable and equitable. Through these actions, they have gained substantial policy credibility and the economy has rebounded.

Growth is expected to accelerate in 2020. Lower taxes and higher pensions and wages—including public sector and minimum wages—are expected to provide a further, albeit one-off, stimulus to consumption. Export and investment growth would remain robust but slow somewhat, reflecting weak growth in trading partners. This moderation could become more pronounced if global trade tensions worsen or investment plans are delayed due to uncertainty during the election period.

Staying on the path of reform is essential to further bolster the economy's resilience to shocks and durably raise income levels. This period of solid growth should be used to rebuild fiscal space, in order to strengthen the economy's ability to cope with future shocks. Going forward, speeding up income convergence and improving living standards will necessitate a more growth-enhancing fiscal policy mix and an unwavering commitment to the ambitious structural reform agenda.

An ambitious consolidation is needed to rebuild fiscal policy space and re-orient public spending toward investment. A cumulative consolidation of 1½ percent of GDP over 2020–22, compared to staff's baseline projections, would achieve primary budget balance and ensure that there is policy space to act in an economic downturn. The consolidation would require steadfast implementation of already approved reforms to pensions and personal income tax, as well as enhanced revenue administration and rationalization of agricultural subsidies. These measures would also make space in the budget to increase essential capital expenditure to narrow the investment gap. This should be underpinned by measures to strengthen the public investment management framework, including better prioritization and addressing bottlenecks in execution of planned projects. To safeguard against fiscal risks, the authorities should wait to approve new PPPs until a strengthened framework is in place.

Reforms to address key labor market and institutional weaknesses will help lift medium-term growth and speed up income convergence. Although growth has been solid in the past two decades, it has not been enough to substantially narrow North Macedonia's large income gap with the EU. To accelerate convergence, it is essential to continue reforms to improve the public administration, rule of law, and control of corruption. This should be complemented by efforts to build physical capital given infrastructure gaps and to boost human capital to address skills shortages and mismatches, including through vocational education and training and more use of skill-enhancing active labor market policies. Reforms to tackle informality would help improve the business climate and protect workers, with potential large revenue gains. Strengthening revenue administration efficiency and compliance should be the priority, combined with measures that raise public trust in institutions and tax morale.

The minimum wage should be aligned closely with productivity. The net minimum wage has been raised by 44 percent cumulatively since 2017 while productivity growth has been low. The minimum wage is estimated to reach 53 percent of the average wage in 2020, which is high by regional standards. These increases may not be effective in reducing overall poverty and may have adverse effects on formal employment and competitiveness.

The monetary policy stance is appropriate. The NBRNM has appropriately used the favorable conditions to accumulate reserves within the de facto exchange rate peg. While reserve coverage is broadly adequate, the central bank should continue building buffers against possible domestic or external shocks. Going forward, should the external environment worsen, the NBRNM should stand ready to tighten monetary policy.

The banking system is healthy, but efforts are needed to further mitigate credit risk. The banking system is well capitalized and liquid. Steps to further increase deposit denarization, coupled with carefully calibrated measures to curb foreign currency lending to households, as needed, would help strengthen financial system resilience. Amid continued high credit growth to households, closer monitoring, including by collecting granular household data, is warranted.

Further strengthening the financial stability framework remains a priority. In line with the recommendations of the 2018 FSAP, the authorities have started to enhance the supervisory and regulatory framework, including by enhancing banks’ liquidity risk reporting and increasing the supervisory intensity for domestic systemically important banks. It is important to strengthen the macroprudential mandate of the NBRNM, together with improved systemic risk identification. Further progress is needed on the financial safety net, by introducing a comprehensive bank resolution framework and buttressing the deposit guarantee scheme.

North Macedonia: Selected Economic Indicators

	2014	2015	2016	2017	2018	2019 (e)	2020 (p)
	Year-on-year change, unless otherwise specified						
Real GDP	3.6	3.9	2.8	1.1	2.7	3.2	3.4
Real domestic demand	4.4	5.4	5.0	0.5	2.0	4.2	3.7
Consumption	2.4	4.3	2.1	0.4	2.4	2.9	3.1
Gross investment	10.7	8.3	12.5	0.8	0.9	7.4	5.2
Net exports	-8.0	-14.1	-16.7	-0.1	-1.2	-5.8	-5.2
CPI inflation (annual average)	-0.3	-0.3	-0.2	1.4	1.5	0.9	1.2
Unemployment rate (annual average)	28.0	26.1	23.8	22.4	20.7	17.9	16.8
Private Sector Credit	9.8	9.5	0.0	5.3	7.3	6.7	6.3
	In percent of GDP						
Current account balance	-0.5	-2.0	-2.9	-1.0	-0.1	-1.0	-1.2
Goods and services balance	-17.2	-16.2	-15.2	-14.1	-12.8	-12.7	-12.2
Exports of goods and services	47.7	48.8	50.9	54.9	60.4	63.0	64.0
Imports of goods and services	64.9	65.0	66.2	69.0	73.2	75.8	76.2
Private transfers	17.3	16.8	15.4	15.9	15.9	15.3	14.8
External debt	70.0	69.3	74.7	73.4	73.4	74.2	74.0
Gross investment	30.3	30.4	32.5	32.3	31.9	32.9	33.3
Domestic saving	29.8	28.5	29.7	31.2	31.8	32.0	32.1
Public	-0.9	-0.1	0.2	0.5	0.1	0.3	0.0
Private	30.6	28.6	29.5	30.7	31.7	31.7	32.0
Foreign saving	0.5	2.0	2.9	1.0	0.1	1.0	1.2
General government gross debt 1/	38.0	38.1	39.8	39.4	40.6	39.8	40.4
Public sector gross debt 1/ 2/	43.3	44.0	46.7	46.1	47.6	47.6	49.1
Central government balance	-4.2	-3.5	-2.7	-2.7	-1.8	-1.8	-2.5
Memorandum items:							
Nominal GDP (billions of denars)	527.6	559.0	594.8	618.1	658.1	692.7	730.9
Nominal GDP (billions of euros)	8.6	9.1	9.7	10.0	10.7	11.2	11.9
GDP per capita (euros)	4138	4380	4657	4837	5145	...	...

Sources: NBRNM; SSO; MOF; IMF staff estimates.

1/ The historical debt ratios differ slightly from the numbers reported by MoF due to using end-year debt in local currency divided by local currency GDP.

2/ Includes general government and public sector enterprises.

INTERNATIONAL MONETARY FUND

REPUBLIC OF NORTH MACEDONIA

December 23, 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

KEY ISSUES

Context. Growth is solid, with strong domestic demand and resilient exports despite the slowdown in global trade. The government has undertaken important reforms in past years to strengthen the economy and support the country's EU candidacy. To bolster the economy's resilience to shocks and speed up income convergence, the authorities should rebuild fiscal policy space, re-orient public spending toward investment and continue improving institutions and government efficiency.

Key Policy Recommendations

- **Fiscal Policies.** To increase the fiscal policy space and allow higher capital spending to meet infrastructure needs, staff recommend gradually reducing current spending and strengthening the revenue base. On the expenditure side, this should include fully implementing the pension reform and rationalizing agricultural subsidies. On the revenue side, additional resources can be mobilized through higher tax efficiency, in particular for VAT. Capital spending should be increased, supported by improvements in public investment management.

- **Monetary and Financial Policies.** Within the de facto exchange rate peg, monetary policy is appropriately accommodative, supporting strong credit growth. The policy stance may need to be tightened if global financial conditions deteriorate. The banking system remains sound, but legal reforms, enhancements of the macroprudential framework and further capacity development remain important to strengthen financial sector oversight.

- **Structural Policies.** Institutional reforms such as strengthening the rule of law and control of corruption are essential to strengthen growth prospects and boost income convergence. Such efforts are also important to reduce informality, in combination with measures to strengthen revenue collection and combat tax evasion. The minimum wage has increased rapidly, and staff recommend preserving competitiveness by aligning the minimum wage closely with productivity going forward.

Approved By
Jörg Decressin (EUR) and Rupa Duttagupta (SPR)

Discussions were held in Skopje during November 6–15, 2019. The mission met with Prime Minister Zaev, Deputy Prime Minister Angjushev, Finance Minister Angelovska, Governor Angelovska Bezoska, other senior officials, parliamentarians, labor unions and representatives of the private sector and diplomatic envoys.

The staff team comprised Ms. Barkbu (head), Mr. Poulain and Ms. Lin (all EUR), Ms. Kida (FIN), Ms. Eble (Resident Representative), and Mr. Nacevski (IMF Local Economist). Ms. Harutyunyan (OED) and Ms. Rabier (EUR) attended some of the meetings. Ms. Maneely and Ms. Tenali (EUR) assisted in the preparation of the report from Headquarters.

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CONTEXT

1. The authorities have revived the reform momentum in recent years. Crucial institutional and governance reforms have demonstrated their commitment to tackle long-standing challenges. Moreover, the frameworks for pension and social spending have been improved, and taxation was made more equitable, strengthening the sustainability of public finances. Notwithstanding these achievements, the European Council has postponed a decision on opening EU accession negotiations, representing a difficult setback for North Macedonia. In this context, parliamentary elections initially scheduled for late 2020 have been brought forward to April 2020. As per the terms of the Przino agreement, a caretaker government will be in place from January 2020.[1]

2. The key challenges for North Macedonia are to bolster the economy's resilience to shocks and speed up income convergence. It is essential to stay on the path of reforms. Steps in the 2020 budget to modify elements of the recent fiscal reforms could undermine the gains. More broadly, the focus of the 2019 Article IV consultation is on policies to rebuild fiscal policy space, re-orient public spending toward investment in physical and human capital; and improve institutions and government efficiency.

RECENT DEVELOPMENTS

3. Real GDP growth rebounded in 2018 and has strengthened further in 2019. Growth remained strong at 3.6 percent year-on-year in the third quarter (Figure 1). Consumption has been buoyed by strong disposable income growth in 2019. Public and private investment have recovered after stagnating in 2018, boosting import growth. Exports, including of automotive parts, remained strong in spite of the slowdown in key European trading partners. The unemployment rate has continued to fall, but remains elevated, at 17.1 percent in September 2019.[2] Inflation, which is mainly driven by euro area inflation as well as food and energy prices, remained subdued at 0.9 percent on average in the first ten months of 2019 despite a closing output gap.

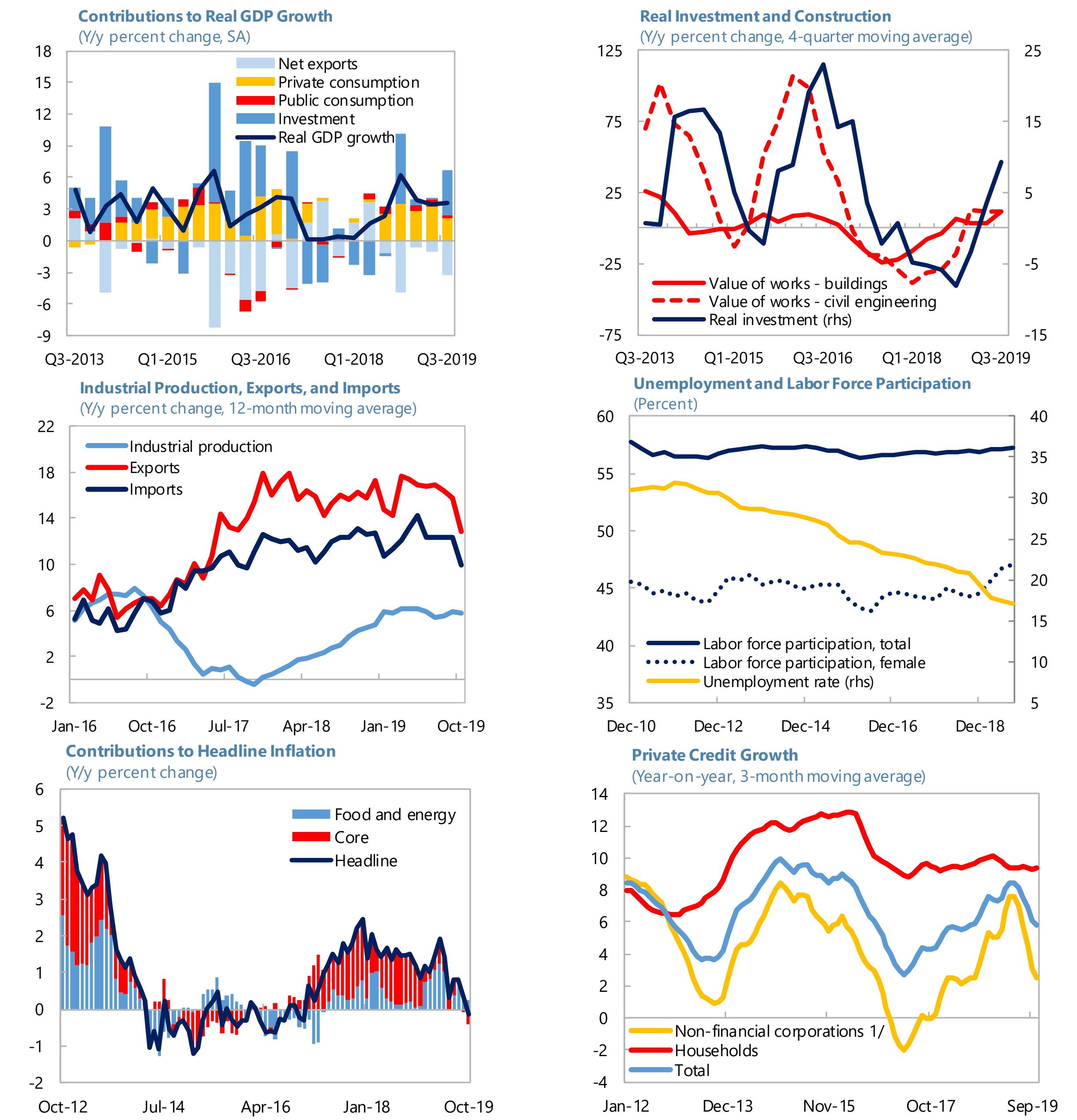
4. Monetary and financial conditions remain accommodative. Against a background of low inflation, solid deposit growth, and favorable FX market developments, the National Bank of the Republic of North Macedonia (NBRNM) has continued steadily accumulating international reserves and further cut its policy rate to 2.25 percent in March 2019. Lending interest rates are declining, and growth in credit to households has remained strong (9.5 percent y/y in September). Corporate credit growth is recovering, although regulatory write-downs led to a slowdown in the third quarter.

[1] The incumbent government will appoint an interim Prime Minister. Two ministerial posts (the Ministry of the Interior and the Ministry of Labor and Social Affairs) will be given to opposition members and additional deputy ministers from the opposition will be appointed for three ministries including the Ministry of Finance.

[2] Actual unemployment could be lower, as suggested by anecdotal evidence of firms' difficulties in filling vacancies. Official statistics may not fully capture informal employment and rely on 2002 census data which does not properly account for the sizable emigration in the last two decades. A new census is planned for April 2021.

5. The fiscal deficit is likely to be below its target in 2019, to a large extent due to projected under-execution of capital spending. The supplementary 2019 budget envisaged a deficit of 2.5 percent for 2019, but based on budget execution through October, staff project a deficit of 1.8 percent of GDP, mostly because capital spending continues to be substantially below the budgeted amount (Figure 4). Current spending has increased compared to last year due to higher transfers, mainly reflecting higher pension expenditures, the impact of social assistance reform, and to a small extent the VAT reimbursement scheme introduced in July.

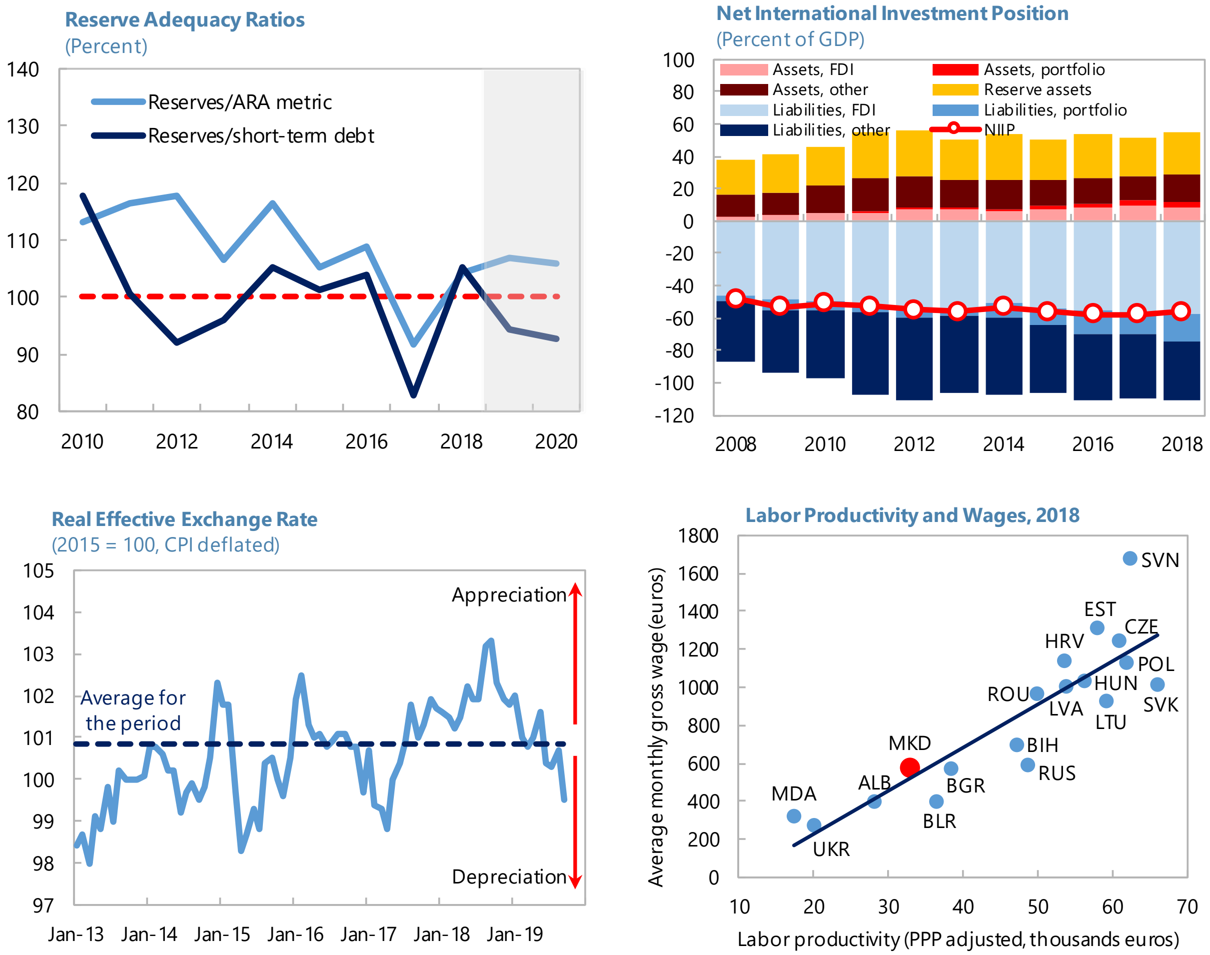
Figure 1. North Macedonia: Recent Developments



Sources: MakStat; Haver Analytics; NBRNM; and IMF staff calculations.

1/ Includes regulatory write-downs. Net of regulatory write-downs, the corporate credit growth in 2019 Q3 is estimated to be 5.1 percent year-on-year.

Figure 2. North Macedonia: External Sector Developments



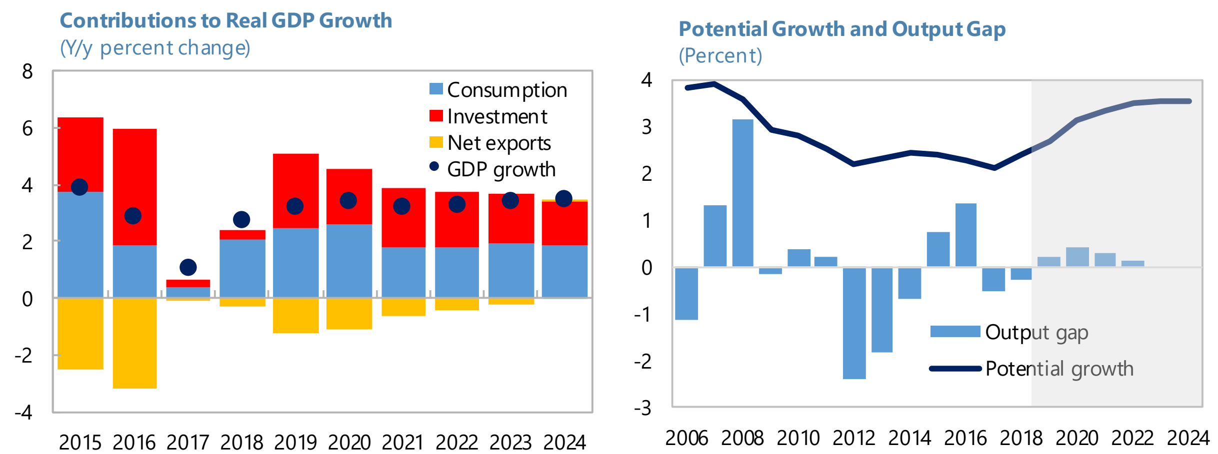
Sources: Haver Analytics; IMF DOTS; NBRNM; National authorities; The Conference Board Total Economy DatabaseTM (Adjusted version); and IMF staff calculations.

6. The external position is estimated to be broadly in line with fundamentals and desirable policies (Figure 2, Table 7). The gap between the cyclically-adjusted current account balance and its multilaterally-consistent norm is estimated to be about 1 percent of GDP in 2018, largely explained by a temporary drop in investment. Based on data through September, staff projects that the current account gap will narrow to -0.1 percent of GDP in 2019, reflecting the ongoing rebound in investment. The two EBA-lite approaches suggest that the real effective exchange rate is close to its equilibrium value. The NBRNM has continued to accumulate reserves in 2019, helped by the disbursement of the World Bank's Development Policy Loan in November. Reserve coverage is expected to reach 107 percent of the Fund's ARA metric and 94 percent of short-term debt at remaining maturity at end-2019.

OUTLOOK AND RISKS

7. **Real GDP growth is projected to reach 3.4 percent in 2020, up from 3.2 percent in 2019.** Rising wages—including from minimum wage and public sector wage adjustments—are expected to provide a further, albeit temporary, boost to consumption in 2019 and 2020. In the medium term, potential growth is expected to increase moderately to 3½ percent reflecting growth dividends from past reforms and continued FDI inflows expanding export capacity. The current account deficit is projected to widen to 1.9 percent of GDP by 2024 as infrastructure-related imports pick up and private transfers in foreign currency (mainly remittances) gradually decrease.

Figure 3. North Macedonia: GDP Growth



Sources: Makstat; and IMF staff calculations.

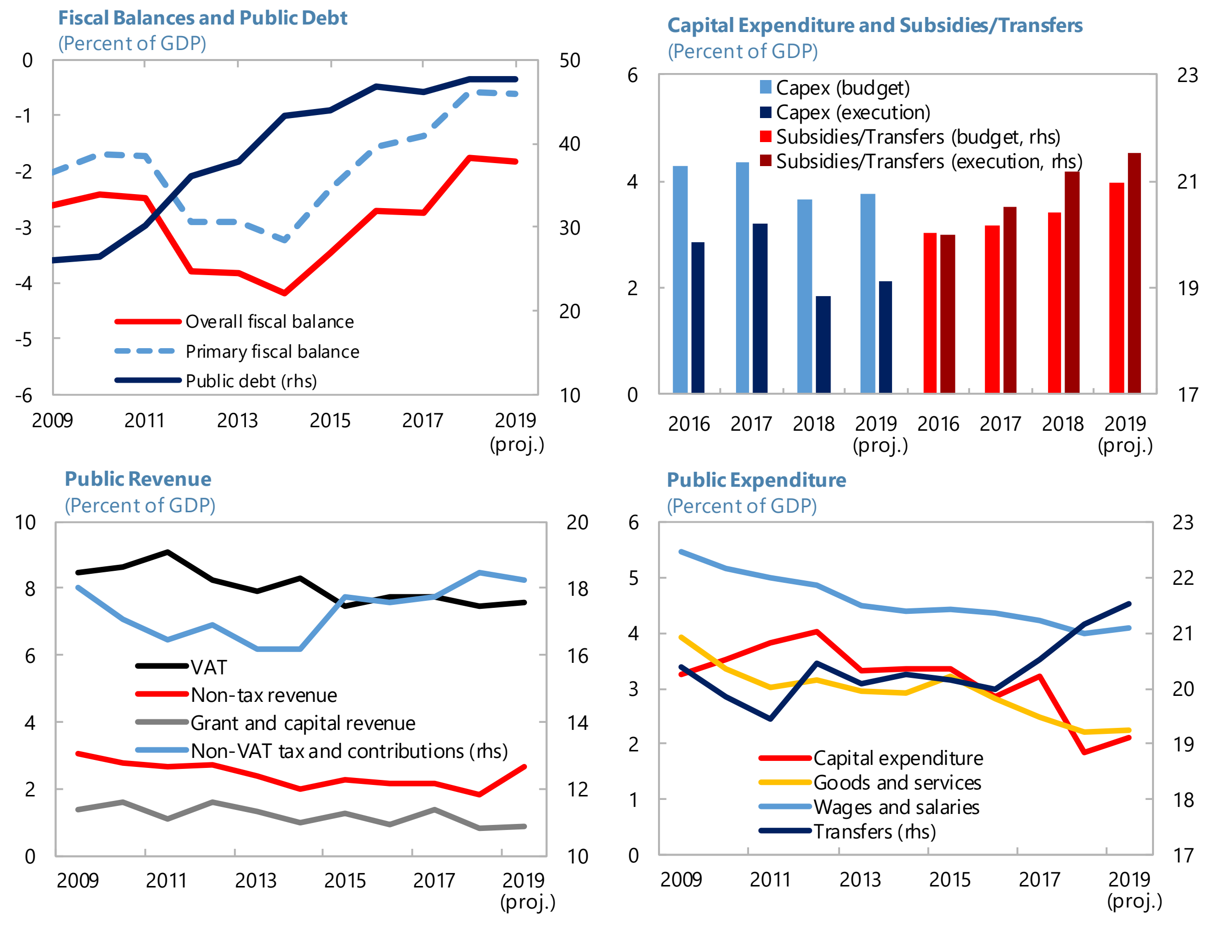
8. **Risks to the growth outlook are skewed to the downside (Table 8).** Rising trade tensions and a protracted increase in global risk aversion are key downside risks to the outlook. Domestically, the further delay in securing a date for opening EU accession negotiations and the election period could trigger a new period of uncertainty and derail the reform momentum. Conversely, a decisive push for structural and institutional reforms, possibly associated with a decision to open EU accession negotiations, could boost capital inflows and confidence.

Authorities' Views

9. **The authorities also expect growth to remain solid and broad-based, reflecting resilient exports and strong domestic demand.** Their 2020 forecast is slightly higher than that of staff, reflecting more optimistic assumptions about domestic demand. Disposable income is expected to be boosted by increases in minimum wages, pensions and public sector wages. The investment rebound is expected to continue, supported by major infrastructure projects. In line with staff's assessment, the authorities consider that risks are skewed to the downside. In particular, uncertainty during the election period could delay some investment plans and further global trade tension could dampen export growth. On the upside, NATO membership and progress toward EU

accession negotiations would likely strengthen confidence and encourage investment. Finally, the authorities agree with staff's external sector assessment.

Figure 4. North Macedonia: Fiscal Developments



Sources: Ministry of Finance; and IMF staff calculations.

BUILDING FISCAL POLICY SPACE

10. Fiscal developments over the past decade have reduced the policy space. Public debt has nearly doubled since 2009. Revenue has weakened—reflecting both cyclical factors and low collection efficiency—and transfers and subsidies have increased. While the deficit has narrowed in recent years, capital spending has been under-executed by more than one percent of GDP each year on average, in spite of large infrastructure and human capital needs. At the same time, subsidies and transfers, including for pensions, have exceeded budgeted amounts (Figure 4 and Box 1). In early 2019, the government put in place reforms that would, if fully implemented, increase the policy space. In particular, pensions were reformed—including higher contribution rates and CPI-only indexation of benefits—and social assistance spending was reoriented to better addressing inequality. Moreover, the personal income tax (PIT) was reformed, including by introducing a higher marginal tax rate for top earners and a higher tax rate for capital income.

11. Staff expect the fiscal stance to ease in 2020. According to the 2020 budget proposal, the key elements of the already implemented PIT reform will be suspended until January 2023. The CPI-only indexation for pension benefits has been altered to allow for additional pension increases in years where wage growth meet certain criteria. This will result in an increase in pension benefits of about 3½ percent more than what would be implied by the CPI-only indexation. Further wage increases are planned in the education sector (10 percent) and the health care sector (5 to 25 percent depending on job categories), on top of the wage increase that became effective in September. The VAT reimbursement scheme, implemented in July, and the subsidy on employers' social security contributions, approved in October, will also add to spending. The total budgetary cost of these measures is estimated at 1.2 percent of GDP in 2020, which has been incorporated in staff's baseline projections.

Estimated Effect of Recently Annouced Measures on the 2020 Budget
(Percent of GDP)

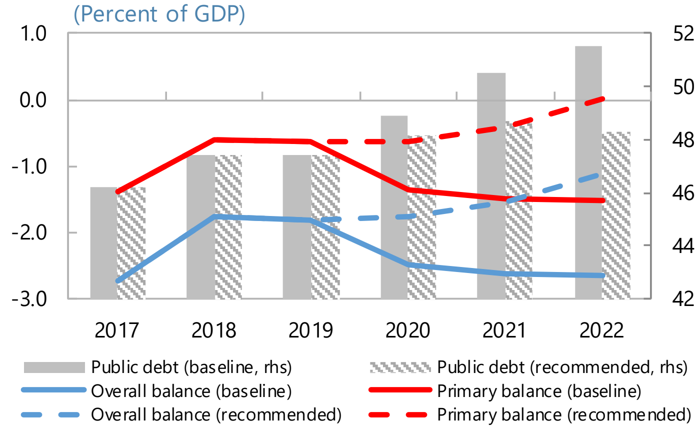
VAT reimbursement	0.4
Public sector wage hike 1/	0.3
Social security contribution subsidies 2/	0.0
Suspension of the personal income tax reform	0.2
Additional increase in pension benefits	0.3
Total impact	**1.2**

Source: IMF staff calculations.
1/ Included the cost of wage hikes for education sector workers (about 1.4 bn denars) and health care sector workers (about 1 bn denars).
2/ Despite a neutral budgetary impact on the general government in 2020, this measure would increase pension expenditures in the future.

12. A continuation of current policies would reduce the ability to accommodate future shocks. Under the baseline scenario, the general government deficit would increase to 2.7 percent of GDP over the medium term. Public debt would continue its upward trajectory and reach around 52 percent of GDP in the medium term (Annex I). While the debt burden is expected to be sustainable, high gross financing needs, projected to peak at about 15 percent of GDP in 2021, and potential shocks to growth constitute important downside risks. Moreover, this path assumes that loan disbursements to the state-owned road infrastructure company (PESR) would decline over the medium term to about one third of the 2020 level. In case shocks materialize, increases in social spending and transfers would be difficult to reverse. At the same time, capital spending would be insufficient to meet development needs, reducing the long-term growth potential.

13. Staff recommend bringing the deficit closer to 1 percent of GDP over the medium term to build policy space, while re-orienting spending to investment. Concretely, staff proposed a consolidation of 1½ percent of GDP over 2020–22, considering the strong cyclical conditions. The authorities should also strengthen tax revenue collection, to create space for higher capital spending over time. Together these measures should help bolster the resilience to shock and enhance the long-term growth potential:

Fiscal Balances: Baseline and Recommendations
(Percent of GDP)



Sources: Macedonia Ministry of Finance; and IMF staff calculations.

- **Implementing recent reforms to pensions and social assistance.** Pensions are in general more generous than in peer countries. Full implementation the CPI indexation of pension benefits approved in 2019 would save about 0.6 percent of GDP by 2022, compared to staff's baseline which assumes that pension benefits will increase by CPI inflation plus a third of nominal GDP growth.

- **Implementing recent reforms to personal income tax.** The personal income tax reform helped to make the tax system more equitable. Re-instating the reform, together with measures to address evasion, would provide 0.2 percent of GDP in additional revenue.

- **Rationalizing agricultural subsidies.** Studies have found that agricultural subsidies do not considerably improve efficiency or reduce poverty.[3] Lowering agricultural subsidies toward the EU-28 average could provide fiscal savings of about 0.4 percent of GDP.

- **Building the revenue base.** An improvement in tax administration, a focus of Fund capacity development, is essential to reduce informality and increase the revenue base. This should be combined with measures to address policy gaps, in particular reducing preferential treatments in VAT and introducing a more broad-based property tax.

- **Raising capital spending and improving its quality.** Considering North Macedonia's large investment needs, the government should re-orient public spending toward investment. This should be underpinned by measures to strengthen the public investment management framework, including better prioritization and addressing bottlenecks in execution of planned projects.

Recommended Fiscal Reforms and Estimated Fiscal Gains/Savings

(Percent of GDP)

Measures (and expected time for budget impacts 1/)	
Steadfast implementation of the CPI only indexation of pension reforms (S-M)	0.6 to 0.9
Steadfast implementation of the PIT reforms adopted in 2019 (S)	0.2
Rationalization of agricultural subsidies (S-M)	0.4 to 0.5
Improving revenue administration and compliance risk management and/or expanding the VAT base by curtailing untargeted preferential treatment of certain goods and services (M)	0.3 to 0.8
Reform of property taxation (M-L)	0.3 to 0.5
Total Savings	**1.8 to 2.9**
Use of savings, including	
Increasing capital expenditure to 4 percent (M) 2/	1.1
Creating new fiscal space	0.7 to 1.8

Source: Estimates by World Bank (VAT, subsidies) and IMF staff (pension, revenue adminsitration).
1/ The letters in brackets stand for gains in the short (S), medium (M) and long (L) term.
2/ Investment by PESR not included.

14. Public investment management should be improved, in particular with respect to Public Private Partnerships. An assessment of the framework for public investment management (PIMA) is planned for early 2020 and a new PPP law is under development with help from the World Bank. To improve the management of PPPs, it is essential to establish a strong legislative and

[3] See "Sowing the Seeds of a Sustainable Future" Republic of North Macedonia Public Finance Review, World Bank Group, March 2019.

institutional framework to analyze project feasibility, assess costs, and monitor fiscal risks. Accordingly, while acknowledging the large investment needs, staff suggest waiting to approve new PPPs until a strengthened framework is in place. Moreover, to improve fiscal transparency, non-market SOEs should be covered in general government data, consistent with recommendations from Fund capacity development and standards for public finance statistics.[4]

Implementation of Past Policy Advice

The authorities remain constructively engaged with the Fund and the traction of Fund advice has been good in recent years.

- ***Fiscal.*** In 2019, the frameworks for pension and social spending were strengthened, and taxation was made more equitable, improving the sustainability of public finances. However, recent modifications (alteration of the CPI-only indexation of pensions; three-year suspension of the progressive PIT rate and capital gains tax) are scaling back some of the gains.
- ***Structural.*** The authorities have stepped efforts to implement ambitious institutional and governance reforms in the past years, and continued efforts are needed. The formalization of the minimum wage setting in 2019 was a step forward, but more attention is needed to ensure that the minimum wage is aligned with productivity developments.
- ***Financial.*** In line with recommendations from the 2018 FSAP, the authorities have started to enhance the supervisory and regulatory framework. They have also embarked on the preparation of legislative packages to strengthen the macroprudential mandate of the NBRNM and improve the financial safety net.

Authorities' Views

15. The 2020 budget aims to support domestic activity and tackle the informal economy, within a limited budget envelope. The authorities found it necessary to pause and reevaluate the progressive income tax and the higher tax rate on capital income, because the measures likely triggered tax evasion while yielding only modest revenue gains during the first six months of implementation in 2019 . However, the income tax from games of chance will remain with the same tax rate as 2019 (15 percent). The costs of the VAT reimbursement scheme are expected to be modest given limited take-up, and over time more than offset by higher revenues from increased VAT registration by business. The additional increase in pension benefits is needed to avoid pensioners falling behind, given high wage growth. The subsidies to social security contributions are expected to support formal employment by lowering the employers' burden from higher wages, while at the same time curtailing informal wage payments.

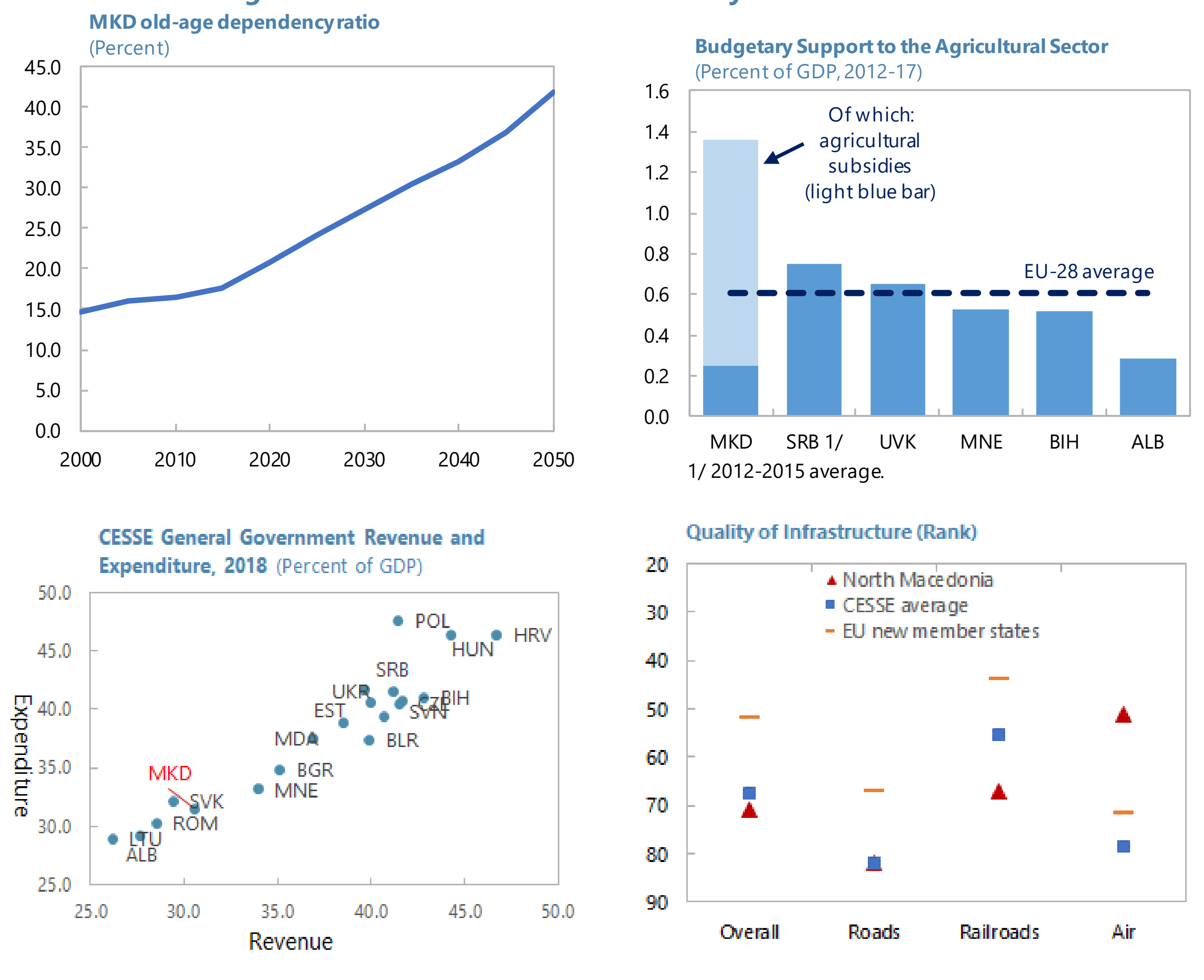
16. The authorities agree with staff's recommendation to consolidate public finances over the medium term and stabilize public debt. They expect the deficit to decline to 2.3 percent of GDP in 2020, consistent with the government's fiscal strategy. The medium-term fiscal strategy

[4] The public road company PESR has a 0.7 percent of GDP deficit in 2018 (latest available) which is not included in general government statistics.

targets a reduction in the deficit to 2 percent of GDP by 2022. They agree on the need to consolidate the pension deficit by implementing the pension reform and will consider ways to rationalize agricultural subsidies over time. They highlight the potential gains from better revenue administration, including making use of new technologies, integrating IT systems, and increasing the capacity of the Public Revenue Office.

17. Raising productive capital spending remains a priority. To address under-execution, the authorities have created a new transparency tool to better monitor the realization of capital expenditure. The Fund's upcoming PIMA will also help strengthen the public investment management framework. In this respect, the authorities agree on the need to strengthen the capacity to consider and monitor PPPs, taking into account the potential fiscal implications. They plan to re-establish a central PPP unit to fully implement the responsibilities prescribed by the new PPP law, including the feasibility study and the process for tender and monitoring.

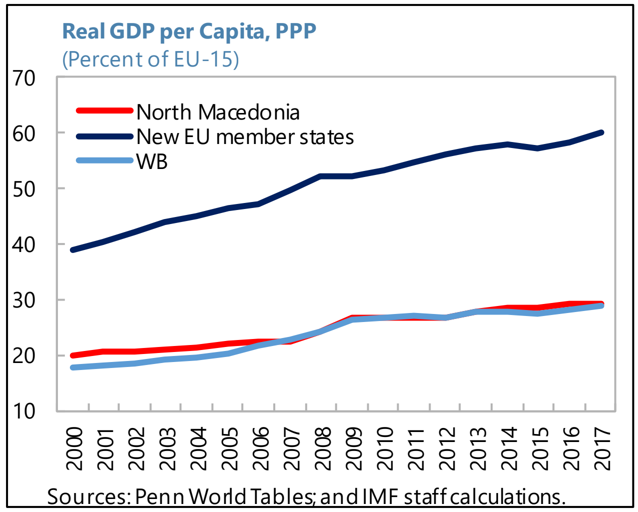
Figure 5. North Macedonia: Fiscal Policy Recommendations



Source: Agricultural Policy Plus; IMF WEO; OECD; United Nations; World Economic Forum; and IMF staff calculations.

STRUCTURAL POLICIES

18. Institutional reforms are critical to boost income convergence. Since 2000, North Macedonia's real GDP per capita has grown from 20 to just below 30 percent of the EU-15 average. Over the same period, new EU member states closed the gap with the EU-15 by more than 20 percentage points. Staff's analysis suggests that the opening of EU accession negotiations is associated with higher growth of GDP per capita (see Selected Issues Paper). This is found to be related to efforts to improve institutional quality that took place in new member states in the years running up to EU accession, as institutional quality is positively associated with higher growth of GDP per capita. North Macedonia should therefore continue to make progress in areas such as rule of law and control of corruption to improve the business environment, living standards, and bring forward EU accession.[5]



19. A comprehensive set of policies is needed to shift economic activity to the formal sector to achieve more inclusive growth and better protection of workers. Staff estimates suggest that more than a third of economic activity could be in the informal sector, above the average of Western Balkans and EU countries (see Annex II). While the shadow economy can create opportunities that are not available in the formal economy, it is detrimental to growth because formal businesses face unfair competition from the ones that do not pay taxes or comply with regulations. Moreover, informal workers are deprived of many labor rights. Further efforts should prioritize strengthening revenue administration efficiency and compliance tools and raising public trust in tax administration and tax morale. The authorities should take stock of the efficiency of tax incentives in reducing informality (MyVAT and the subsidy on employers' social security contributions). Experience in other countries suggests that these incentives are costly, make the tax system complex, and do not meaningfully improve tax morale.

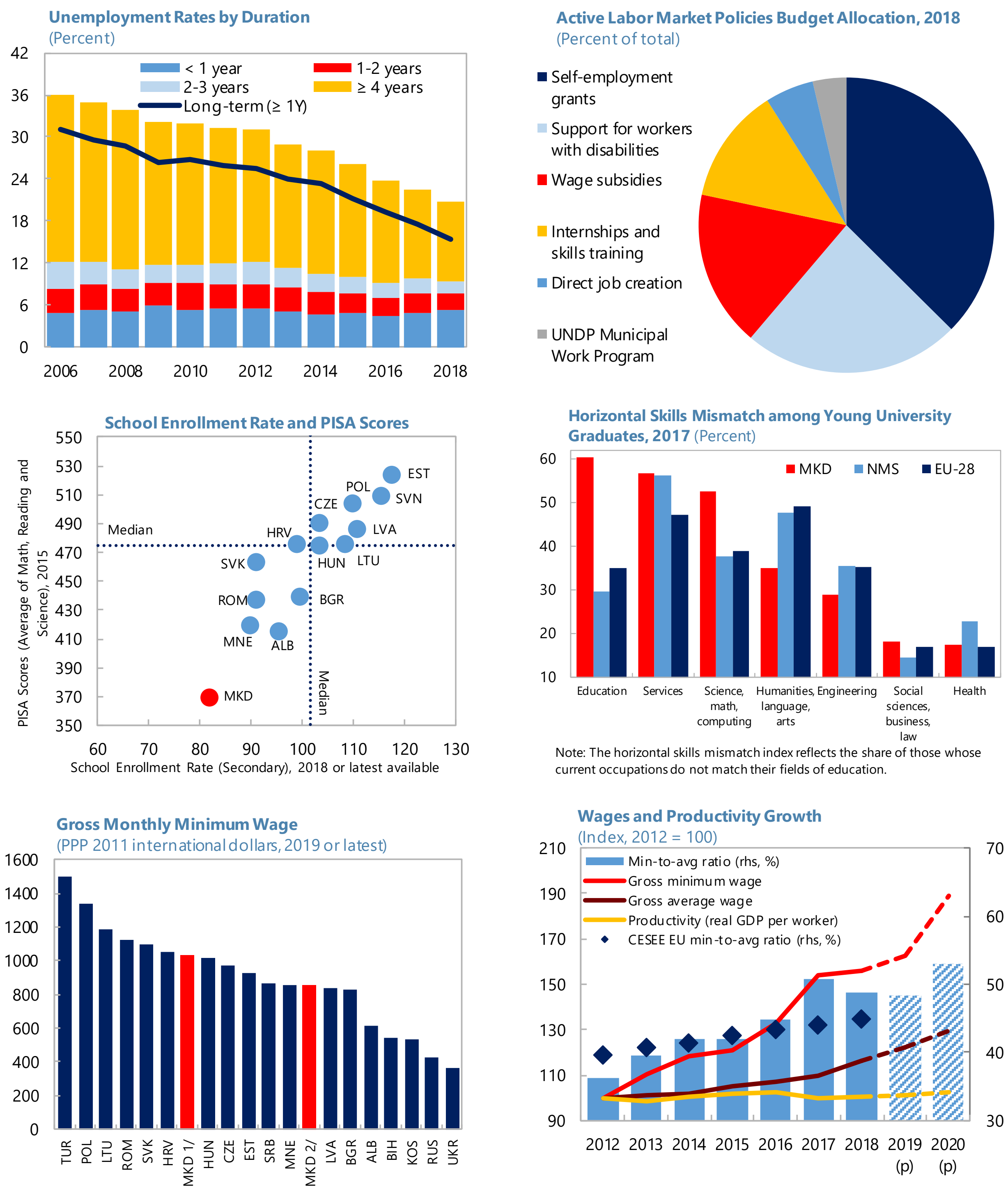
20. Elevated long-term and youth unemployment call for further efforts to address labor market weaknesses. Challenges associated with high structural unemployment and deficiencies in the education system are compounded by emigration of skilled labor (Figure 6). At the same time, improved employment prospects, together with better governance and institutions, could help curtailing net emigration flows.[6] Against this background, to address skill shortages and mismatches, education reform should focus on increasing completion rates and quality of secondary education

[5] See IMF country report No 19/32 - Annex I "Judicial Reform and Anti-Corruption Efforts in FYR Macedonia: Recent Progress and Next Steps" for staff analysis of governance issues.

[6] See "Emigration and its economic impact on Eastern Europe". IMF Staff Discussion Note SDN/16/07. July 2016

and modernizing the vocational educational system. This should be complemented by active labor market policies (ALMP) focused on skill-enhancing, such as training and internship programs. Wage subsidies and self-employment grants are costly and require rigorous monitoring.

Figure 6. North Macedonia: Labor Market and Education Policies



Note: 1/ After December 2019. 2/ Before December 2019
Sources: Eurostat; MakStat; North Macedonia authorities; OECD; and IMF staff calculations.

21. Reform efforts could also help attract foreign investment to sectors with high value added. Experience of new EU member states shows that FDI inflows, facilitated by financial incentives, skilled low-cost labor and a predictable business environment, can act as a strong anchor for export-driven growth and convergence. At the current juncture, given that several companies in the Technological Industrial Development Zones (TIDZ) are nearing capacity and that low-skilled labor supply is scarce, a key challenge will be to attract higher value-added FDI. This will require decisive progress in addressing labor market weaknesses discussed above. Finally, efforts to improve the ability of domestic suppliers to meet technical and safety requirements for exports to the EU could increase positive spillovers from the TIDZ to the domestic economy, which remain limited.

22. Increases in the minimum wage could hurt employment and may not effectively reduce poverty. The net minimum wage has been raised by 44 percent cumulatively since 2017 while productivity remained mostly stagnant. It is expected to reach 53 percent of the average wage in 2020, which is high by regional standards. Moreover, in purchasing power parity terms, the new minimum wage is relatively high compared to regional peers. While higher minimum wage can reduce poverty among the working population, it may not be effective in reducing overall poverty because most of the persons at risk of poverty are not working. Moreover, higher minimum wages could reduce formal employment (see Box 2). To preserve competitiveness, staff recommend aligning minimum wage increases with productivity growth.

Authorities' Views

23. The authorities consider reforms crucial to improve citizens' living standards. In particular, they continue the implementation of important institutional and governance reform to boost growth prospects. They have undertaken substantial efforts to attract FDI to higher value-added sectors. Moreover, they are currently designing a national strategy for human capital, aimed at improving the education system and reducing skill shortages and mismatches. Finally, they have increased the budget allocation for active labor market policies, with a focus on internship and training programs as well as self-employment grants, given the demonstrated effectiveness of these programs.

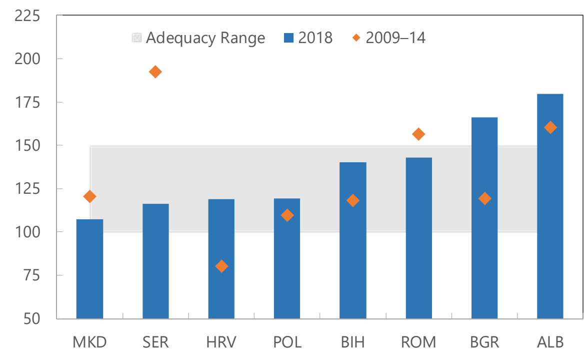
24. The minimum wage hike aims to improve living standards and reduce poverty. It was agreed with labor unions and the business community. The authorities are confident that it will not significantly hamper competitiveness, as the minimum wage level is still moderate compared to regional peers. Moreover, the subsidy on social security contributions is expected to mitigate any potential effect on formal employment. Higher wages are seen as an important lever to stem emigration and ensure adequate living standards for the working population, of which about 9 percent were at risk of poverty before the minimum wage increase.

25. Tackling informality is high on the authorities' agenda. They are currently updating their Action Plan, considering new measures that have been effective in EU countries, such as a new voucher system for wage payment in sectors like agriculture and household services, identification cards to facilitate labor inspections, and a public campaign to increase tax morale. They concurred with staff that stronger tax administration and labor inspections are essential to reduce informal activity, but also emphasized the role of fiscal incentives such as MyVAT to encourage VAT registration and the subsidy on social security contributions to reduce envelope payments.

BOLSTERING MONETARY AND FINANCIAL STABILITY

26. Monetary policy is appropriately accommodative. North Macedonia has a de facto stabilized exchange rate arrangement.[7] The NBRNM has traditionally kept the interest rate spread with the ECB main refinancing rate at about 300 basis points in non-crisis times. Against a background of continued foreign exchange inflows and low inflation over the past year, the NBRNM has continued to accumulate and has been able to reduce the policy rate spread to 225 basis points. While reserve coverage is broadly adequate, it is somewhat lower than for regional peers and favorable conditions should be used to build further buffers against possible domestic or external shocks in the context of the de facto exchange rate peg. Moreover, the policy rate cuts have been transmitted to money market rates and bank deposit and lending rates, and credit growth is now solid (Box 3). If global financial conditions were to tighten, the NBRNM should stand ready to increase its policy rate and reserve requirements, as needed.

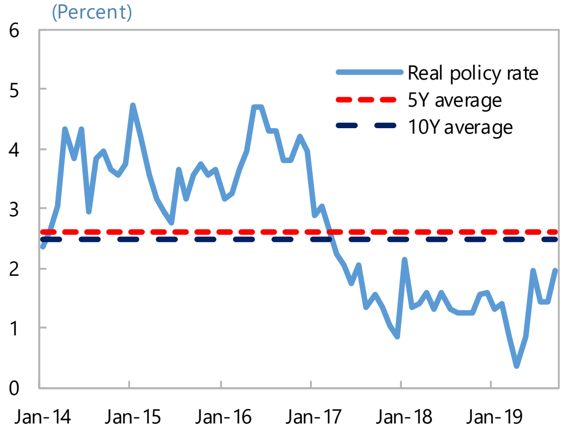
International Reserves
(Percent of ARA metric)



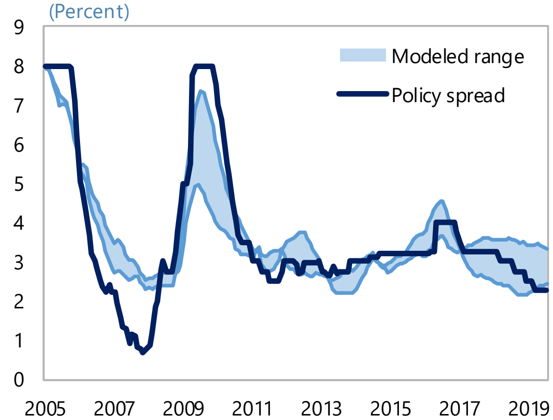
Sources: IMF Staff calculations

Figure 7. North Macedonia: Monetary Policy Stance

Real Policy Rate
(Percent)



Policy Interest Rate Spread - Actual vs. Modeled 1/
(Percent)

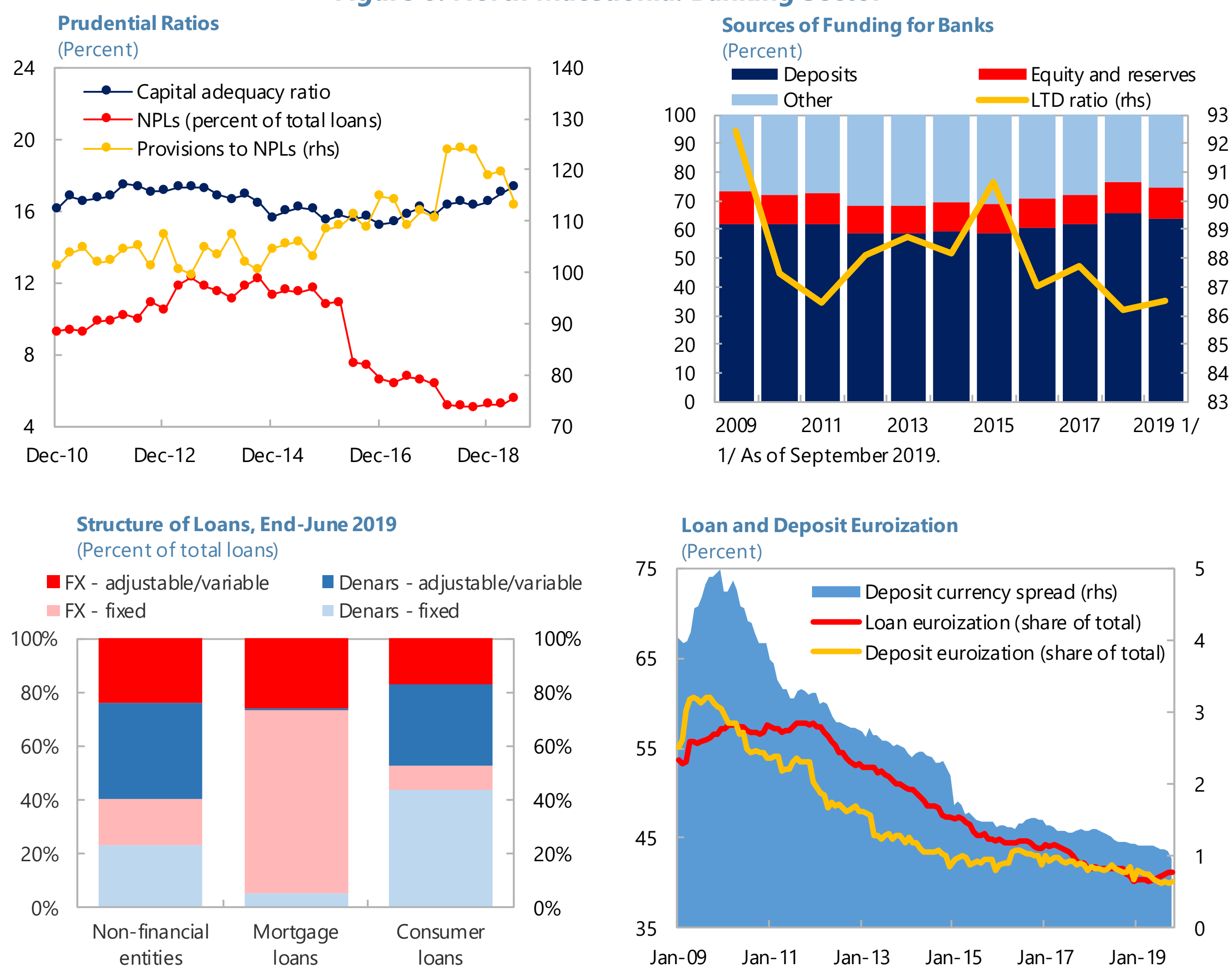


Sources: Haver Analytics; NBRNM; IMF staff calculations.
1/ Policy rate spread with the ECB modeled as a function of its own lagged value and the reserve gap, credit growth, domestic and euro area inflation, deposit euroization and EMBI.

[7] Price stability is the primary objective of the NBRNM as specified by the law, and the maintenance of the denar/euro exchange rate stability serves as an intermediate target for achieving price stability. When there is full capital mobility, monetary policy is ineffective under such an arrangement. However, in North Macedonia, imperfect capital mobility provides the central bank with some degree of autonomy in the short run.

27. The banking system remains well capitalized and profitable, but efforts are needed to further mitigate credit risk. At end-June 2019, capital adequacy ratios stood at 17.4 percent, one percentage point higher than last year. Non-performing loans remain relatively low, at 5.4 percent of total loans, and have declined, helped in part by accelerated NPL write-offs in the third quarter of 2019. Nevertheless, the still high share of FX and FX-linked loans (around 50 percent) in household loans and limited hedging of borrowers create vulnerabilities. The NBRNM is taking steps to access granular household data to improve their systemic-risk monitoring. Moreover, implementation of measures envisaged in the denarization strategy could help curb FX lending. An ongoing bank merger between two subsidiaries of euro area banks will help consolidate the relatively overcrowded banking system and improve efficiency.

Figure 8. North Macedonia: Banking Sector



Source: NBRNM and IMF staff calculations

28. The authorities are stepping up their efforts to implement the 2018 FSAP recommendations (Table 9). Capacity development by Fund staff is planned to support these efforts. Many of the substantial changes envisaged require legislative change that, given the elections, is expected to be submitted to Parliament in the fall of 2020.

- **Macroprudential policy framework**. Amendments to the central bank law are being drafted to give the NBRNM a clearer mandate for macroprudential policy and, as discussed above, access to more granular data for better systemic risk monitoring. In parallel, a memorandum of understanding for the Financial Stability Committee (FSC) is being finalized to improve interagency coordination of macroprudential policy.

- **Supervision and regulation**. The NBRNM has adopted a new Decision on risk management to strengthen banks' internal liquidity monitoring and is drafting a new regulation on liquidity risk management, which closely follows requirements under Basel III. A full-scope inspection of one D-SIBs has been completed but a shortage of experienced supervisors is an important hurdle for increasing inspection frequency.

- **Crisis management and resolution**. New laws are being prepared to (i) modernize the bank resolution framework in line with international best practice and (ii) strengthen the Deposit Insurance Fund respectively. A new resolution unit in the NBRNM has not been fully staffed and work on new resolution toolkit and contingency planning has been delayed.

- **AML/CFT.** A national strategy has been adopted to address the weaknesses identified by MONEYVAL. Guidelines for effective implementation of the new AML/CFT law have been published by the relevant sector supervisors and staffing at the Financial Intelligence Office has been strengthened. However, a closer coordination among government agencies is needed to further improve the registries of beneficial owners and politically exposed persons and the integrated database for identification and combating money laundering.

Authorities' Views

29. The monetary policy stance has supported private sector borrowing, while at the same time allowing the NBRNM to accumulate further foreign exchange reserves. The NBRNM considers the level of reserves to be adequate based on a range of reserve adequacy metrics, and noted the large share of inter-company lending and trade credits in short-term debt, which would likely not require swift use of reserve in case of an external shock. Given the uncertainty, both domestically and externally, they agreed on the need to carefully assess any further move in the policy rate.

30. The NBRNM is monitoring credit risk and is prepared to deploy additional measures, if needed. The higher risk weight (of 150 percent) has helped moderate the rapid growth of long-term consumer loans with maturity of eight years or longer. The denarization strategy, published in December 2018, envisages measures to reduce deposit-driven euroization, such as further differentiation of reserve requirements based on the currency structure. Several additional measures are also embedded in the strategy, such as possible gradual reduction of the limit on banks' open FX positions, and measures for further development of the domestic capital markets.

31. The authorities are committed to timely implementation of the FSAP recommendations. Efforts are ongoing to craft on an ambitious legislative package to upgrade and modernize the macroprudential, supervisory, and resolution frameworks. However, they stressed the recruitment challenges they faced to intensify supervision and welcomed the ongoing capacity building from developing partners, including from the Fund. On the AML/CFT, the authorities are closely monitoring the implementation of the national action plan to address remaining vulnerabilities identified by MONEYVAL in 2014 and 2018.[8]

STAFF APPRAISAL

32. After a protracted political crisis, the economy has entered a period of solid growth and stability. Over the recent years, the authorities have reviewed the reform momentum, with crucial institutional and governance reforms and efforts to make public finances more sustainable and equitable. Through these actions, they have gained substantial policy credibility and the economy has rebounded.

33. Growth is expected to accelerate in 2020. Lower taxes and higher pensions and wages—including public sector and minimum wages—are expected to provide a further, albeit one-off, stimulus to consumption. Export and investment growth would remain robust but slow somewhat, reflecting weak growth in trading partners. This moderation could become more pronounced if global trade tensions worsen or investment plans are delayed due to uncertainty during the election period.

34. Staying on the path of reform is essential to further bolster the economy's resilience to shocks and durably raise income levels. This period of solid growth should be used to rebuild fiscal space, in order to strengthen the economy's ability to cope with future shocks. Going forward, speeding up income convergence and improving living standards will necessitate a more growth-enhancing fiscal policy mix and an unwavering commitment to the ambitious structural reform agenda.

35. An ambitious consolidation is needed to rebuild fiscal policy space and re-orient public spending toward investment. A cumulative consolidation of 1½ percent of GDP over 2020–22, compared to staff's baseline projections, would achieve primary budget balance and ensure that there is policy space to act in an economic downturn. The consolidation would require steadfast implementation of already approved reforms to pensions and personal income tax, as well as enhanced revenue administration and rationalization of agricultural subsidies. These measures would also make space in the budget to increase essential capital expenditure to narrow the investment gap. This should be underpinned by measures to strengthen the public investment management framework, including better prioritization and addressing bottlenecks in execution of planned projects. To safeguard against fiscal risks, the authorities should wait to approve new PPPs until a strengthened framework is in place.

[8] The next MONEYVAL review is expected in 2021.

36. Reforms to address key labor market and institutional weaknesses will help lift medium-term growth and speed up income convergence. Although growth has been solid in the past two decades, it has not been enough to substantially narrow North Macedonia's large income gap with the EU. To accelerate convergence, it is essential to continue reforms to improve the public administration, rule of law, and control of corruption. This should be complemented by efforts to build physical capital given infrastructure gaps and to boost human capital to address skills shortages and mismatches, including through vocational education and training and more use of skill-enhancing active labor market policies. Reforms to tackle informality would help improve the business climate and protect workers, with potential large revenue gains. Strengthening revenue administration efficiency and compliance should be the priority, combined with measures that raise public trust in institutions and tax morale.

37. The minimum wage should be aligned closely with productivity. The net minimum wage has been raised by 44 percent cumulatively since 2017 while productivity growth has been low. The minimum wage is estimated to reach 53 percent of the average wage in 2020, which is high by regional standards. These increases may not be effective in reducing overall poverty and may have adverse effects on formal employment and competitiveness.

38. The monetary policy stance is appropriate. The NBRNM has appropriately used the favorable conditions to accumulate reserves within the de facto exchange rate peg. While reserve coverage is broadly adequate, the central bank should continue building buffers against possible domestic or external shocks. Going forward, should the external environment worsen, the NBRNM should stand ready to tighten monetary policy.

39. The banking system is healthy, but efforts are needed to further mitigate credit risk. The banking system is well capitalized and liquid. Steps to further increase deposit denarization, coupled with carefully calibrated measures to curb foreign currency lending to households, as needed, would help strengthen financial system resilience. Amid continued high credit growth to households, closer monitoring, including by collecting granular household data, is warranted.

40. Further strengthening the financial stability framework remains a priority. In line with the recommendations of the 2018 FSAP, the authorities have started to enhance the supervisory and regulatory framework, including by enhancing banks' liquidity risk reporting and increasing the supervisory intensity for domestic systemically important banks. It is important to strengthen the macroprudential mandate of the NBRNM, together with improved systemic risk identification. Further progress is needed on the financial safety net, by introducing a comprehensive bank resolution framework and buttressing the deposit guarantee scheme.

41. It is recommended that the next Article IV consultation takes place on the standard 12-month cycle.

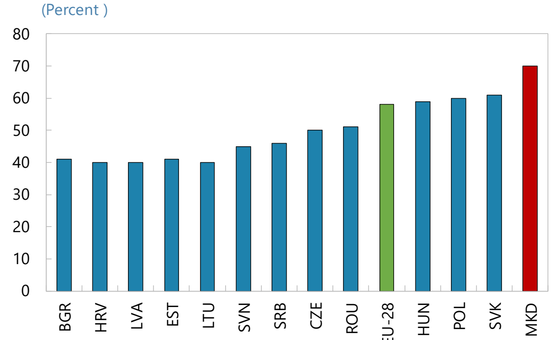
Box 1. Improving Government Spending Efficiency

Despite large infrastructure needs, capital spending has declined in recent years. Capital spending by the central government was on average 2.9 percent of GDP over the past five years (2014–18). Accounting also for investment by the state-owned road infrastructure company (PESR), capital spending in North Macedonia, at about 4.2 percent of GDP, is slightly below the level in CESSE countries over the same period. Partly reflecting the decisions to stay away from less productive investment, total capital spending declined to 3.3 percent of GDP in 2018 and is projected to remain weak in 2019. And, according to the Ministry of Finance, less than 50 percent of capital spending was in infrastructure investment.

Growth-enhancing spending should be protected. The relatively small revenue base—about 9.3 percent of GDP below the average of CESEE countries in 2018 – is limiting the space for higher capital spending. This calls for strengthening the revenue base, including by resisting the roll-back of the personal income tax reforms. Meanwhile, there is also a need to improve the efficiency of spending. In recent years, capital spending has been under-executed by about one percent of GDP or more per year, while subsidies and transfers, including for pensions, exceeded budgeted amounts.

Pension spending and untargeted subsidies and transfers should be contained, to preserve fiscal sustainability. In 2019, total subsidies and transfers (projected at 21.4 percent of GDP) are close to 5 percent of GDP higher than the pre-crisis level in 2007. The bulk of the increase is in non-pension/non-health related transfers and subsidies. As discussed in previous staff reports, untargeted budget subsidies could be rationalized, in particular in the agricultural sector, while preserving space for other priority spending. Higher pension spending has gradually but steadily increased public finance burdens. This is partly related to demographic factors, but it is also due to increase in pension benefits over time. The replacement ratio increased by 0.15 points since 2012 to 0.70 in 2017, based on latest available data from Eurostat.[1] The stronger wage increases in recent years have likely led to a smaller replacement ratio. Nevertheless, the replacement ratio is still higher than in peer countries and pension expenditure is higher than in countries of similar demographic profile. The recent pension reform that adopts a CPI-only indexation to pension benefits was an important step to improve fiscal sustainability of the pension system in the face of a rapidly aging population.

Aggregate replacement ratio
(Percent)



Sources: Eurostat.
Note: Latest available data are used: 2017 for North Macedonia and 2018 for the rest.

1/The replacement ratio is defined as the median individual gross pension in the 65-74 age category relative to the median individual gross earnings of the 50-59 age category, excluding other social benefits.

Box 2. Minimum Wage Policy

The government has raised the minimum wage with the objective of improving living standards for lower-income earners. The net minimum wage has been raised by 44 percent cumulatively over the past two years. In the government's Economic Reform Program, it is targeted to increase further to 16,000 denars per month by 2020, which would represent an additional 10 percent increase.

With minimum wage growth significantly outpacing productivity growth, further increases could harm competitiveness. Over the past decade, the minimum-to-average wage ratio has increased from 38 percent to an estimated 53 percent in 2020 if no further increase is enacted.

- **The impact on labor costs may be large.** The passthrough of a one percent increase in the minimum wage to the average wage has recently been around 0.3–0.5 percentage points, in line with estimates for CESEE countries (IMF, 2016), and slightly above those for the euro area (IMF, Forthcoming). The average wage could therefore increase by 9–14 percent cumulatively by 2020. Given high labor-intensity and stagnant productivity growth, this could reduce competitiveness.

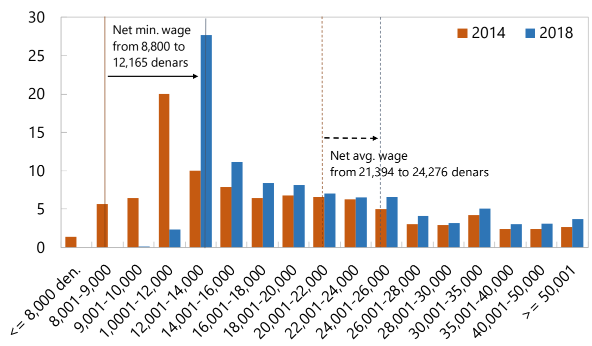
- **The skill premium may decline, reducing the incentives for human capital accumulation.** Further wage compression without significant improvements in skills of minimum wage earners could imply a lower premium for skilled workers and, in turn, disincentivize efforts and human capital investment, thereby hurting labor quality and productivity (Dube et al, 2007; Hirsch et al, 2011; IMF, 2016).

Although minimum wage can reduce in-work poverty, it may not reduce poverty overall:

- **A minimum wage increase is not a well-targeted measure.** In 2018, the risk-of-poverty rate was 22 percent for the population overall, whereas for employed persons it was about 9 percent.

- **Further minimum wage increases could be associated with dis-employment effects and subsequently increase the risk of poverty.** The limited adverse employment effects so far could be attributed to subsidies and other financial incentives for employment, which temporarily reduce labor costs. Moreover, the dis-employment effects could become stronger for higher minimum wage levels. For CESEE countries, the reduction in youth employment after a minimum wage increase is more than five times higher when the initial minimum-to-average wage ratio is about 45 percent (IMF, 2016).

North Macedonia. Net Wage Distributions
(Percent of total wage employed)



Source: State Statistical Office.

- **Without efforts to increase tax and wage compliance, generous minimum wages are also found to be associated with a larger share of informality** (Lotti et al, 2016). If minimum wages are too high compared to labor productivity, they could disincentivize employers to create formal jobs.

References:

Dube et al., 2007, "The economic Effects of a Citywide Minimum Wages," Industrial and Labor Relations Review, 60, pp.522–543.

Hirsch, Kaufman, and Zelenska, 2011, "Minimum Wage Channels of Adjustments," IZA Discussion Paper No. 6132.

IMF, 2016, "Cross-country Report on Minimum Wages – Selected Issues," IMF Country Report No. 16/151.

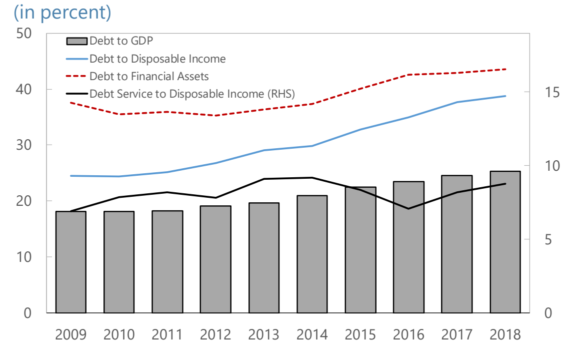
IMF Staff Discussion Note, Forthcoming, "A European Minimum Wage: Options and Tradeoffs,".

Lotti, G., J. Messina, and L. Nunziata, 2016, "Minimum Wage and Informal Employment in Developing Countries".

Box 3. Corporate and Household Credit Risk

Household debt has been rising rapidly from a low base, but debt service capacity remains strong. Household indebtedness is low (25 percent of GDP at end-2018) but has grown steadily since 2011. However, households' repayment capacity remains strong, with debt servicing at only 8.8 percent of disposable income, and low default rates on banks' loan exposures (2 percent).

Household Debt Ratios
(in percent)

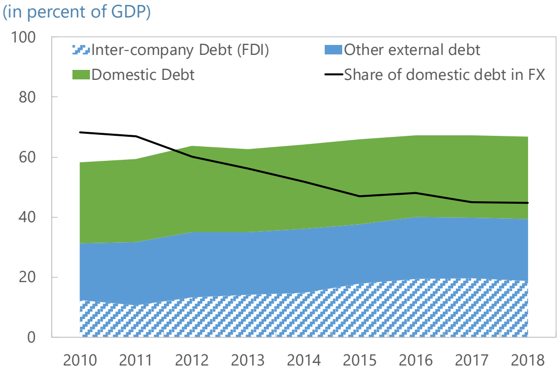


Sources: NBRM and IMF staff calculations

Household vulnerabilities warrant close monitoring. Debt maturities are lengthening amid easing credit standards and a rising share of debt goes to lower-income households (around 40 percent of consumer loans are to households earning less than the average wage). Furthermore, the share of FX loans is large (45 percent of total), and most household loans have variable or adjustable rates (52 percent). Household FX risks are in part mitigated by large FX deposits (about 32 percent of bank deposits), albeit with dispersion across households. Further, household confidence plays a key role for banks' funding stability, with households providing about two-thirds of banks' deposits. During distress, households typically convert quickly denar deposits into euro deposits, thus straining domestic FX liquidity.

Corporate borrowing from domestic banks is limited. It has been at about 28 percent of GDP since 2011, with 36 percent of all firms borrowing from domestic banks. However, inter-company debt from FDI investment has risen significantly, at 19 percent of GDP (from 10.6 percent in 2011), amidst an expansion of Technological Industrial Development Zones (TIDZ) firms which largely rely on foreign parent financing. Importantly, spillovers from an external slowdown to the domestic financial sector appear limited, given minimum real-sector linkages between TIDZ and domestic corporates (based on episodic evidence).

Corporate Debt by Sources
(in percent of GDP)



Sources: NBRM and IMF staff calculations

The domestic corporate sector is subject to vulnerabilities. In aggregate, firms that borrow from domestic banks have sound debt service capacity, with an interest coverage ratio of 7.2. However, corporate reporting quality remains weak and impairs assessment of firms' financial conditions. Corporate domestic borrowing in FX has been declining gradually, but the aggregate FX exposure of the sector remains large (74 percent of corporate debt). Domestic corporates appear unhedged, and collection of hedging information by domestic corporates (including natural versus financial hedging), e.g., via a periodic survey, is highly encouraged for monitoring systemic risks. Firms that borrow domestically are also exposed to interest rate risk, with their total domestic and external borrowing mostly in variable or adjustable rates (54 percent of total).

Table 1. North Macedonia: Macroeconomic Framework, 2015–24

(Year-on-year percentage change, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
					Projections					
Real GDP	3.9	2.8	1.1	2.7	3.2	3.4	3.2	3.3	3.4	3.5
Real domestic demand	5.4	5.0	0.5	2.0	4.2	3.7	3.2	3.0	3.0	2.8
Consumption	4.3	2.1	0.4	2.4	2.9	3.1	2.1	2.2	2.3	2.3
Private consumption	4.4	3.9	0.7	2.4	2.9	3.1	2.6	2.7	2.8	2.8
Gross investment	8.3	12.5	0.8	0.9	7.4	5.2	5.5	5.0	4.5	4.0
Exports (volume)	8.5	9.1	13.1	16.9	10.5	8.5	8.3	8.2	8.1	8.0
Imports (volume)	9.9	11.1	9.4	12.9	9.4	7.8	7.1	6.9	6.7	6.4
Contributions to growth 1/										
Domestic demand	6.3	6.0	1.1	3.0	4.4	4.5	3.9	3.7	3.6	3.4
Net exports	-2.5	-3.2	0.0	-0.3	-1.2	-1.1	-0.7	-0.4	-0.2	0.1
Output gap (percent of potential GDP)	0.8	1.3	-0.5	-0.3	0.2	0.4	0.3	0.1	0.0	0.0
Central government operations (percent of GDP)										
Revenues	28.7	28.4	29.0	28.6	29.4	29.6	29.4	29.5	29.5	29.5
Expenditures	32.2	31.1	31.8	30.4	31.2	32.1	32.1	32.2	32.2	32.2
Of which: capital	3.3	2.9	3.2	1.8	2.1	2.5	2.6	2.7	2.8	2.9
Balance	-3.5	-2.7	-2.7	-1.8	-1.8	-2.5	-2.6	-2.7	-2.7	-2.7
Savings and investment (percent of GDP)										
National saving	28.5	29.7	31.2	31.8	32.0	32.1	32.7	33.2	33.7	34.2
Public	-0.1	0.2	0.5	0.1	0.3	0.0	0.0	0.1	0.2	0.2
Private	28.6	29.5	30.7	31.7	31.7	32.0	32.7	33.1	33.6	34.0
Foreign saving	2.0	2.9	1.0	0.1	1.0	1.2	1.5	1.7	1.8	1.9
Gross investment	30.4	32.5	32.3	31.9	32.9	33.3	34.1	34.9	35.5	36.1
Consumer prices										
Period average	-0.3	-0.2	1.4	1.5	0.9	1.2	1.6	1.9	2.0	2.2
End-period	-0.3	-0.2	2.4	0.8	1.0	1.4	1.6	2.0	2.0	2.2
Private sector credit growth	9.5	0.0	5.3	7.3	6.7	6.3	5.6	5.0	4.5	4.0
Memorandum items:										
Current account balance (percent of GDP)	-2.0	-2.9	-1.0	-0.1	-1.0	-1.2	-1.5	-1.7	-1.8	-1.9
Gross official reserves (millions of euros)	2,262	2,613	2,336	2,867	3,123	3,316	3,495	3,707	3,837	4,010
in percent of ST debt	101.2	104.0	82.8	105.2	94.4	92.7	115.8	104.8	123.5	126.3
in months of prospective imports	4.2	4.5	3.6	4.0	4.1	4.1	4.0	3.9	3.8	3.6
Gross general government debt (percent of GDP) 2/	38.1	39.8	39.4	40.6	39.8	40.4	41.1	41.8	42.5	43.0
Public and publicly guaranteed debt (percent of GDP) 2/ 3/	44.0	46.7	46.1	47.6	47.6	49.1	50.7	51.7	51.8	51.9
Foreign direct investment (percent of GDP)	2.2	3.3	1.8	5.6	3.0	3.8	4.0	4.0	4.0	4.0
External debt (percent of GDP)	69.3	74.7	73.4	73.4	74.2	74.0	73.5	73.6	73.0	72.5
Nominal GDP (billions of denars)	559	595	618	658	693	731	770	811	856	904
Nominal GDP (millions of euros)	9,073	9,656	10,038	10,687	11,250	11,869	12,499	13,175	13,906	14,687

Sources: NBRM; SSO; MOF; World Bank; and IMF staff estimates and projections. National Accounts are revised by SSO, using ESA 2010
1/ The inconsistency between Real GDP growth and contributions to growth results from discrepancies in the official data on GDP and its
2/ The historical debt ratios differ slightly from the numbers reported by MoF due to using end-year debt in local currency divided by local
3/ Includes general government and public sector non-financial enterprises debt.

Table 2a. North Macedonia: Central Government Operations, 2015–24

(Billions of Denars)

	2015	2016	2017	2018	2019		2020		2021	2022	2023	2024
					Budget	Proj.	Budget	Proj.	Proj.	Proj.	Proj.	Proj.
Total Revenues	160.7	169.0	179.4	188.4	210.6	203.4	222.3	216.0	226.5	239.4	252.7	266.8
Tax Revenues and Contributions	140.8	150.4	157.5	171.0	184.0	179.1	197.2	192.1	201.3	212.8	224.6	237.2
PIT	12.9	14.2	15.3	17.6	19.1	18.9	20.3	19.6	19.7	20.8	21.9	23.2
CIT	12.0	10.8	11.4	14.7	15.3	11.6	16.0	14.0	15.1	16.7	17.6	18.6
VAT (net)	41.7	45.9	47.9	49.3	52.1	52.6	55.7	54.9	58.4	62.2	65.7	69.4
Excises	19.8	22.2	23.1	25.1	27.3	26.3	28.9	27.5	28.6	29.9	31.6	33.4
Custom Duties	4.3	4.8	5.2	5.6	5.8	5.9	6.2	6.2	6.6	6.9	7.3	7.7
Other Taxes	2.2	2.2	1.9	2.2	3.0	2.3	3.0	2.4	2.5	2.7	2.8	3.0
Social Contributions	47.9	50.3	52.9	56.5	61.5	61.5	67.0	67.5	70.4	73.6	77.7	82.0
Pensions	32.2	33.8	35.6	38.0	41.4	41.4	45.4	45.8	47.8	49.9	52.7	55.7
Unemployment	2.0	2.2	2.3	2.4	2.6	2.6	2.8	2.8	2.9	3.1	3.3	3.4
Health	13.6	14.3	15.0	16.1	17.5	17.5	18.9	18.8	19.7	20.6	21.7	22.9
Non-Tax Revenues	12.9	13.0	13.3	12.1	19.1	18.4	17.3	16.9	17.8	18.7	19.8	20.9
Capital Revenues	2.3	2.0	1.5	2.4	2.0	1.6	2.2	1.7	1.8	1.9	2.0	2.1
Grants	4.7	3.6	7.2	3.0	5.3	4.3	5.6	5.4	5.7	6.0	6.3	6.7
Expenditures	180.1	185.0	196.3	200.0	228.3	216.0	239.7	234.4	246.9	261.0	275.6	291.2
Current Expenditures	162.0	168.4	176.7	187.9	205.5	201.4	215.9	215.8	226.6	238.8	251.4	264.8
Wages and salaries	24.7	26.0	26.2	26.4	28.4	28.4	30.6	30.6	32.2	34.0	35.9	37.9
Goods and services	18.1	16.8	15.3	14.6	19.3	15.6	20.6	17.2	18.1	19.1	20.1	21.3
Transfers	112.7	118.9	126.8	139.3	149.6	149.1	156.5	159.7	167.5	176.6	185.7	195.4
Pension fund expenditures	50.3	54.6	58.1	61.2	65.4	65.4	68.9	68.9	72.3	76.0	80.0	84.5
Health	23.6	25.6	27.0	28.9	30.9	30.9	33.7	33.7	35.5	37.4	39.5	41.7
Other	38.8	38.7	41.6	49.1	53.3	52.8	53.9	57.2	59.7	63.2	66.2	69.2
Interest	6.5	6.8	8.4	7.7	8.3	8.3	8.3	8.3	8.7	9.2	9.7	10.2
Capital Expenditures	18.7	17.0	19.9	12.1	22.7	14.7	23.8	18.6	20.3	22.1	24.2	26.5
Lending minus repayment 1/	-0.5	-0.4	-0.3	-0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall fiscal balance	-19.4	-16.1	-16.9	-11.6	-17.7	-12.6	-17.4	-18.4	-20.3	-21.6	-22.9	-24.4
Primary fiscal balance	-13.0	-9.2	-8.5	-3.9	-9.4	-4.4	-9.1	-10.1	-11.6	-12.4	-13.2	-14.2
Financing	19.4	16.1	16.9	11.6	17.7	12.6	17.4	18.4	20.4	21.6	22.9	24.4
Domestic, net	21.7	-3.4	21.3	-5.3	2.5	8.1	-1.0	11.0	25.2	5.6	21.0	25.7
Central Bank deposits	10.3	-5.3	10.5	-9.6	-10.3	4.0	-1.1	-0.8	-1.3	-1.3	-1.3	-1.3
Other net domestic financing	11.4	1.9	10.8	4.3	12.8	4.1	0.1	11.8	26.5	6.9	22.2	26.9
Privatization receipts	0.0	0.2	0.4	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign, net	-2.3	19.3	-4.8	16.6	15.2	4.6	18.3	7.4	-4.9	16.0	2.0	-1.2
Memo items:												
Gross general government debt (in percent of GDP) 2/	38.1	39.8	39.4	40.6	40.5	39.8	40.9	40.4	41.1	41.8	42.5	43.0
Nominal GDP (billions of denars)	559	595	618	658	697	693	740	731	770	811	856	904
Stock of government deposits at the NBRM (billions of denars eop)	26	33	22	35		31		32	33	35	36	37
Public and publicly guaranteed debt (in percent of GDP) 2/ 3/	44.0	46.7	46.1	47.6	48.4	47.6	49.8	49.1	50.7	51.7	51.8	51.9

Sources: MoF and IMF staff estimates.

1/ Results from excluding: (i) revenues from lending; and (ii) lending guarantees from current expenditures.

2/ The historical debt ratios differ slightly from the numbers reported by MoF due to using end-year debt in local currency divided by local currency GDP.

3/ Includes general government and non-financial SOEs.

Table 2b. North Macedonia: Central Government Operations, 2015–24

(Percent of GDP)

	2015	2016	2017	2018	2019		2020		2021	2022	2023	2024
					Budget	Proj.	Budget	Proj.	Proj.	Proj.	Proj.	Proj.
Total Revenues	28.7	28.4	29.0	28.6	30.2	29.4	30.0	29.6	29.4	29.5	29.5	29.5
Tax Revenues and Contributions	25.2	25.3	25.5	26.0	26.4	25.9	26.6	26.3	26.2	26.2	26.2	26.2
PIT	2.3	2.4	2.5	2.7	2.7	2.7	2.7	2.7	2.6	2.6	2.6	2.6
CIT	2.2	1.8	1.8	2.2	2.2	1.7	2.2	1.9	2.0	2.1	2.1	2.1
VAT (net)	7.5	7.7	7.7	7.5	7.5	7.6	7.5	7.5	7.6	7.7	7.7	7.7
Excises	3.5	3.7	3.7	3.8	3.9	3.8	3.9	3.8	3.7	3.7	3.7	3.7
Custom Duties	0.8	0.8	0.8	0.9	0.8	0.9	0.8	0.9	0.9	0.9	0.9	0.9
Other Taxes	0.4	0.4	0.3	0.3	0.4	0.3	0.4	0.3	0.3	0.3	0.3	0.3
Social Contributions	8.6	8.5	8.6	8.6	8.8	8.9	9.1	9.2	9.2	9.1	9.1	9.1
Non-Tax Revenues	2.3	2.2	2.1	1.8	2.7	2.7	2.3	2.3	2.3	2.3	2.3	2.3
Capital Revenues	0.4	0.3	0.2	0.4	0.3	0.2	0.3	0.2	0.2	0.2	0.2	0.2
Grants	0.8	0.6	1.2	0.5	0.8	0.6	0.8	0.7	0.7	0.7	0.7	0.7
Expenditures	32.2	31.1	31.8	30.4	32.7	31.2	32.4	32.1	32.1	32.2	32.2	32.2
Current Expenditures	29.0	28.3	28.6	28.6	29.5	29.1	29.2	29.5	29.4	29.4	29.4	29.3
Wages and salaries	4.4	4.4	4.2	4.0	4.1	4.1	4.1	4.2	4.2	4.2	4.2	4.2
Goods and services	3.2	2.8	2.5	2.2	2.8	2.3	2.8	2.4	2.4	2.4	2.4	2.4
Transfers	20.2	20.0	20.5	21.2	21.4	21.5	21.1	21.9	21.8	21.8	21.7	21.6
Pension fund expenditures	9.0	9.2	9.4	9.3	9.4	9.4	9.3	9.4	9.4	9.4	9.3	9.3
Health	4.2	4.3	4.4	4.4	4.4	4.5	4.6	4.6	4.6	4.6	4.6	4.6
Other	6.9	6.5	6.7	7.5	7.6	7.6	7.3	7.8	7.8	7.8	7.7	7.7
Interest	1.2	1.1	1.4	1.2	1.2	1.2	1.1	1.1	1.1	1.1	1.1	1.1
Capital Expenditures	3.3	2.9	3.2	1.8	3.3	2.1	3.2	2.5	2.6	2.7	2.8	2.9
Lending minus repayment 1/	-0.1	-0.1	0.0	0.0		0.0		0.0	0.0	0.0	0.0	0.0
Overall fiscal balance	-3.5	-2.7	-2.7	-1.8	-2.5	-1.8	-2.3	-2.5	-2.6	-2.7	-2.7	-2.7
Primary fiscal balance	-2.3	-1.6	-1.4	-0.6	-1.4	-0.6	-1.2	-1.4	-1.5	-1.5	-1.5	-1.6
Financing	3.5	2.7	2.7	1.8	2.5	1.8	2.3	2.5	2.6	2.7	2.7	2.7
Domestic	3.9	-0.6	3.5	-0.8	0.4	1.2	-0.1	1.5	3.3	0.7	2.4	2.8
Central Bank deposits	1.8	-0.9	1.7	-1.5	-1.5	0.6	-0.1	-0.1	-0.2	-0.2	-0.1	-0.1
Other domestic financing	2.0	0.3	1.7	0.7	1.8	0.6	0.0	1.6	3.4	0.8	2.6	3.0
Foreign	-0.4	3.2	-0.8	2.5	2.2	0.7	2.5	1.0	-0.6	2.0	0.2	-0.1
Memo items:												
Gross general government debt (in percent of GDP) 3/	38.1	39.8	39.4	40.6	40.5	39.8	40.9	40.4	41.1	41.8	42.5	43.0
Nominal GDP (billions of denars)	559	595	618	658	697.4	693	739.9	731	770	811	856	904
Stock of government deposits at the NBRM (billions of denars eop)	26	33	22	35		31		32	33	35	36	37
Public and publicly guaranteed debt (in percent of GDP) 2/ 3/	44.0	46.7	46.1	47.6	48.4	47.6	49.8	49.1	50.7	51.7	51.8	51.9

Sources: MoF and IMF staff estimates.

1/ Results from excluding: (i) revenues from lending; and (ii) lending guarantees from current expenditures.

2/ The historical debt ratios differ slightly from the numbers reported by MoF due to using end-year debt in local currency divided by local currer

3/ Includes general government and non-financial SOEs.

Table 3a. North Macedonia: Balance of Payments, 2015–24
(Millions of Euros)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
					Projections					
Current account	-177	-275	-105	-15	-109	-144	-181	-220	-252	-280
Trade balance	-1823	-1813	-1787	-1735	-1804	-1879	-1954	-2033	-2118	-2208
Exports	3047	3529	4075	4881	5442	5849	6409	7019	7687	8412
Imports	4870	5342	5862	6616	7246	7728	8363	9052	9805	10620
Services (net)	349	341	375	362	371	436	478	512	547	582
Primary Income (net)	-286	-384	-398	-451	-504	-562	-612	-655	-702	-741
Secondary Income (transfers, net)	1583	1581	1705	1809	1829	1862	1907	1956	2021	2087
Of which										
Official	54	91	113	109	104	109	107	107	108	107
Private	1529	1490	1592	1699	1725	1753	1800	1849	1913	1980
Capital account (net)	7	11	18	12	12	12	13	13	13	14
Net lending (+) / Net borrowing (-)	-170	-265	-87	-3	-97	-132	-169	-207	-239	-266
Financial account	12	-610	49	-544	-353	-324	-347	-419	-368	-440
Direct investment (net)	-203	-317	-180	-604	-335	-451	-500	-527	-556	-587
Portfolio investment (net)	-66	-429	19	-320	-35	-241	-13	-121	36	30
Other investment	280	136	210	380	17	368	166	229	151	118
Trade credits (net)	-61	-37	-75	102	-67	-59	-62	-66	-70	-73
MLT loans (net)	58	-94	51	-1	-168	167	12	16	-70	-91
ST loans (net)	-4	-12	-14	-6	-19	-8	-9	4	5	21
Currency and deposits (net)	287	279	248	286	271	268	225	275	286	262
Other (net)	0	0	0	0	0	0	0	0	0	0
Errors and omissions	-2	-8	-10	8	0	0	0	0	0	0
Overall Balance	-183	337	-146	549	256	193	179	212	130	173
Memorandum Items:										
ST debt at residual maturity (year-end)	2236	2513	2821	2724	3308	3578	3018	3537	3107	3176
Gross foreign exchange reserves	2262	2613	2336	2867	3123	3316	3495	3707	3837	4010
Months of prospective imports of G&S	4.2	4.5	3.6	4.0	4.1	4.1	4.0	3.9	3.8	3.6
Percent of short-term debt (residual maturity)	101.2	104.0	82.8	105.2	94.4	92.7	115.8	104.8	123.5	126.3
External debt (percent of GDP)	69.3	74.7	73.4	73.4	74.2	74.0	73.5	73.6	73.0	72.5
External debt service	1948	1740	1908	2228	2477	3067	3342	2790	3314	2892
Percent of exports of G&S	44.0	35.4	34.6	34.5	34.9	40.3	40.4	31.0	33.9	27.2
Percent of exports of G&S and transfers	32.7	27.2	26.9	27.3	28.1	32.8	33.2	25.7	28.3	22.9

Sources: NBRM; and IMF staff estimates.

Table 3b. North Macedonia: Balance of Payments, 2015–24

(Percent of GDP)

	Avg 2003-12	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
						Projections					
Current account	-4.9	-2.0	-2.9	-1.0	-0.1	-1.0	-1.2	-1.5	-1.7	-1.8	-1.9
Trade balance	-23.4	-20.1	-18.8	-17.8	-16.2	-16.0	-15.8	-15.6	-15.4	-15.2	-15.0
Exports	25.3	33.6	36.5	40.6	45.7	48.4	49.3	51.3	53.3	55.3	57.3
Imports	48.6	53.7	55.3	58.4	61.9	64.4	65.1	66.9	68.7	70.5	72.3
Services (net)	3.0	3.8	3.5	3.7	3.4	3.3	3.7	3.8	3.9	3.9	4.0
Primary Income (net)	-1.6	-3.2	-4.0	-4.0	-4.2	-4.5	-4.7	-4.9	-5.0	-5.0	-5.0
Secondary Income (transfers, net)	17.1	17.4	16.4	17.0	16.9	16.3	15.7	15.3	14.8	14.5	14.2
Of which											
Official	0.9	0.6	0.9	1.1	1.0	0.9	0.9	0.9	0.8	0.8	0.7
Private	16.1	16.8	15.4	15.9	15.9	15.3	14.8	14.4	14.0	13.8	13.5
Capital account (net)	0.0	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net lending (+) / Net borrowing (-)	-4.9	-1.9	-2.7	-0.9	0.0	-0.9	-1.1	-1.3	-1.6	-1.7	-1.8
Financial account	-7.2	0.1	-6.3	0.5	-5.1	-3.1	-2.7	-2.8	-3.2	-2.6	-3.0
Direct investment (net)	-4.1	-2.2	-3.3	-1.8	-5.6	-3.0	-3.8	-4.0	-4.0	-4.0	-4.0
Portfolio investment (net)	-0.7	-0.7	-4.4	0.2	-3.0	-0.3	-2.0	-0.1	-0.9	0.3	0.2
Other investment	-2.4	3.1	1.4	2.1	3.6	0.1	3.1	1.3	1.7	1.1	0.8
Trade credits (net)	-0.9	-0.7	-0.4	-0.7	1.0	-0.6	-0.5	-0.5	-0.5	-0.5	-0.5
MLT loans (net)	-1.6	0.6	-1.0	0.5	0.0	-1.5	1.4	0.1	0.1	-0.5	-0.6
ST loans (net)	-0.1	0.0	-0.1	-0.1	-0.1	-0.2	-0.1	-0.1	0.0	0.0	0.1
Currency and deposits (net)	0.6	3.2	2.9	2.5	2.7	2.4	2.3	1.8	2.1	2.1	1.8
Of which: Commercial banks	-0.1	-0.2	-0.2	-0.1	0.3	0.0	0.1	0.1	0.1	0.1	0.1
Other (net)	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	0.0	0.0	-0.1	-0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance	2.3	-2.0	3.5	-1.5	5.1	2.3	1.6	1.4	1.6	0.9	1.2
					(Percentage change, year-on-year)						
Exports of G&S (Value)	10.8	8.2	11.2	12.0	17.1	9.9	7.2	8.8	8.8	8.9	8.8
Volume	8.5	8.5	9.1	13.1	16.9	10.5	8.5	8.3	8.2	8.1	8.0
Price	1.6	-0.2	1.9	-1.0	0.2	-0.5	-1.2	0.4	0.5	0.7	0.7
Imports of G&S (Value)	9.4	6.1	8.4	8.3	13.1	8.9	6.1	7.7	7.9	8.1	8.0
Volume	6.9	9.9	11.1	9.4	12.9	9.4	7.8	7.1	6.9	6.7	6.4
Price	2.0	-3.5	-2.5	-1.0	0.2	-0.4	-1.5	0.6	1.0	1.3	1.5

Sources: NBRM; and IMF staff estimates.

Table 4. North Macedonia: Monetary Survey, 2015–24

(Billions of Denars, unless specified otherwise)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
							Projections			
NFA	137.5	158.5	144.0	180.7	196.3	208.1	219.1	232.1	240.0	250.6
Central Bank	134.2	155.6	138.9	171.5	187.1	198.9	209.9	222.9	230.8	241.4
Commercial Banks	3.3	2.9	5.1	9.2	9.2	9.2	9.2	9.2	9.2	9.2
NDA	166.5	163.7	193.0	192.7	211.2	228.6	242.0	254.7	274.0	292.2
Credit to Government (net)	13.3	2.5	14.8	-1.6	5.4	4.6	4.8	3.5	2.3	1.0
From Banks (net)	36.5	32.6	34.0	35.4	33.5	33.4	34.9	34.9	34.9	34.9
of which: Credit (Tbills)	38.0	34.0	35.3	37.0	35.4	35.3	36.8	36.8	36.8	36.8
From Central Bank (net)	-23.2	-30.1	-19.1	-37.0	-28.1	-28.9	-30.1	-31.4	-32.6	-33.9
of which: Deposits	-26.2	-32.6	-21.9	-35.4	-31.4	-32.2	-33.5	-34.7	-36.0	-37.2
Credit to Private Sector (Gross)	285.7	285.8	300.9	322.9	344.5	366.3	386.8	406.2	424.6	441.7
From Banks	284.8	284.8	299.9	322.0	343.6	365.4	385.9	405.3	423.7	440.7
Denars	157.6	160.0	175.0	191.8	200.1	212.8	224.7	236.0	246.7	256.6
FX	127.2	124.8	124.9	130.2	143.5	152.6	161.2	169.3	177.0	184.1
From Central Bank	0.9	1.0	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Other Items (net)	-132.4	-124.7	-122.7	-128.6	-99.6	-103.2	-110.5	-115.9	-113.7	-111.3
Broad Money (M3)	304.1	322.2	337.0	373.4	407.5	436.7	461.1	486.8	514.0	542.8
Currency in Circulation	26.3	28.2	30.0	32.2	33.9	35.8	37.7	39.7	41.9	44.3
Total Deposits	277.8	294.0	307.0	341.2	373.6	400.9	423.4	447.1	472.1	498.5
Denars	165.0	172.8	181.5	205.2	224.7	241.1	254.7	268.9	284.0	299.9
FX	112.8	121.2	125.5	136.0	148.9	159.8	168.7	178.2	188.1	198.7
					(Percentage change, year-on-year)					
Private Sector Credit	9.5	0.0	5.3	7.3	6.7	6.3	5.6	5.0	4.5	4.0
Broad Money	7.7	6.0	4.6	10.8	9.1	7.2	5.6	5.6	5.6	5.6
Private Sector Deposits	7.2	5.8	4.4	11.1	9.5	7.3	5.6	5.6	5.6	5.6
					(Contribution to annual growth in broad money)					
NFA	-3.2	6.9	-4.5	10.9	4.2	2.9	2.5	2.8	1.6	2.1
NDA	10.8	-0.9	9.1	-0.1	4.9	4.3	3.1	2.8	4.0	3.5
					(Percent of GDP)					
Private Sector Credit	51.1	48.0	48.7	49.1	49.7	50.1	50.3	50.1	49.6	48.8
Broad Money	54.4	54.2	54.5	56.7	58.8	59.8	59.9	60.0	60.0	60.0
Private Sector Deposits	49.7	49.4	49.7	51.9	53.9	54.9	55.0	55.1	55.1	55.1
Memorandum Items:										
Money Multiplier	5.0	4.9	4.8	4.5	4.9	4.8	4.8	4.8	4.8	4.9
Reserve Requirement Ratio (% of deposits)										
Denars	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0
FX Indexed	20.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0
FX	15.0	15.0	18.0	18.0	18.0	18.0	18.0	18.0	18.0	18.0
Velocity	1.8	1.8	1.8	1.8	1.7	1.7	1.7	1.7	1.7	1.7

Sources: NBRM; and IMF staff estimates.

Table 5. North Macedonia: Central Bank Survey, 2015–24

(Billions of Denars, unless specified otherwise)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
							Projections			
NFA	134.2	155.6	138.9	171.5	187.1	198.9	209.9	222.9	230.8	241.4
Assets	139.4	160.7	143.7	176.4	192.1	204.0	215.0	228.0	236.0	246.7
Liabilities	-5.1	-5.1	-4.8	-4.9	-5.0	-5.0	-5.1	-5.1	-5.2	-5.2
NDA	-73.0	-90.1	-67.3	-87.7	-103.2	-108.9	-114.1	-122.1	-124.7	-129.6
Banks (net)	-33.9	-41.1	-35.9	-39.1	-58.6	-63.5	-67.5	-74.2	-75.5	-79.2
of which:										
NBRM Bills and short-term facilities	-34.0	-36.5	-35.9	-39.1	-39.1	-39.1	-39.1	-39.1	-39.1	-39.1
Central Government (net)	-20.1	-26.6	-16.1	-29.5	-25.5	-26.3	-27.5	-28.8	-30.0	-31.3
of which:										
Deposits at Central Bank	-26.2	-32.6	-21.9	-35.4	-31.4	-32.2	-33.5	-34.7	-36.0	-37.2
Denar	-8.8	-11.0	-13.9	-15.5	-13.7	-14.1	-14.6	-15.2	-15.8	-16.3
FX	-17.4	-21.7	-8.0	-19.9	-17.7	-18.1	-18.8	-19.5	-20.2	-20.9
State and Local Governments (net)	-3.1	-3.5	-3.0	-7.5	-7.5	-7.5	-7.5	-7.5	-7.5	-7.5
Other items (net)	-15.9	-18.9	-12.3	-11.6	-11.6	-11.6	-11.6	-11.6	-11.6	-11.6
Reserve Money	61.2	65.5	69.7	82.9	83.9	90.1	95.8	100.8	106.2	111.8
Currency in Circulation	26.3	28.2	30.0	32.2	33.9	35.8	37.7	39.7	41.9	44.3
Other	34.9	37.4	39.7	50.6	50.0	54.3	58.1	61.1	64.2	67.5
Cash in Vaults	5.7	6.2	6.2	7.6	7.8	8.0	8.2	8.4	8.6	8.8
Total Reserves	29.3	31.1	33.5	43.0	42.2	46.3	49.9	52.7	55.6	58.7
on Denar Deposits	16.0	17.0	19.4	27.4	24.8	27.6	30.2	31.8	33.6	35.5
on FX Deposits	13.3	14.1	14.1	15.6	17.4	18.7	19.7	20.8	22.0	23.2
					(Contribution to annual growth in reserve money)					
NFA	-17.8	34.9	-25.5	46.7	18.9	14.0	12.2	13.6	7.9	10.0
NDA	18.4	-27.9	34.7	-29.2	-18.7	-6.8	-5.8	-8.3	-2.6	-4.7
					(Percentage change, year-on-year)					
Reserve Money	0.6	7.1	6.3	18.9	1.3	7.3	6.3	5.3	5.3	5.3
Memorandum Items:					(Percent of GDP)					
NBRM Bills	4.5	3.9	4.0	3.8	4.3	4.1	3.9	3.7	3.5	3.3
Government Deposits at Central Bank	4.7	5.5	3.5	5.4	4.5	4.4	4.3	4.3	4.2	4.1

Sources: NBRM; and IMF staff estimates.

Table 6. North Macedonia: Financial Soundness Indicators of the Banking System, 2012–19

(Percent)

	2012	2013	2014	2015	2016	2017	2018	2019 Q2
Capital adequacy								
Regulatory capital/risk weighted assets	17.1	16.8	15.7	15.5	15.2	15.7	16.5	17.4
Tier I capital/risk weighted assets	14.5	14.4	13.7	13.9	13.9	14.2	15.0	15.8
Equity and reserves to Assets	11.2	11.3	10.8	10.8	10.6	10.8	10.8	11.6
Asset composition								
Structure of loans								
Enterprises (loans to enterprises/total loans)	56.9	55.4	55.2	53.9	51.3	50.2	49.3	48.4
Households (loans to households/total loans)	36.4	37.7	38.7	40.0	42.9	44.8	46.4	47.7
Lending with foreign currency component to private sector	55.4	52.7	49.4	46.5	44.9	42.5	41.4	41.7
Foreign currency lending/total credit to private sector	25.5	23.8	22.4	20.5	18.0	16.5	15.5	15.0
Foreign currency indexed lending/total credit to private sector	29.8	28.9	27.0	25.9	27.0	26.1	25.9	26.7
NPLs 1/								
NPLs/gross loans	10.1	10.9	10.8	10.3	6.3	6.1	5.0	5.4
NPLs net of provision/own funds	-3.7	-1.8	-3.0	-5.3	-5.5	-3.7	-5.2	-3.7
Provisions to Non-Performing Loans	107.1	103.1	104.6	108.4	114.8	110.6	119.0	113.3
Large exposures/own funds	205.1	188.5	233.1	212.4	185.4	176.3	218.2	217.5
Connected lending								
Banking system exposure to subsidiaries and shareholders/own funds	3.5	4.2	4.3	3.4	8.4	3.8	3.8	3.1
Banking system equity investments/own funds	1.8	1.7	2.6	2.6	2.0	1.9	1.2	1.4
Earning and profitability								
ROAA 2/	0.4	0.6	0.8	1.1	1.5	1.4	1.7	1.4
ROAE 2/	3.8	5.7	7.4	10.4	13.6	13.5	16.0	12.5
Interest margin/gross income 3/	60.7	62.2	63.5	62.8	62.7	60.6	57.9	61.0
Noninterest expenses/gross income 4/	65.3	62.8	58.1	54.7	53.2	52.5	50.5	55.4
Personnel expenses/noninterest expenses	33.1	35.0	35.5	35.8	35.2	34.8	37.4	37.7
Interest Rates								
Local currency spreads	3.5	3.6	4.0	4.2	3.9	3.8	3.9	3.7
Foreign currency spreads	4.6	4.8	4.9	4.6	4.2	3.9	3.4	3.3
Interbank market interest rate	2.1	2.2	1.5	1.2	1.0	1.1	1.1	1.0
Liquidity								
Highly liquid assets/total assets 5/	29.4	27.3	25.5	24.3	25.7	23.2	22.6	23.0
Highly liquid assets/total short-term liabilities 6/	48.2	47.6	45.5	42.4	44.5	40.1	39.2	39.9
Liquid assets/total assets	32.4	31.2	29.8	28.2	28.9	27.1	26.7	26.6
Liquid assets/total short-term liabilities	53.0	54.5	53.2	49.2	50.1	46.9	46.4	46.2
Customer deposits/total (noninterbank) loans	113.5	112.7	113.4	110.3	114.9	114.0	116.0	115.6
Foreign currency deposits/total deposits	47.3	44.9	42.3	42.1	43.0	42.7	42.3	42.2
Including foreign exchange-indexed 7/	48.3	45.5	42.8	42.4	43.1	43.1	42.5	42.4
Sensitivity to market risk								
Net open foreign exchange position/own funds	11.4	15.6	17.5	11.1	14.5	6.2	3.8	1.8

Source: NBRNM Financial Stability Unit.

1/ Includes loans to financial and nonfinancial sector.

2/ Adjusted for unallocated provisions for potential loan losses.

3/ Interest margin represents interest income less interest expense. Gross income includes net interest income, fees and commissions income.

4/ Noninterest expenses include fees and commissions expenses, operating expenses and other expenses excluding extraordinary expenses.

5/ Highly liquid assets are defined as cash and balance with the NBRM, treasury bills, NBRM bills, and correspondent accounts with foreign banks. Assets in domestic banks are excluded from total assets.

6/ Short-term liabilities are defined as deposits and other liabilities with a maturity of one year or less (without deposits and borrowings from domestic banks).

7/ FX indexed deposits include deposits and other FX indexed liabilities.

Table 7. North Macedonia: External Sector Assessment

Foreign Asset and Liability Position and Trajectory	**Background.** The net international investment position (NIIP) stood at -56.5 percent of GDP at end-2018, improving from -58.0 percent in 2017. The change was mostly driven by the increase in foreign exchange reserves that followed the Eurobond issuance of EUR 500 million in January 2018. Gross liabilities of the banking sector only represent 5.5 percent of GDP, down from a peak of 9.3 percent of GDP in 2010. Gross foreign asset and liability positions were 55.3 percent of GDP and 111.8 percent of GDP, respectively in 2018. **Assessment.** The large negative NIIP poses some risks to external sustainability though it is mitigated by the large share of FDI (representing 91 percent of the NIIP). The NIIP is projected to contract to -54.4 percent in 2019 and continue to gradually improve over the medium term (-48.4 percent of GDP by 2024).	**Overall Assessment:** The external position of North Macedonia is assessed to be broadly in line with medium-term fundamentals and desirable policies. Based on current baseline projections for 2019, the ongoing rebound in investment is expected to bring the current account close to its estimated norm without a need for the exchange rate to adjust.
Current Account	**Background.** The current account (CA) deficit further contracted in 2018, to 0.1 percent of GDP vs. 1.0 percent in 2017, driven by investment contraction, only partially offset by the increase in disposable incomes supported by recent minimum wage increases, and strong export growth. Against the background of the rebound in investment, the CA deficit is projected to widen in 2019, to -1.0 percent of GDP. Over the medium term, the CA deficit is expected to gradually increase toward 1.9 percent of GDP as the gradual reduction in secondary income surplus more than offsets the gradual improvement in the trade balance. North Macedonia has continued to gain export market shares, but further minimum wage increases should be aligned with labor productivity growth. **Assessment.** The EBA-lite CA model suggests a multilaterally-consistent cyclically-adjusted CA norm of - 1.9 percent of GDP for 2018, which is lower than the observed cyclically-adjusted CA balance of -0.9 percent of GDP. This suggests a CA gap of 1.0 percent of GDP, implying a small REER undervaluation of 2.1 percent. In 2019, the CA gap is projected to narrow to -0.1 percent of GPD.	
Real Exchange Rate	**Background.** The CPI-based real effective exchange rate (REER) was broadly flat in 2018 (0.1 percent increase) and decreased slightly in the first seven months of 2019 (-1.6 percent). **Assessment.** The REER EBA-lite approach points to a small undervaluation of 2.3 percent, close to the 2.1 percent estimated by the CA model. This is consistent with the very gradual reduction in the NIIP projected over time.	
Capital and Financial Accounts: **Flows and Policy Measures**	**Background.** North Macedonia experienced net capital inflows in 2018, mostly because of the Eurobond issuance in January 2018 and record FDI inflows. **Assessment.** Capital and financial flows are dominated by FDI flows and portfolio flows due to sovereign issuance. Other private flows have been small in recent years amidst stable external corporate borrowing and the reduction in banks' external funding.	
FX Intervention and Reserves Level	**Background.** North Macedonia has a de facto stabilized exchange rate regime. The peg to the euro is implemented by the NBRNM with standing offers to buy and sell FX with the main banks at a small window around the target. **Assessment.** Reserves covered 104 percent of the ARA metric in 2018 and coverage is expected to remain broadly stable in 2019 (107 percent) and in the medium term (108 percent on average over 2020-24). Coverage of short-term debt at remaining maturity is more volatile, reflecting the repayment profile of government borrowing. It is projected to rebound from 94 percent in 2019 to 116 percent in 2021, as maturing government securities are rolled over with longer-term debt.	

Table 8. North Macedonia: Risk Assessment Matrix[1]
(Scale—high, medium, or low)

Source of Risks	Relative Likelihood	Impact If Realized	Recommended Policy Response
Country-specific			
Virtuous cycle following positive EU decision on a date for opening accession negotiations	**Medium**	**High** • A stronger push for structural reforms and higher FDI inflows which could lift both near- and medium-term growth	• Accelerated implementation of the EU's Urgent Reform Priorities to benefit most from the opening of accession negotiations
Renewed political instability, triggered for example by delays in opening EU accession negotiations	**Medium**	**Medium** • Deterioration of investor confidence, possible deposit outflows and financial instability; pressure on foreign exchange reserves • Higher sovereign borrowing costs • Slowdown in structural reforms	• Tighten monetary policy and adopt targeted macro-prudential measures to counter financial sector stress • Durable fiscal consolidation within a credible medium-term budget framework
Global			
Rising protectionism and retreat from multilateralism	**High**	**Medium** • Potential setback to global trade could lower exports and FDI	• Adopt a slower pace of fiscal consolidation, depending on the size of the shock • Accelerate structural reforms to enhance productivity and diversification and attract FDI. • Invest in skills and human capital
Weaker-than-expected global growth, particularly in the euro area	**High**	**Medium** • Weaker exports, remittances, and FDI, given significant direct trade and FDI linkages with the Euro area	
Sharp rise in risk premia	**High**	**High** • Higher debt service costs and refinancing risks • Higher euroization which could put pressure on the peg	• Adopt a more ambitious fiscal consolidation plan to reduce financing needs • Tighten monetary policy to strengthen confidence

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks at the time of discussions with the authorities.

Table 9. North Macedonia: Implementation of Key 2018 FSAP Recommendations

FSAP Recommendations	Time	Actions Since 2018 Article IV
Financial Stability Assessment		
Create a centralized macrofinancial database; collect granular household data.	MT	The amendments to the NBRNM Law have been prepared by the NBRNM and submitted to the Ministry of Finance, which will, inter alia, allow access to a broader set of data to facilitate systemic risk monitoring. A draft Memorandum of Understanding (MoU) with the Revenue Office for sharing household income data is being reviewed by the Revenue Office.
Improve liquidity reporting to better estimate stable and less stable deposit outflows and prepare for implementation of the liquidity coverage ratio (LCR).	ST	The NBRNM has adopted a new Decision on risk management, which requires banks to implement an Internal Liquidity Adequacy Assessment Process. A new regulation on liquidity risk management, which closely follows requirements under Basel III and the EU requirements, is in the final stage of drafting. The new regulation requires banks to report the LCR to the NBRNM at least monthly, and more frequently in periods of liquidity stress.
Monitor and gradually strengthen banks' FX liquidity buffers.	MT	More stringent reporting requirements of liquidity risks (above) will enable closer monitoring of FX liquidity buffers. However, consistent with EU regulations, the banks are not required to report LCR by currency. The NBRNM does not plan to impose a separate minimum ratio for FX positions, but is ready to use its regulatory power to limit excessive currency mismatches if observed.
Financial Stability Oversight		
Systemic Risk Oversight and Macroprudential Policies		
Assign the NBRNM a legal macroprudential mandate via primary legislation.	ST	The NBRNM has started the work to draft the amendments to the NBRNM Law, which will give a clear mandate for macroprudential powers, with expected submission to parliament in fall 2020.
Reconstitute the Financial Stability Committee (FSC) as principal domestic coordination body for macroprudential policy and crisis management.	MT	A draft MoU has been prepared to redefine the role and the composition of the FSC as the coordinating body for macroprudential policy and crisis management. Fund staff have provided detailed comments on the MoU.
Further develop the systemic risk monitoring framework.	ST	Planned amendments to the NBRNM Law will allow access to a broader set of data to facilitate systemic risk monitoring. Ongoing capacity development (CD) from development partners is helping to further strengthen the monitoring framework (e.g., developing monitoring indicators of systemic risks). The NBRNM has requested IMF CD to strengthen the capacity for bottom-up bank stress tests. More resources, including technical and skilled staff, are required to effectively implement the framework.
Banking Supervision		
Enhance the NBRNM's independence by excluding it from the scope of the Law on Administrative Officers; and strengthen governance arrangements.	ST	An amendment to the Law on Administrative Officers is being finalized. To strengthen governance arrangement, a separate body has been established within the NBRNM in 2018 to deal with issues where there are disagreements between the Governor and the supervisory staff.

Table 9. North Macedonia: Implementation of Key 2018 FSAP Recommendations (continued)		
FSAP Recommendations	**Time**	**Actions Since 2018 Article IV**
Increase supervisory intensity for domestic systemically important banks (D-SIBs), supported by adequate rise in staffing.	MT	Full-scope inspection of one D-SIB was undertaken in the first half of 2019. Full-scope inspections of the remaining D-SIBs will be undertaken in the next years. The on-site supervisory staff has been increased by two, but more experienced supervisors are needed to sustain the intensity.
Financial Markets Infrastructure (FMI) Oversight		
Amend the legal framework to enhance transparency and consistency in FMI identification, regulation, and oversight. Extend NBRNM oversight to all FMIs.	ST	The NBRNM has started its work to draft amendments to the NBRNM Law, which include provisions for extending NBRNM's oversight to all FMIs, with expected submission to parliament in the fall of 2020.
Financial integrity		
Ensure effective implementation of the new Law and National Strategy on AML/CFT and strengthen staffing at the Financial Intelligence Office (FIO).	MT	Sector-specific guidelines for effective implementation of the new AML/CFT law have been prepared and published by the relevant sector supervisors. Staffing at the FIO has been increased.
Crisis Management and Resolution		
Finalize draft legislation for a new resolution regime, aligned with international best practices as appropriate to North Macedonia, and strengthen the Deposit Insurance Fund (DIF).	ST	The new law on bank resolution is being finalized for submission to parliament in the fall of 2020. The NBRNM is receiving CD, for the preparation of the law and its implementation. In addition, the procedures for providing emergency loans by the NBRNM have been amended.
Establish the NBRNM's new resolution unit, develop resolution toolkit, and initiate resolvability assessments and resolution planning for at least all D-SIBs.	MT	From May 2019, bank resolution activities have been delegated to the newly created Financial Stability and Banking Regulation Department (formerly a division within the Supervision). The new Department is not yet fully functioning, and development of resolution toolkit and resolvability analysis have not started. IMF TA has been requested for contingency planning.
Financial Efficiency and Inclusion		
Enhance the out-of-court restructuring framework.	ST	
Strengthen auditors' quality and corporate accounting standards and practices.	MT	A new Audit Law is being drafted to fully comply with the EU Audit Directive and Regulation on specific requirements regarding statutory audit of public-interest entities to ensure that the audit is of adequate quality and carried out by auditors and firms that are subject to stringent requirements. Broadening of the definition of public-interest companies is being considered, e.g., to include state-owned or joint-stock companies and other listed nonfinancial companies. The latest versions of the International Financial Reporting Standards (IFRS) and International Accounting Standards will be translated in the course of 2020 and implemented gradually starting in 2021.

Table 9. North Macedonia: Implementation of Key 2018 FSAP Recommendations (concluded)		
Develop a legal and institutional framework for financial consumer protection.	MT	A working group between the Ministry of Finance and the other regulators has been established to develop a legal and institutional framework for financial consumer protection. A financial Ombudsman model is being considered as a possible approach. TA from World Bank has been requested and the framework is expected to be in place in the next two years.

Annex I. Debt Sustainability Analysis

General government and public debt are projected to gradually increase over the forecast horizon. Public debt is assessed sustainable under staff's baseline projection, but high gross financing needs and potential shocks to growth continue to constitute major risks. Durable fiscal consolidation is therefore needed to rebuild fiscal space and put debt on a downward path.

A. Background

1. North Macedonia's public debt, which includes guaranteed debt of state-owned enterprises, has nearly doubled since 2008, reaching about 48 percent of GDP in 2018.[1] Over this period, general government debt has increased by 20 percentage points to about 41 percent of GDP. Despite increases in pensions and subsidies, the fiscal deficit has narrowed in recent years due to less spending on goods and services, as well as lower capital investment spending. Publicly guaranteed debt of state-owned enterprises rose from 2½ percent of GDP in 2008 to about 8 percent of GDP in 2019, mainly due to public transport infrastructure projects by the Public Enterprise for State Roads (PESR). Meanwhile, medium-term gross financing requirements of the non-financial public sector are expected to peak at about 15 percent of GDP in 2021 due to high rollover needs.

2. There have been improvements in the public debt structure, particularly in domestic public debt. The average maturity of outstanding government securities increased significantly from less than 12 months in 2011 to close to 8 years by October 2019, reflecting increasing reliance on long-term borrowing. In the meantime, the share of domestic government securities that are denominated in FX declined from 95 percent in 2009 to around 60 percent in 2017. Interest rates on all types of securities have decreased noticeably. However, most of the public debt is external, resulting in around three-quarters of public debt being FX-denominated.

3. External debt has increased by 26 percent of GDP since 2008, reaching 73 percent of GDP in 2018. The main drivers of the increases in external debt have been public sector borrowing and FDI-related intercompany borrowing. External gross financing needs were stable at 20 percent of GDP in 2018, as a moderate increase in debt service was mostly offset by a moderate improvement in the trade balance.

B. Public DSA Results

Baseline

4. The baseline scenario assumes that the fiscal deficit increases to 2.5 percent of GDP in 2020, followed by a gradual increase over the medium term. It is underpinned by the following assumptions.

[1] This debt sustainability analysis covers general government debt, see Figures 1-5, and public debt, see Figures 6-9. Public debt is equal to general government debt plus government-guaranteed debt of state-owned enterprises.

- *Real GDP growth* is projected to increase to 3.2 percent in 2019, driven by higher investment. Medium-term growth is projected to pick up to its potential of around 3½ percent, supported by investment, expanded export capacities, and continued improvements in the labor markets.
- *Headline inflation* is projected to gradually reach 1.6 percent by end-2021.
- *The general government overall deficit* is projected to stay at 1.8 percent of GDP in 2019 and rise to 2.5 percent of GDP in 2020, mainly due to higher public investment spending and transfers. The deficit is expected to increase modestly to 2.7 percent of GDP by 2024, reflecting gradually increasing capital spending.

5. Forecast error analysis suggests no systemic bias in historical estimations of real GDP growth and primary balance, but some negative bias on inflation. Primary balance forecasts were optimistic between 2012 and 2014. However, this bias has disappeared in recent years as the projections became more conservative. Growth projections have remained broadly within the interquartile range in the past five years, except for in 2017 when growth slowed because of the political crisis and a halt in investment.

6. Under the baseline scenario, public debt is expected to rise to around 52 percent in the medium term, with gross financing needs reaching about 15 percent of GDP in 2021. General government debt would continue its upward trajectory to about 43 percent at end-2024. Publicly guaranteed debt is expected to grow by around 2 percentage points of GDP between 2019 and 2022, reflecting continued borrowing to finance public infrastructure investments, before gradually declining at the end of the projection period. Baseline public gross financing requirements are projected to remain high and peak in 2021 above the 15-percent benchmark, mainly due to the general government's amortization of Eurobonds and syndicated loans.

Macro-Fiscal and Additional Stress Tests

7. Macroeconomic and fiscal shocks can significantly increase public debt and public gross financing needs relative to the baseline. Among all stress test scenarios, North Macedonia has the highest vulnerability to a combined macro-fiscal shock and the real GDP growth shock of one standard deviation in 2020–21.[2] Under these stress test scenarios, public debt would rise to about 59 percent of GDP in the medium term with gross financing needs peaking at about 17.6 percent of GDP in 2021. Closing the real exchange rate gap implies a small exchange rate appreciation which will result in a slight decline in external public debt and external gross financing needs.[3] Nonetheless, the still substantial share of FX-denominated public debt poses general vulnerability to exchange rate risks.

[2] Stress tests include individual shocks to macro variables (real interest rate, real GDP growth, real exchange rate) and primary balance. The combined macro-fiscal shock incorporates the largest effect of individual shocks on all variables.

[3] The real exchange rate gap is estimated to be around 2.3 percent.

8. In addition, fan charts illustrate the possible evolution of public debt over the medium term. They present a spectrum of possible outcomes for the public debt level based on a probabilistic view of uncertainty around the baseline. Under a symmetric distribution, the public debt stock at end-2024 would be above 54.5 percent of GDP in 25 percent of the simulated outcomes. Under a restricted distribution, which precludes positive shocks to the primary balance, public debt would be above 57 percent in 25 percent of simulations.

C. External Debt Sustainability

9. External debt is expected to peak in 2019 before gradually declining thereafter. The debt level is expected to peak at 74 percent of GDP in 2019 and gradually decline thereafter. Trade deficits are projected to decrease moderately but steadily from 13 percent of GDP in 2019 to 11 percent in 2024. The projected expansion in private sector borrowing in medium and long-term loans is expected to be remain modest while public debt service is set to decline gradually starting in 2022.

10. The external debt path is particularly sensitive to real exchange rate depreciation and non-interest current account shocks. Under a 30 percent exchange rate depreciation shock, the external debt level would increase to 108 percent of GDP in 2020 and stay above 106 percent afterwards. A shock to the current account of half a standard deviation (around 2 percent of GDP) would cause a more gradual deterioration in external debt, with external debt stabilizing over the forecast horizon around 77 percent of GDP. A higher fiscal deficit than assumed under the baseline could also have a significant impact on external debt dynamics by leading to larger and more expensive external borrowing as well as higher trade deficits (Figure 9).

D. Conclusion

11. Stronger fiscal consolidation is needed to create fiscal space to counter shocks and increase capital spending. While the level of public debt is not alarmingly high, the speed of debt accumulation since the financial crisis calls for caution. Baseline gross financing needs are above the 15 percent of GDP benchmark, and adverse shocks, particularly in GDP growth, could raise general government and public debt to about 46 and 55 percent of GDP respectively by 2024. Space for fiscal policy, the main countercyclical stabilization policy tool in North Macedonia, is limited. The general government's primary deficit is expected to be about 1.6 percent of GDP by 2024, higher than the debt-stabilizing primary balance. This implies a need for fiscal consolidation to put public debt firmly on a downward path. In addition, public debt sustainability depends on sound macroeconomic management and continuing progress on institutional and structural issues which would help unlock the economy's growth potential and reduce its vulnerability to shocks.

12. Efforts to improve public debt management should continue. Notwithstanding positive progress to date, efforts to further lengthen the average maturity of domestic debt and deepen the secondary market would help reduce the domestic debt rollover and interest rate risks. With a large share of public debt being external, the medium-term fiscal strategy should be accompanied by a debt management strategy that strikes a balance between achieving an efficient mix of external and domestic financing to maintain overall macroeconomic stability.

Figure 1. North Macedonia: General Government Debt Sustainability Analysis (DSA)—Baseline Scenario

(in percent of GDP unless otherwise indicated)

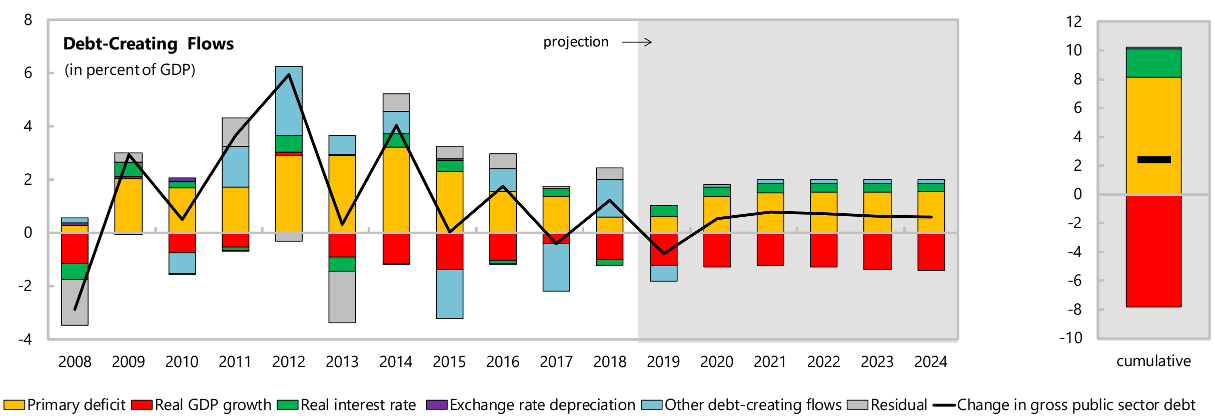
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2008-2016 [2/]	2017	2018	2019	2020	2021	2022	2023	2024
Nominal gross public debt	31.1	39.4	40.6	39.8	40.4	41.1	41.8	42.5	43.0
Public gross financing needs	14.7	12.2	12.4	9.2	11.4	13.3	10.3	12.2	9.6
Real GDP growth (in percent)	2.6	1.1	2.7	3.2	3.4	3.2	3.3	3.4	3.5
Inflation (GDP deflator, in percent)	2.7	2.8	3.6	2.0	2.0	2.0	2.0	2.0	2.0
Nominal GDP growth (in percent)	5.4	3.9	6.5	5.3	5.5	5.3	5.4	5.6	5.6
Effective interest rate (in percent) [4/]	3.1	3.6	3.2	3.1	3.0	3.0	2.9	2.9	2.8

As of December 16, 2019		
Sovereign Spreads		
EMBIG (bp) 3/	175	
5Y CDS (bp)	n.a.	
Ratings	Foreign	Local
Moody's	n.a.	n.a.
S&Ps	BB-	BB-
Fitch	BB+	BB+

Contribution to Changes in Public Debt

	Actual			Projections							
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	1.8	-0.4	1.2	-0.8	0.5	0.8	0.7	0.6	0.6	2.4	
Identified debt-creating flows	1.9	-0.5	0.8	-0.8	0.5	0.8	0.7	0.6	0.6	2.4	
Primary deficit	2.1	1.4	0.6	0.6	1.4	1.5	1.5	1.5	1.6	8.2	-1.0
Primary (noninterest) revenue and grants	29.5	29.0	28.6	29.4	29.6	29.4	29.5	29.5	29.5	176.9	
Primary (noninterest) expenditure	31.5	30.4	29.2	30.0	30.9	30.9	31.0	31.1	31.1	185.0	
Automatic debt dynamics [5/]	-0.6	-0.1	-1.2	-0.8	-0.9	-0.9	-1.0	-1.1	-1.1	-5.9	
Interest rate/growth differential [6/]	-0.6	-0.1	-1.2	-0.8	-0.9	-0.9	-1.0	-1.1	-1.1	-5.9	
Of which: real interest rate	0.1	0.3	-0.2	0.4	0.3	0.3	0.3	0.3	0.3	1.9	
Of which: real GDP growth	-0.7	-0.4	-1.0	-1.2	-1.3	-1.2	-1.3	-1.4	-1.4	-7.8	
Exchange rate depreciation [7/]	0.0	0.0	0.0	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.5	-1.8	1.4	-0.6	0.1	0.2	0.2	0.1	0.1	0.1	
Privatization receipts (negative)	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Changes in cash, deposits, and securities held for liquidity purposes	0.7	-1.7	1.5	-0.6	0.1	0.2	0.2	0.1	0.1	0.1	
Residual, including asset changes [8/]	-0.1	0.1	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

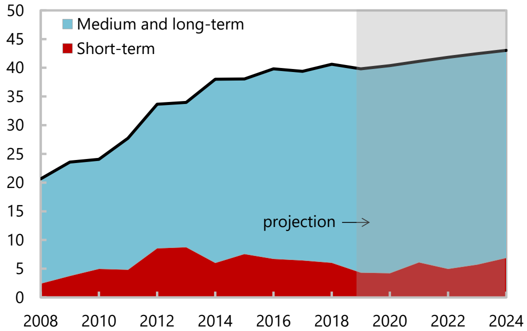
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

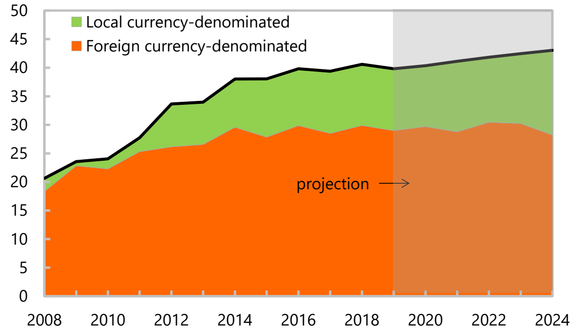
Figure 2. North Macedonia: General Government DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



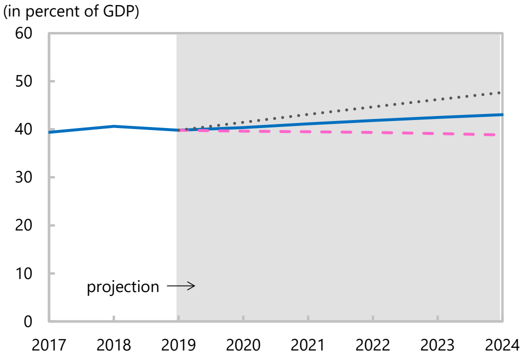
By Currency
(in percent of GDP)



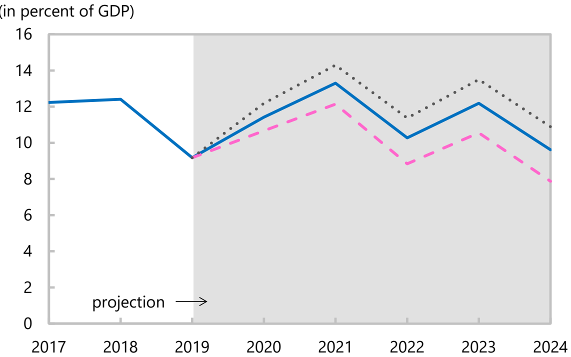
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



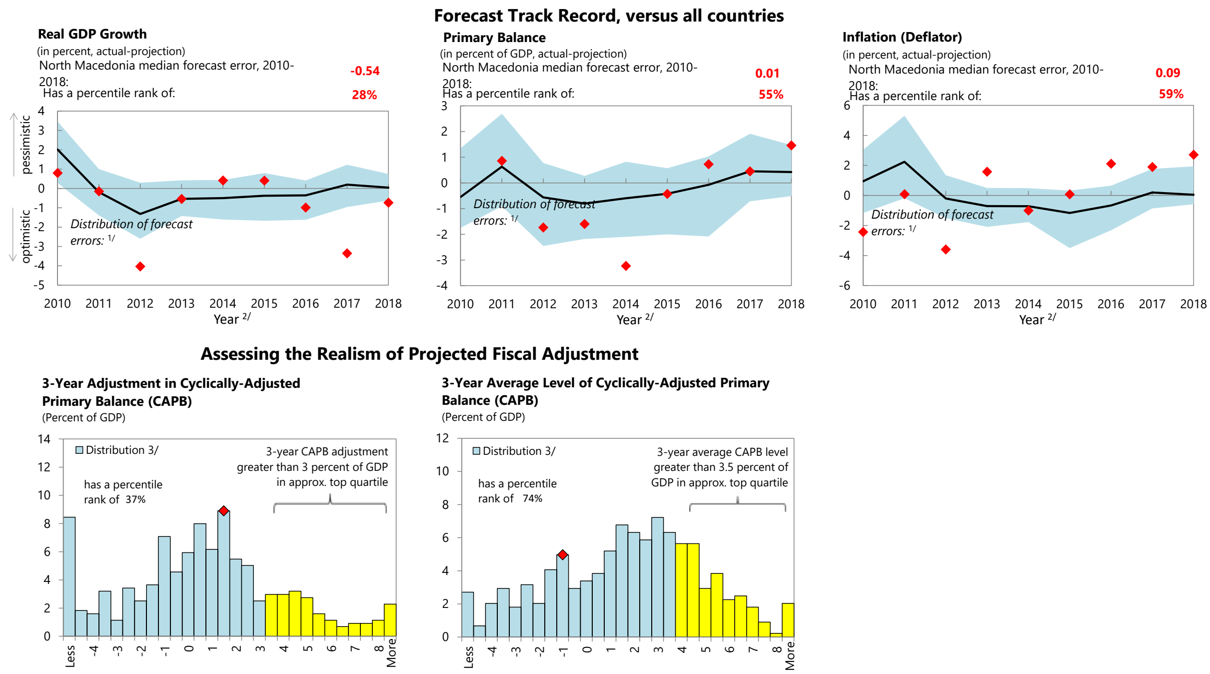
Underlying Assumptions
(in percent)

Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	3.2	3.4	3.2	3.3	3.4	3.5
Inflation	2.0	2.0	2.0	2.0	2.0	2.0
Primary Balance	-0.6	-1.4	-1.5	-1.5	-1.5	-1.6
Effective interest rate	3.1	3.0	3.0	2.9	2.9	2.8
Constant Primary Balance Scenario						
Real GDP growth	3.2	3.4	3.2	3.3	3.4	3.5
Inflation	2.0	2.0	2.0	2.0	2.0	2.0
Primary Balance	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6
Effective interest rate	3.1	3.0	3.0	2.9	2.9	2.8

Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	3.2	2.2	2.2	2.2	2.2	2.2
Inflation	2.0	2.0	2.0	2.0	2.0	2.0
Primary Balance	-0.6	-2.0	-2.0	-2.0	-2.0	-2.0
Effective interest rate	3.1	3.0	2.9	2.8	2.7	2.7

Source: IMF staff.

Figure 3. North Macedonia: General Government DSA—Realism of Baseline Assumptions



Source : IMF Staff.

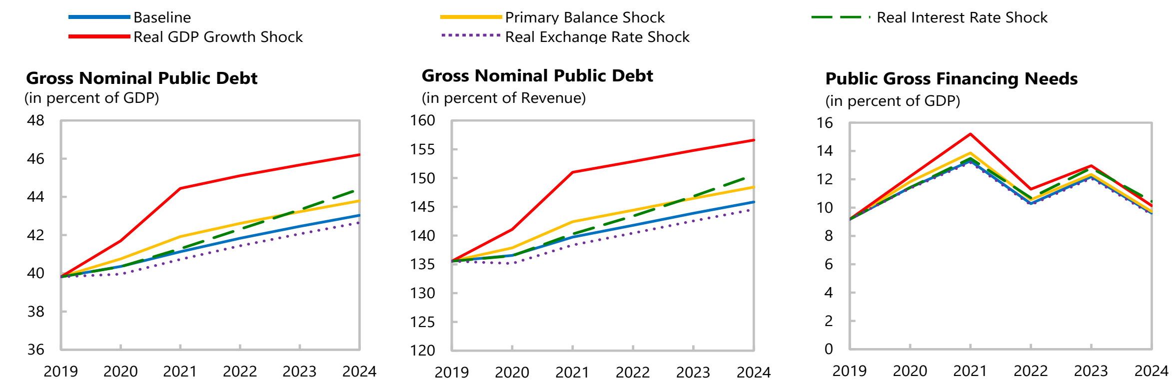
1/ Plotted distribution includes all countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

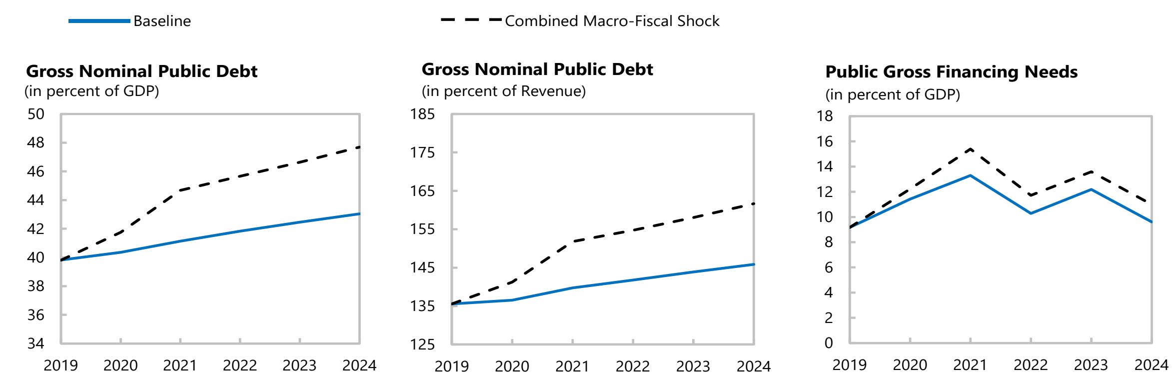
3/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure 4. North Macedonia: General Government DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

	2019	2020	2021	2022	2023	2024
Primary Balance Shock						
Real GDP growth	3.2	3.4	3.2	3.3	3.4	3.5
Inflation	2.0	2.0	2.0	2.0	2.0	2.0
Primary balance	-0.6	-1.8	-1.9	-1.5	-1.5	-1.6
Effective interest rate	3.1	3.0	3.0	2.9	2.9	2.9
Real Interest Rate Shock						
Real GDP growth	3.2	3.4	3.2	3.3	3.4	3.5
Inflation	2.0	2.0	2.0	2.0	2.0	2.0
Primary balance	-0.6	-1.4	-1.5	-1.5	-1.5	-1.6
Effective interest rate	3.1	3.0	3.4	3.7	3.9	4.1
Combined Shock						
Real GDP growth	3.2	1.8	1.6	3.3	3.4	3.5
Inflation	2.0	1.5	1.6	2.0	2.0	2.0
Primary balance	-0.6	-2.0	-2.7	-1.5	-1.5	-1.6
Effective interest rate	3.1	3.0	3.4	3.8	3.9	4.1

	2019	2020	2021	2022	2023	2024
Real GDP Growth Shock						
Real GDP growth	3.2	1.8	1.6	3.3	3.4	3.5
Inflation	2.0	1.6	1.6	2.0	2.0	2.0
Primary balance	-0.6	-2.0	-2.7	-1.5	-1.5	-1.6
Effective interest rate	3.1	3.0	3.0	3.0	2.9	2.9
Real Exchange Rate Shock						
Real GDP growth	3.2	3.4	3.2	3.3	3.4	3.5
Inflation	2.0	1.5	2.0	2.0	2.0	2.0
Primary balance	-0.6	-1.4	-1.5	-1.5	-1.5	-1.6
Effective interest rate	3.1	3.0	3.0	2.9	2.9	2.8

Source: IMF staff.

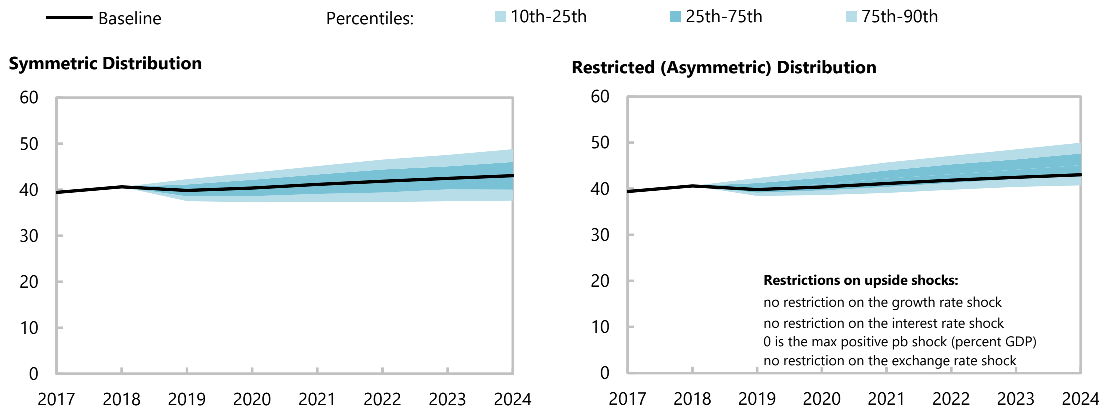
Figure 5. North Macedonia: General Government DSA Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

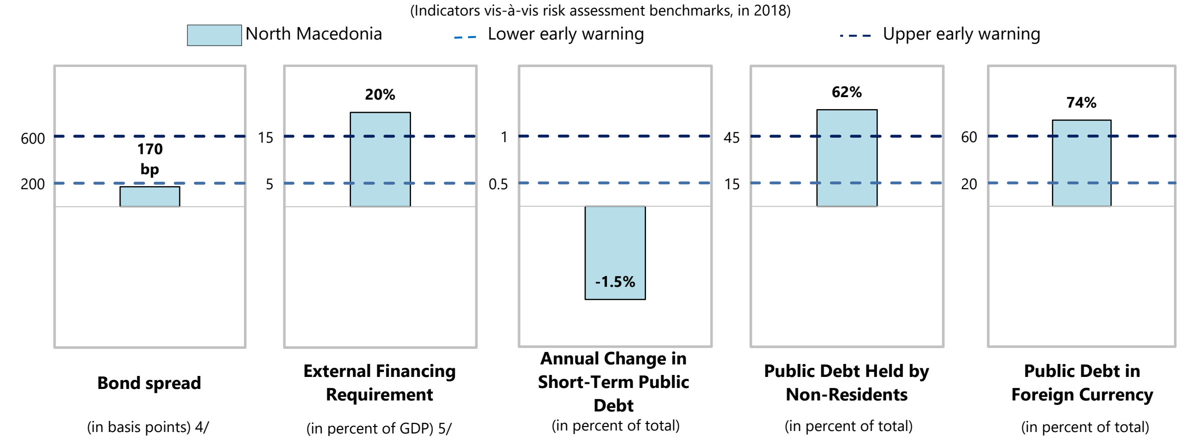
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2018)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ Long-term bond spread over German bonds, an average over the last 3 months, 17-Sep-19 through 16-Dec-19.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Figure 6. North Macedonia: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

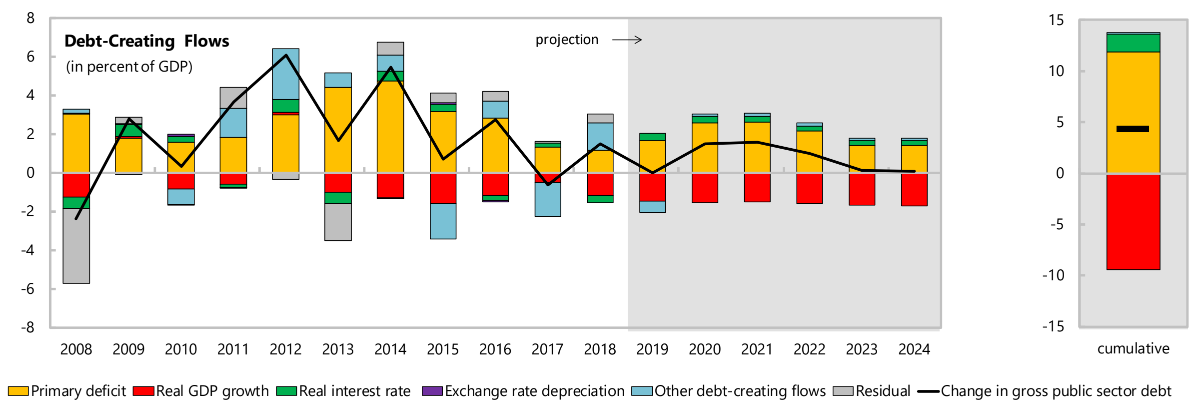
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of December 16, 2019		
	2008-2016 [2/]	2017	2018	2019	2020	2021	2022	2023	2024	Sovereign Spreads		
Nominal gross public debt	34.9	46.1	47.6	47.6	49.1	50.7	51.7	51.8	51.9	EMBIG (bp) 3/		175
Public gross financing needs	16.5	12.8	13.5	10.8	13.6	15.4	12.0	13.1	10.5	5Y CDS (bp)		n.a.
Real GDP growth (in percent)	2.6	1.1	2.7	3.2	3.4	3.2	3.3	3.4	3.5	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	2.7	2.8	3.6	2.0	2.0	2.0	2.0	2.0	2.0	Moody's	n.a.	n.a.
Nominal GDP growth (in percent)	5.4	3.9	6.5	5.3	5.5	5.3	5.4	5.6	5.6	S&Ps	BB-	BB-
Effective interest rate (in percent) [4/]	3.1	3.2	2.9	2.9	2.8	2.8	2.7	2.6	2.6	Fitch	BB+	BB+

Contribution to Changes in Public Debt

	Actual			Projections							
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	2.3	-0.6	1.5	0.0	1.5	1.6	1.0	0.1	0.1	4.3	
Identified debt-creating flows	2.7	-0.7	1.1	0.0	1.5	1.6	1.0	0.1	0.1	4.3	
Primary deficit	2.9	1.4	1.2	1.7	2.6	2.6	2.2	1.4	1.4	11.9	-1.3
Primary (noninterest) revenue and grants	29.5	29.0	28.6	29.4	29.6	29.4	29.5	29.5	29.5	176.9	
Primary (noninterest) expenditure	32.4	30.4	29.8	31.0	32.2	32.1	31.7	30.9	30.9	188.8	
Automatic debt dynamics [5/]	-0.7	-0.3	-1.5	-1.1	-1.2	-1.2	-1.3	-1.4	-1.5	-7.7	
Interest rate/growth differential [6/]	-0.7	-0.3	-1.5	-1.1	-1.2	-1.2	-1.3	-1.4	-1.5	-7.7	
Of which: real interest rate	0.1	0.2	-0.4	0.4	0.3	0.3	0.3	0.2	0.2	1.8	
Of which: real GDP growth	-0.8	-0.5	-1.2	-1.4	-1.5	-1.5	-1.6	-1.7	-1.7	-9.5	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.5	-1.8	1.4	-0.6	0.1	0.2	0.2	0.1	0.1	0.1	
Privatization receipts (negative)	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Changes in cash, deposits, and securities held for liquidity purposes	0.7	-1.7	1.5	-0.6	0.1	0.2	0.2	0.1	0.1	0.1	
Residual, including asset changes [8/]	-0.3	0.1	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	



Source: IMF staff.

1/ Public sector is defined as non-financial public sector.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

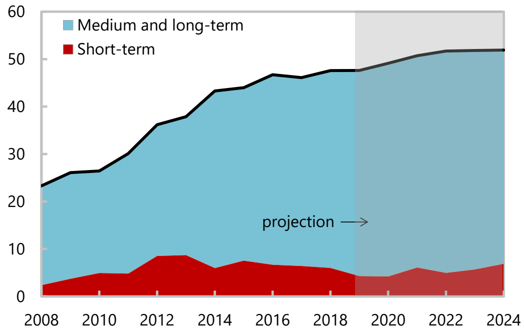
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

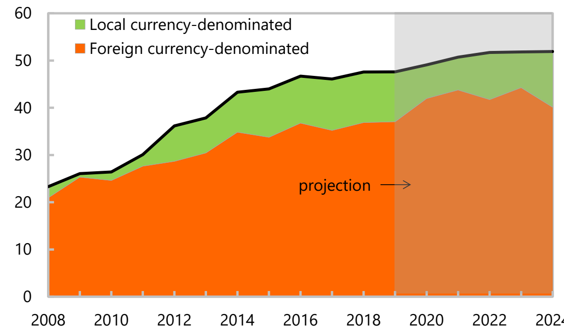
Figure 7. North Macedonia: Public Sector DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



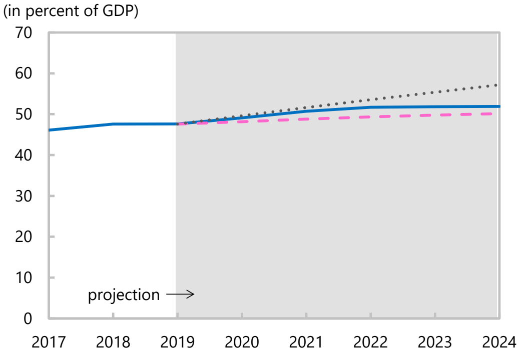
By Currency
(in percent of GDP)



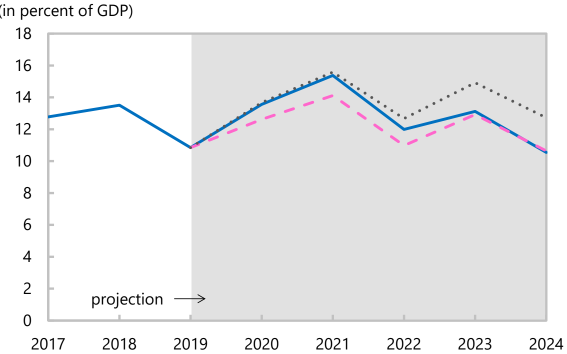
Alternative Scenarios

Baseline Historical Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

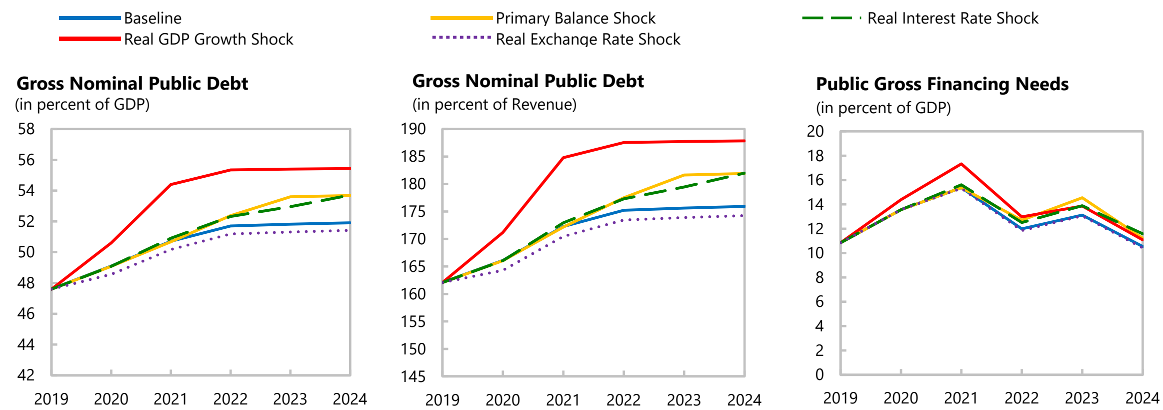
Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	3.2	3.4	3.2	3.3	3.4	3.5
Inflation	2.0	2.0	2.0	2.0	2.0	2.0
Primary Balance	-1.7	-2.6	-2.6	-2.2	-1.4	-1.4
Effective interest rate	2.9	2.8	2.8	2.7	2.6	2.6
Constant Primary Balance Scenario						
Real GDP growth	3.2	3.4	3.2	3.3	3.4	3.5
Inflation	2.0	2.0	2.0	2.0	2.0	2.0
Primary Balance	-1.7	-1.7	-1.7	-1.7	-1.7	-1.7
Effective interest rate	2.9	2.8	2.8	2.7	2.6	2.6

Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	3.2	2.2	2.2	2.2	2.2	2.2
Inflation	2.0	2.0	2.0	2.0	2.0	2.0
Primary Balance	-1.7	-2.6	-2.6	-2.6	-2.6	-2.6
Effective interest rate	2.9	2.8	2.7	2.6	2.6	2.5

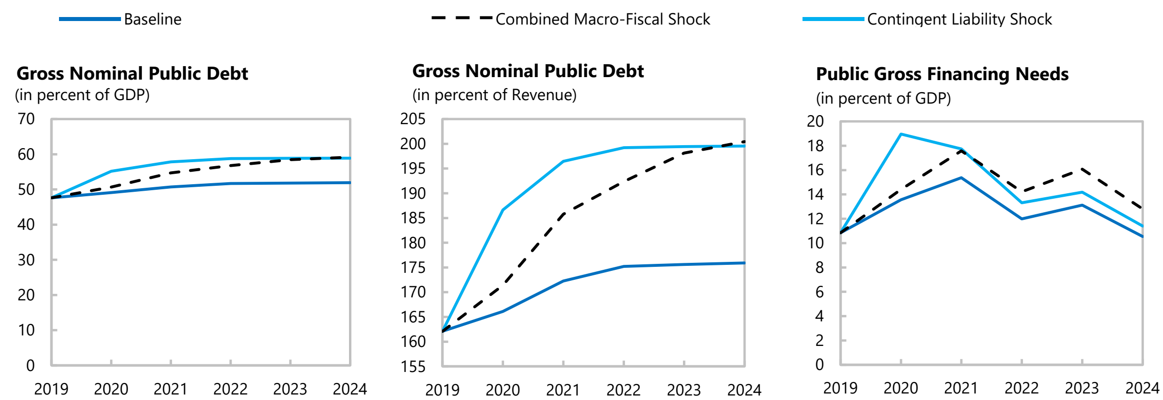
Source: IMF staff.

Figure 8. North Macedonia: Public Sector DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

	2019	2020	2021	2022	2023	2024
Primary Balance Shock						
Real GDP growth	3.2	3.4	3.2	3.3	3.4	3.5
Inflation	2.0	2.0	2.0	2.0	2.0	2.0
Primary balance	-1.7	-2.6	-2.6	-2.9	-2.5	-1.4
Effective interest rate	2.9	2.8	2.8	2.7	2.6	2.7
Real Interest Rate Shock						
Real GDP growth	3.2	3.4	3.2	3.3	3.4	3.5
Inflation	2.0	2.0	2.0	2.0	2.0	2.0
Primary balance	-1.7	-2.6	-2.6	-2.2	-1.4	-1.4
Effective interest rate	2.9	2.8	3.2	3.6	3.7	4.0
Combined Shock						
Real GDP growth	3.2	1.8	1.6	3.3	3.4	3.5
Inflation	2.0	1.5	1.6	2.0	2.0	2.0
Primary balance	-1.7	-3.2	-3.9	-2.9	-2.5	-1.4
Effective interest rate	2.9	2.8	3.3	3.6	3.7	4.0

	2019	2020	2021	2022	2023	2024
Real GDP Growth Shock						
Real GDP growth	3.2	1.8	1.6	3.3	3.4	3.5
Inflation	2.0	1.6	1.6	2.0	2.0	2.0
Primary balance	-1.7	-3.2	-3.9	-2.2	-1.4	-1.4
Effective interest rate	2.9	2.8	2.8	2.8	2.7	2.7
Real Exchange Rate Shock						
Real GDP growth	3.2	3.4	3.2	3.3	3.4	3.5
Inflation	2.0	1.5	2.0	2.0	2.0	2.0
Primary balance	-1.7	-2.6	-2.6	-2.2	-1.4	-1.4
Effective interest rate	2.9	2.8	2.8	2.7	2.6	2.6
Contingent Liability Shock						
Real GDP growth	3.2	1.8	1.6	3.3	3.4	3.5
Inflation	2.0	1.6	1.6	2.0	2.0	2.0
Primary balance	-1.7	-7.6	-2.6	-2.2	-1.4	-1.4
Effective interest rate	2.9	3.1	3.1	2.9	2.9	2.9

Source: IMF staff.

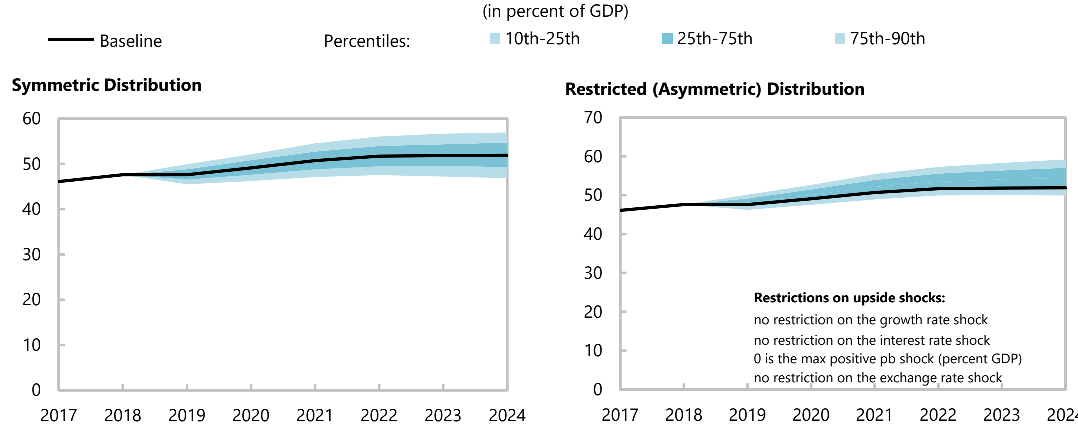
Figure 9. North Macedonia: Public Sector DSA Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

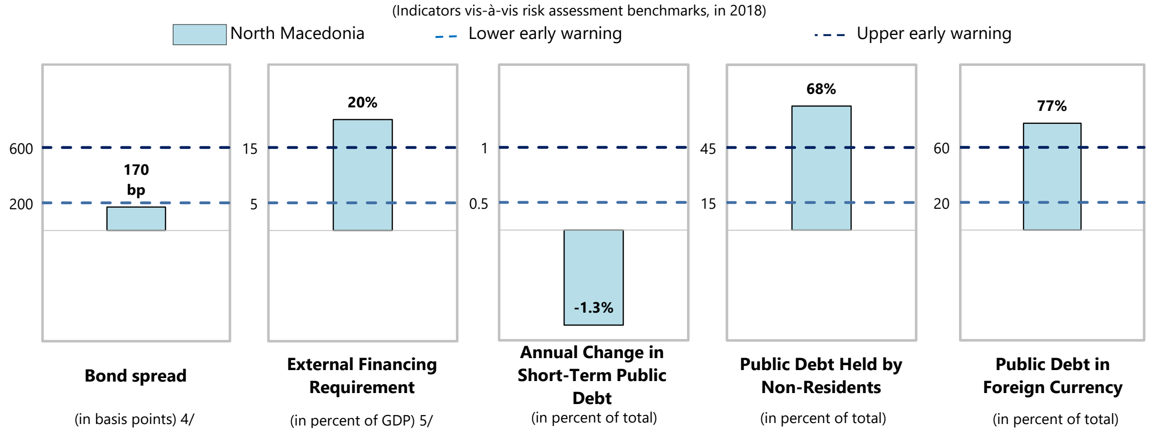
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2018)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ Long-term bond spread over German bonds, an average over the last 3 months, 17-Sep-19 through 16-Dec-19.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Table 1. North Macedonia: Non-Financial Public Sector Debt Stress Test Scenarios

Name	Description	Impact on debt 1/
Primary balance shock	Minimum shock equivalent to 50% of planned adjustment (50% implemented), or baseline minus half of the 10-year historical standard deviation, whichever is larger. There is an increase in interest rates of 25bp for every 1% of GDP worsening in the primary balance.	1.8
Real GDP growth shock	Real GDP growth is reduced by 1 standard deviation for 2 consecutive years; revenue-to-GDP ratio remains the same as in the baseline; level of non-interest expenditures is the same as in the baseline; deterioration in primary balance lead to higher interest rate (see above); decline in growth leads to lower inflation (0.25 percentage points per 1 percentage point decrease in GDP growth).	3.5
Interest rate shock	Interest rate increases by difference between average real interest rate level over projection and maximum real historical level, or by 200bp, whichever is larger.	1.8
Exchange rate shock	Estimate of overvaluation or maximum historical movement of the exchange rate, whichever is higher; pass-through to inflation with default elasticity of 0.25 for EMs and 0.03 for AEs.	-0.5
Combined Macro-Fiscal Shock	Shock size and duration based on the underlying shocks.	7.2

Source: IMF staff estimates.

1/ Percentage points in excess of the baseline at the end of the projection period.

Table 2. North Macedonia: External Debt Sustainability Framework, 2008–2024

(In percent of GDP, unless otherwise indicated)

	Actual													Projections						
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018			2019	2020	2021	2022	2023	2024	Debt-stabilizing non-interest current account 6/
Baseline: External debt	49.1	56.0	57.9	64.2	68.2	64.0	70.0	69.3	74.7	73.4	73.4			**74.2**	**74.0**	**73.5**	**73.6**	**73.0**	**72.5**	**-6.6**
Change in external debt		7.0	1.8	6.4	3.9	-4.1	5.9	-0.7	5.4	-1.3	0.0			0.8	-0.2	-0.5	0.1	-0.6	-0.5	
Identified external debt-creating flows (4+8+9)		5.9	0.1	-8.2	8.0	-6.7	-6.9	10.7	-2.6	-3.5	-10.7			-3.9	-4.2	-3.9	-3.8	-3.7	-3.6	
Current account deficit, excluding interest payments		6.7	1.3	1.8	2.6	1.1	0.0	1.3	2.1	0.1	-0.8			0.0	0.3	0.5	0.7	0.9	1.0	
Deficit in balance of goods and services		22.8	19.7	20.5	22.4	18.3	17.2	16.2	15.2	14.1	12.8			12.7	12.2	11.8	11.5	11.3	11.1	
Exports	42.7	31.8	38.5	45.6	44.5	43.3	47.7	48.8	50.9	54.9	60.4			63.0	64.0	66.1	68.2	70.4	72.5	
Imports		54.5	58.2	66.1	66.9	61.6	64.9	65.0	66.2	69.0	73.2			75.8	76.2	77.9	79.8	81.7	83.6	
Net non-debt creating capital inflows (negative)		-3.6	-1.8	-3.9	-1.1	-1.6	-4.2	-0.4	-1.4	-0.3	-3.3			-2.5	-3.0	-3.2	-3.2	-3.2	-3.2	
Automatic debt dynamics 1/		2.8	0.6	-6.1	6.6	-6.2	-2.6	9.7	-3.3	-3.4	-6.6			-1.4	-1.5	-1.3	-1.3	-1.4	-1.5	
Contribution from nominal interest rate		0.1	0.7	0.7	0.6	0.5	0.5	0.6	0.7	0.9	0.9			0.9	0.9	0.9	0.9	0.9	0.9	
Contribution from real GDP growth		0.2	-1.9	-1.2	0.3	-1.8	-2.2	-3.0	-1.9	-0.8	-1.8			-2.3	-2.4	-2.2	-2.3	-2.4	-2.4	
Contribution from price and exchange rate changes 2/		2.5	1.8	-5.6	5.7	-5.0	-0.9	12.2	-2.2	-3.5	-5.7			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/		1.1	1.7	14.6	-4.1	2.5	12.8	-11.3	8.0	2.2	10.7			4.7	4.0	3.4	3.9	3.2	3.1	
External debt-to-exports ratio (in percent)	114.8	176.4	150.5	140.8	153.3	147.9	146.6	142.2	146.7	133.8	121.6			117.8	115.6	111.1	107.9	103.8	100.1	
Gross external financing need (in billions of US dollars) 4/		2.5	2.3	2.2	2.7	2.8	2.1	2.4	2.1	2.1	2.5			2.8	3.5	3.8	3.3	3.9	3.5	
in percent of GDP		26.2	24.6	20.8	28.1	26.0	18.8	24.3	19.7	18.2	20.0	10-Year	10-Year	22.3	26.1	27.2	21.8	24.7	20.6	
Scenario with key variables at their historical averages 5/														**74.2**	**77.8**	**81.8**	**86.4**	**90.0**	**93.9**	**-3.8**
												Historical	Standard							
Key Macroeconomic Assumptions Underlying Baseline												Average	Deviation							
Real GDP growth (in percent)		-0.4	3.4	2.3	-0.5	2.9	3.6	3.9	2.8	1.1	2.7	2.2	1.6	3.2	3.4	3.2	3.3	3.4	3.5	
GDP deflator in US dollars (change in percent)		-4.8	-3.1	10.6	-8.1	7.8	1.4	-14.8	3.2	5.0	8.4	0.6	8.1	-3.0	1.8	3.0	2.8	2.6	2.8	
Nominal external interest rate (in percent)		0.2	1.2	1.3	0.9	0.8	0.9	0.8	1.1	1.3	1.4	1.0	0.4	1.3	1.3	1.3	1.4	1.4	1.4	
Growth of exports (US dollar terms, in percent)		-29.5	21.3	34.3	-10.8	8.1	15.9	-9.6	10.9	14.3	22.5	7.7	19.0	4.5	6.9	9.8	9.6	9.5	9.6	
Growth of imports (US dollar terms, in percent)		-24.7	6.9	28.6	-7.5	2.2	10.9	-11.4	8.1	10.5	18.3	4.2	15.3	3.5	5.9	8.8	8.7	8.7	8.8	
Current account balance, excluding interest payments		-6.7	-1.3	-1.8	-2.6	-1.1	0.0	-1.3	-2.1	-0.1	0.8	-1.6	2.1	0.0	-0.3	-0.5	-0.7	-0.9	-1.0	
Net non-debt creating capital inflows		3.6	1.8	3.9	1.1	1.6	4.2	0.4	1.4	0.3	3.3	2.2	1.5	2.5	3.0	3.2	3.2	3.2	3.2	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

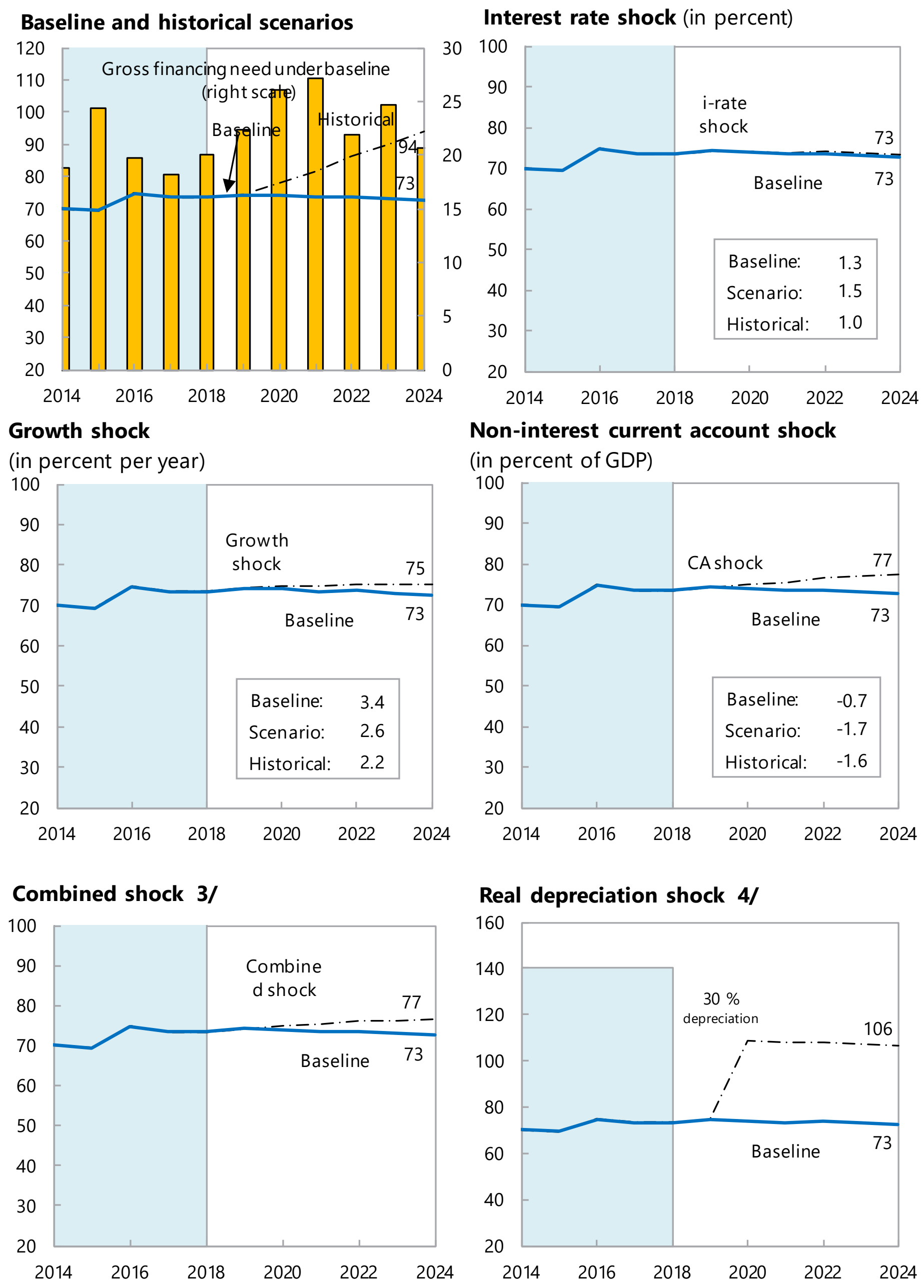
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure 10. North Macedonia: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



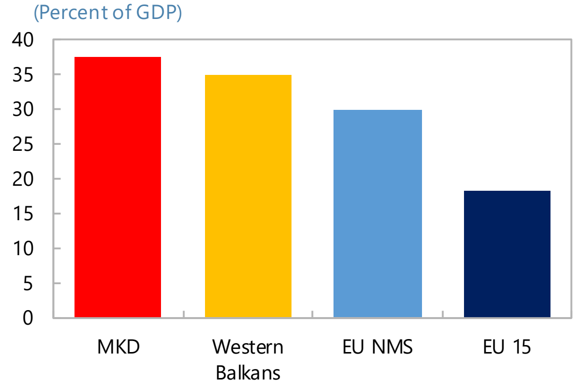
Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2020.

Annex II. Tackling Informality[1]

North Macedonia suffers from widespread informality. While the shadow economy can contribute to economic growth by creating opportunities that are not available in the formal economy, it creates inefficiencies and reduces the economy's long-term growth potential. A comprehensive set of policies is needed to shift economic activity to the formal sector. It should combine measures that strengthen tax compliance and improve tax morale with policies to incentivize more formal job opportunities.

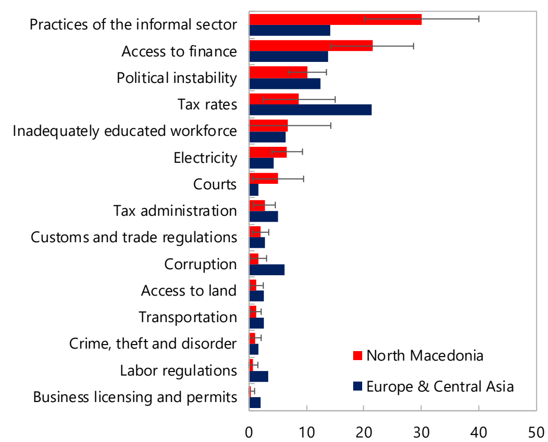
1. **More than one third of North Macedonia's economic activity could be in the informal sector.** Estimates run from 10 to 45 percent of GDP, depending on the definition of the shadow economy and methodology employed. A recent IMF study (Kelmanson et al., 2019) estimates the share of the informal economy in North Macedonia at 38 percent in 2016 (Text Figure 1). Accordingly, informal employment is also frequent. Based on State Statistical Office statistics, 19 percent of employment was informal in 2018. For the young population, measured by those below 24 years, an even larger share of employment, at 29 percent, was found to be informal in 2018.

Text Figure 1: Size of the Shadow Economy in Europe, 2016
(Percent of GDP)



Source: IMF staff estimates (Kelmanson et al., 2019).

Text Figure 2: Biggest Obstacle Reported by Firms
(2013 or latest, percent of firms)



Source: World Bank Enterprise Surveys.
Black bars represent 90 percent confidence interval.

2. **The economic costs of a large informal sector are substantial.** While the shadow economy can contribute to economic growth by creating opportunities that are not available in the formal economy, it creates inefficiencies and reduces the economy's long-term growth potential:

- For **businesses,** informality is a key obstacle, encouraging a race to the bottom as legitimate businesses face competition from shadow businesses which disincentivizes investment, human capital formation and technological innovation. Meanwhile, lack of verifiable information about the financial position may make undeclared businesses' access to financing more difficult.

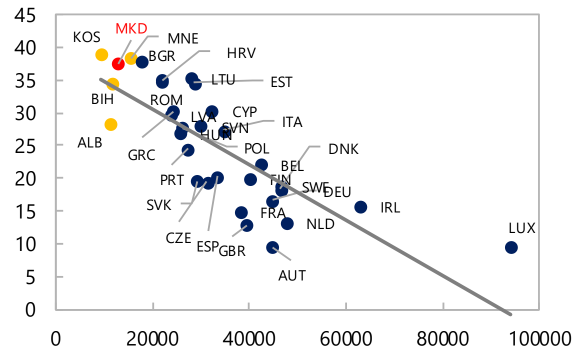
[1] This note was prepared by Louise Rabier (IMF Brussels Office). It builds on previous work by the North Macedonia team on the informal sector and a recent cross-country study by Kelmanson et al. (2019).

Informality is considered as the largest obstacle by a third of firms according to the World Bank Enterprise Surveys (see Text Figure 2).[2]

- For **informal workers,** undeclared work deprives them of many labor rights, such as sick leave, unemployment benefits and minimum wages. Also, the absence of formal training or employment history makes it more difficult for workers to enter the formal economy, resulting in high and persistent unemployment.
- For the **public sector,** the inability to collect taxes on shadow economic activity weakens public finances, with adverse impact on public investment, and public goods and services, including education and training programs.

3. The informal sector tends to be smaller for countries with higher income levels. Countries such as North Macedonia, which have a lower level of income per capita, have larger informal sectors (Text Figure 3).[3] The link with income inequality is ambiguous. Informality has been found to reduce inequality through the introduction of allocative distortions that compress the skill premium. However, informality may also generate inequality, as wages are generally lower in the informal sector, especially for low-skilled workers, and transitioning to the formal economy maybe difficult without formal experience. Messina and Silvia (2018) show that in Latin-American countries where informality delined substantially in the 2000s and 2010s, pay among workers with similar skills became more equal (and the more so for low-skilled workers), the pay gap between high- and low-skilled workers declined, and levels of education rose.

Text Figure 3: Size of the Shadow Economy and GDP per Capita, 2016



Source: IMF staff estimates (Kelmanson et al., 2019). Western Balkans in yellow.

4. Escaping taxes and regulation may be easier for smaller firms, which could restrain firm growth and reduce economies of scale. There are 27 formal businesses per 1000 inhabitants in North Macedonia, compared to 48 in the EU-28.[4] As in the EU, most businesses are micro firms, with 91 percent of firms employing less than 10 persons (94 percent in the EU).

A. Drivers of Informality

5. The motivation behind operating in the shadow economy, beyond criminal activities, is usually to evade taxes and regulations. While North Macedonia has a relatively low regulatory burden as well as low tax pressure, factors such as a high tax wedge for low-income earners,

[2] The World Bank Enterprise Survey presents perceptions.

[3] Throughout this report, North Macedonia will be compared to other Western Balkan economies (Albania, Bosnia and Herzegovina, Kosovo, Montenegro, and Serbia), and new EU member states, who joined after 2004.

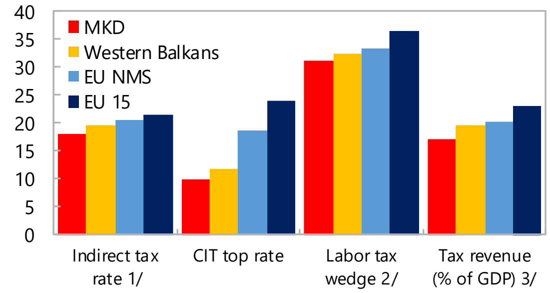
[4] Eurostat, 2016.

inefficient tax administration, low tax morale linked to low trust in public institutions, persistently high unemployment and skill shortage are likely to be behind the elevated level of informality.

Taxation and Minimum Wages

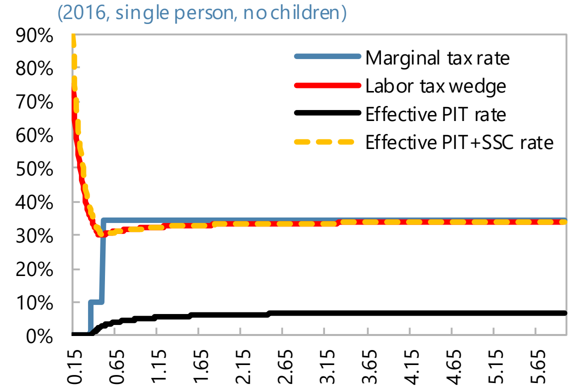
6. The tax burden overall does not appear a major obstacle to formal businesses. Both corporate and value added tax rates are low compared to other European countries (Text Figure 4). The average labor tax wedge among low-income earners is also lower than in peer economies. However, a high marginal tax wedge for lower-income earners could prevent workers to join the formal labor market. The minimal basis to social security contributions is set at half the average gross income, making marginal rates of social security contributions high at low levels of income (Text Figure 5), which could reduce the incentives either to take up formal employment or to report the full wage earnings. Moreover, unemployed retain access to certain social assistance benefits, though the coverage appears limited and only a small share of the unemployed are captured.

Text Figure 4: Tax Rates in Europe
(2019 for CIT, indirect tax rates, latest for others)



Sources: KPMG; World Bank; Eurostat; IMF staff calculations.
1/ Indirect tax rate usually corresponds to the standard VAT rate.
2/ Labor tax wedge is calculated for single earner at 67 percent of national average wage (2018 data).
3/ 2017 data.

Text Figure 5: North Macedonia: Labor Income Taxation
(2016, single person, no children)



Source: IMF Working Paper WP/17/194.

7. A high minimum wage could increase the incentives for informal employment. The minimum wage is elevated compared to peers, at 53 percent of the average wage.[5] A higher wage could attract more workers to the formal sector. However, it also increases the cost of labor to firms, potentially reducing the number of formal jobs available. If the minimum wage is set too high, workers may be forced to move to the informal sector.

Tax Administration, Fiscal Transparency, and Institutional Quality

8. Ineffective tax administration provides incentives for tax evasion and undeclared work. Tax collection efficiency is weak in North Macedonia.[6] Partly reflecting a lack of resources, the extent of initiatives to detect unregistered taxpayers and inaccurate reporting is limited. Moreover,

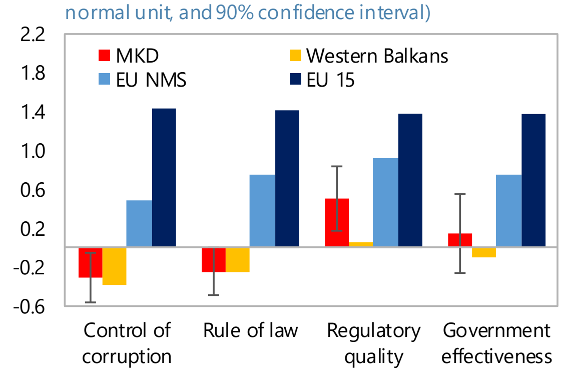
[5] This ratio might be biased upward given that declared wages are often lower than actual wages. On the other hand, it may be biased downward if on average, undeclared wages in the informal sector are lower than wages in the formal sector.

[6] See the IMF's Tax Assessment Diagnostic Assessment Tool (TADAT).

shortfalls in fiscal transparency could diminish tax morale and the willingness to pay taxes, as it may hamper the perception that the tax system is fair and citizens may not have enough information about how tax revenue is spent.

9. A high perception of corruption and weak quality of public institutions could also diminish trust and lower tax morale. North Macedonia scores on perceived control of corruption and rule of law are substantially lower than EU NMS and similar to other Western Balkan countries, according to the "Worldwide Governance Indicators" (see Text Figure 6). Weak institutions and high corruption reduce the incentives of operating a registered business (Hassen and Schneider, 2016). In particular, Litina and Palivos (2016) show that in countries with a higher perception of political corruption, tax evasion is more accepted.

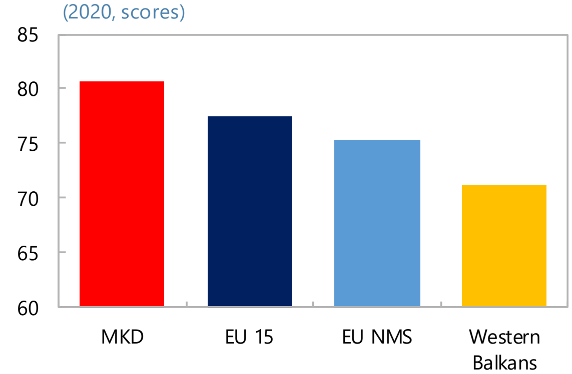
Text Figure 6: Governance Quality Percentile Score
(2017, from -2.5 (lowest) to 2.5 (highest) in standard normal unit, and 90% confidence interval)



Source: Worldwide Governance Indicators.

10. On the upside, perceived higher government effectiveness and regulatory quality, tend to encourage the establishment of formal businesses. The World Bank Doing Business Indicators also suggest a low regulatory burden (see Text Figure 7).[7] However, there is still scope for improvement on government effectiveness and regulatory quality, reflecting shortcomings in the application of regulations.

Text Figure 7: Doing Business in Europe
(2020, scores)



Source: World Bank Doing Business.
Higher score means greater ease of doing business.

Unemployment and Education

11. High unemployment can drive workers to the informal sector.[8] With unemployment around 17 percent, job opportunities in the formal sector are limited. Moreover, long-term unemployed (75 percent of the unemployed have been out of a job for more than a year) and young unemployed (17 percent of the unemployed) are more vulnerable. Long-term unemployed may be forced to take up jobs in the informal sector for subsistence, and young employed may not have the experience required to get a job in the formal sector.

12. Low educational attainment may also represent a barrier to formal employment. Most jobs in the informal sector are for low-skilled workers.[9] The competencies of 15-year-old students

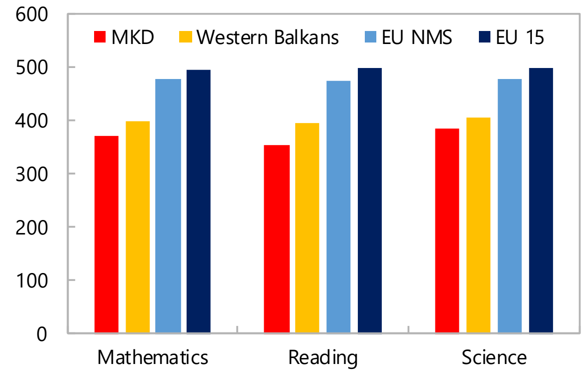
[7] "Getting electricity" component excepted, because of high costs and lengthy procedures.

[8] See Schneider et al. (2010).

[9] See Docquier, Muller and Naval (2014).

are lower than in new EU member states and Western Balkans (see Text Figure 8). The overall enrolment rate in higher education has increased to more than 40 percent in recent years, but the tertiary education completion rate remains low at 30 percent, against 40 percent in the EU and Western Balkans. Higher investment in education is found to significantly reduce informality in economies where institutional quality is high.[10] To the extent that wages are lower in the informal sector, individual returns to education are lower in the informal sector, which reduces incentives to invest human capital. [11]

Text Figure 8: Educational Attainment at the Age of 15
(2015, PISA score)



Source: OECD PISA.

B. A Set of Policies to Reduce Informality

13. A comprehensive set of policies is needed to tackle informality. The government's 2018 Strategy for Formalization of the Informal Economy aims to improve the detection of informal activity, reinforce the business environment, provide incentives for formalization and strengthen the tax morale. The implementation of actions should be evaluated, and further efforts should be put in place to strengthen tax administration and tax compliance.

14. Improved tax administration would increase tax revenues and represent a key deterrent to informal activity. Efforts have been made to improve tax administration efficiency, including via the development of electronic payment systems. However, the Tax Administration Diagnostic Assessment Tool (IMF, 2016) highlights that the capacity of tax administration risk management and audit units should be raised further. The extent of initiatives to detect unregistered tax payers is limited and the tax audit program does not provide adequate coverage, is under-resourced and poorly focused. Focus should be on improving the Public Revenue Office (PRO)'s identification and treatment of compliance risk, and implementing better targeted audits. This will require addressing the PRO's underfunding and capacity constraints.

15. Better tax administration can also help boost tax morale. Improving taxpayers' trust in fair tax administration is a precondition for improved voluntary tax compliance and higher revenues without excessive recourse to enforcement.[12] This will need to include reforms to make self-assessment by taxpayers more effective, such as providing every taxpayer with swift and impartial review of their complaints through an independent review process inside the tax administration.

[10] Buehn and Farzanegan (2013).

[11] See Herrera-Idárraga et al. (2013) for evidences in Colombia.

[12] In this respect, the Public Revenue Office has organized a national campaign to increase citizens' tax morale and public awareness of the benefits of paying taxes and is envisaging one on informal work within the project "Improvement of work conditions."

Ongoing measures to improve governance and the rule of law are also likely to improve the tax morale.

16. It is also important to ensure that all parameters of tax and benefits systems are compatible with formalization of activity.

- **The tax wedge for low-income earners should be evaluated.** In particular, a reduction in the minimum social security contribution base could help lower the labor income tax wedge for low-paid workers. Nonetheless, to avoid under-reporting, this would have to be accompanied by efforts to strengthen the audit and compliance processes.

- **Conditional on a strong tax administration, in-work tax credits could be considered to stimulate formal employment of low-income workers.** In many advanced economies, tax credits constitute a net transfer to an individual whose earned income falls below income tax liabilities. These tax credits increase the net income gain from accepting a job, compared to the alternative of being out of work (and receiving other benefits that would likely be withdrawn once taking a job). Minimum hours-worked requirements could be used to avoid providing income support to high-skilled workers in part-time jobs. However, this requires a strong tax administration, as in-work tax credits may be costly and ineffective if most low-income earners are not filing tax returns, or if there is no effective withholding system.

17. The minimum wage should take into account productivity developments, to avoid becoming an obstacle for formal employment. Ensuring that the minimum wage is fully enforced throughout the economy is essential to protect workers. However, if the minimum wage is too high relative to productivity, it may reduce formal employment.

18. The effectiveness in reducing informality of recent tax incentive schemes should be evaluated.

- **The VAT reimbursement scheme (July 2019)** ("MyVAT"). The scheme provides taxpayers a 15 percent rebate on VAT paid, up to a certain cap, after submitting fiscal receipts. The scheme aims to increase formality by incentivizing taxpayers to ask for a VAT receipt and has been made possible by improvements in electronic tax systems. International experiences suggest that VAT reimbursement schemes in general have had limited impact on informality, unless accompanied by reinforced administrative capacity and better enforcement. Moreover, the scheme will be costly and a framework for evaluation and audit needs to be established to avoid abuse.

- **Subsidy on employers' social security contribution (October 2019).** The government will subsidize, for the next three years, social security contributions for employers on net salary increases of up to MKD 6000 per month. In addition to helping firms raise salaries, the intention is to reduce the incidence of 'envelope payments' by encouraging workers and firms to declare the full wage. Although the government estimates that the measure would be budget-neutral, it would increase long-term pension liabilities. At the same time, the subsidy will make the tax system more complex.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF NORTH MACEDONIA

December 23, 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

European Department
(In Consultation with Other Departments)

CONTENTS

FUND RELATIONS

(As of November 30, 2019)

Missions. Article IV, Skopje, November 6–15, 2019. Concluding statement is available at: https://www.imf.org/en/News/Articles/2019/11/17/mcs111819-republic-of-north-macedonia-staff-concluding-statement-of-the-2019-article-iv-mission

Staff team. Ms. Barkbu (head), Mr. Poulain and Ms. Lin (all EUR), Ms. Kida (FIN), Ms. Eble (Resident Representative), and Mr. Nacevski (IMF Local Economist).

Discussions. The staff team met Prime Minister Zaev, Deputy Prime Minister Angjushev, Minister of Finance Angelovska, National Bank Governor Angelovska Bezoska, other senior officials, and representatives of the banking, business, political and international communities.

Membership Status: Joined 12/14/1992; Article VIII

General Resources Account:	SDR Million	Percent of Quota
Quota	140.30	100.00
Fund holdings of currency	140.30	100.00
Reserve position	0.00	0.00

SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	65.62	100.00
Holdings	2.26	3.34

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PLL [1/]	01/19/2011	01/18/2013	413.40	197.00
Stand-By	08/31/2005	08/30/2008	51.68	10.50
Stand-By	04/30/2003	08/15/2004	20.00	20.00

[1/] Formerly PCL.

Projected Payments to the Fund (Expectation Basis)[1]
(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2019	2020	2021	2022	2023
Principal					
Charges/Interest		0.50	0.50	0.50	0.50
Total		0.50	0.50	0.50	0.50

Exchange Arrangement:
The de jure exchange rate arrangement is floating. Under the Law on Foreign Exchange Operations (Article 33), the denar exchange rate is freely determined on the basis of supply and demand in the foreign exchange market. However, the National Bank of the Republic of North Macedonia (NBRNM) participates in the foreign exchange market (Article 34), in order to achieve the goals of the monetary and foreign exchange policies. The NBRNM implements the monetary strategy of targeting the nominal exchange rate against the euro. The intermediary objective of the monetary policy is to maintain a stable denar exchange rate. Thus, the NBRNM maintains a stable exchange rate within a narrow band of bid-ask exchange rates determined by the Committee for Operational Monetary Policy. The de facto exchange rate arrangement is classified as a stabilized arrangement. North Macedonia has accepted the obligations of Article VIII, Sections 2, 3 and 4 and currently maintains an exchange system free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions.

Article IV Consultations:
The first consultation with the Republic of North Macedonia was concluded in August 1993. The last consultation was concluded on January 23, 2019 (IMF Country Report 19/32). North Macedonia is on the standard 12-month Article IV consultation cycle.

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Table 1. Technical Assistance Since 2015

Purpose	Department	Date
Public Debt Management	MCM/WB	January 2017
Public Financial Management	FAD	September 2019
Cash Management (in the context of broader PFM reforms)	FAD	October 2017
Organic Budget Law	FAD	December 2017
Fiscal Rule and Fiscal Council	FAD	February 2018
Fiscal Transparency Evaluation	FAD	March 2018 April 2018
Tax Policy	FAD	January 2017 September 2017
Tax Administration	FAD	April 2016 May 2016 July 2016 May 2017 September 2017 March 2018 December 2018 March 2019 May 2019
Tax IT System Improvement	FAD	May 2017 September 2017
Taxpayer Registration	FAD	November 2018
Tax Treaty Policy	FAD	October 2019
Tax Audit Function	FAD	February 2016 November 2016 March 2017 February 2018
Tax Arrears Management	FAD	September 2018 November 2019
Large Taxpayers Office	FAD	March 2016 October 2019
Property Tax System	FAD	September 2017 April 2018
Transfer Pricing and Related International Issues	FAD	September 2017 December 2018
Tax Compliance Management	FAD	February 2015 October 2015 October 2016 November 2016 October 2018 October 2019

Table 1. Technical Assistance Since 2015 (concluded)		
Government Finance Statistics	STA	January 2015 June 2016 November 2016 February 2017 July 2017 November 2017 March 2018 June 2018 November 2018 March 2019 July 2019
External Sector Statistics	STA	April 2017
Monetary and Financial Statistics (MFS)	STA	January 2015
Sectoral Financial Accounts and Balance Sheet Statistics	STA	October 2018
Regional Advisors		
Revenue Administration	FAD	2015-
Public Financial Management	FAD	2015-
FSAP Participation and ROSCs (since 2003)		
FSAP	MCM/WB	May-June 2003
FSAP update	MCM/WB	March 2008 April 2018 July 2018 September 2018
Data ROSC	STA	February 2004
Fiscal ROSC	FAD	February 2005

IMF–WORLD BANK COLLABORATION

Background

The Bank and the Fund country teams on the Republic of North Macedonia maintain close collaboration, seeking synergies and harmonizing policy recommendations. The teams broadly agree in their assessment of the economic situation in the country.

Key Areas of World Bank Involvement

- The new World Bank Country Partnership Framework (CPF) for the period 2019–2023 was adopted in April 2019. The strategic objective of the CPF is to support North Macedonia's ability to achieve faster, inclusive, and sustainable growth and provide its citizens with greater opportunities for a better life. The CPF aims to support the Government's program and medium-term strategy, which present a vision of accelerated economic growth with better employment opportunities, social cohesion and inclusion, and a plan to tackle the persistent bottlenecks. The CPF is also consistent with the Systematic Country Diagnostic (SCD) analysis and recommendations.

- The CPF is based on three interconnected focus areas that will help North Macedonia improve the environment for a dynamic private sector to enhance export-led growth, strengthen human capital for inclusive development, and build sustainability. Focus Area I aim to remove some of the bottlenecks that prevent the emergence of a dynamic and competitive private sector by improving connectivity and access to markets (the first CPF objective) through activities that support "hard" and "soft" trade connectivity and strengthen local firms' technological uptake, innovation, access to finance, and capacities. Focus Area II will support the development of human capital and skills to boost labor productivity and encourage more inclusive labor market participation. The CPF will also improve the quality and relevance of education (the second CPF objective), as well as the access to and quality of social services (the third CPF objective). Focus Area III will mitigate fiscal and environmental vulnerabilities to enhance fiscal sustainability by strengthening fiscal and public financial management (the fourth CPF objective) and environmental sustainability by helping accelerate the transition to a more sustainable energy mix (the fifth CPF objective).

- The Government strategy is consistent with the SCD's vision of a better-connected, vibrant domestic economy engaged in the region and beyond as it secures its footing in areas of strong comparative advantage.

Republic of North Macedonia: IBRD Lending
FY 19–23

	Focus Area I Export-Led Growth: Improve the Environment for a Competitive Private Sector	**Focus Area II Inclusive Growth: Expand Skills and Opportunities for the Most Vulnerable**	**Focus Area III Sustainable Growth: Enhance Sustainability and Build Resilience to**	Total amount
Current Portfolio from CPS FY15–FY18	National and Regional Roads rehabilitation Project (US$71 million) Road Upgrading and Development Project (RUDP) (US$91 million) Local and Regional Competitiveness Project (US$17.2 million)	Social Services Improvement Project (SSIP) (US$33.4 million) Skills Development and Innovation Support Project (SDIS) (US$24 million)	Municipal Services Improvement I (US$92.7 million) Municipal Services Improvement II (US$28 million)	US$357.3, of which about 58 percent is yet to be disbursed
Proposed lending FY19	Western Balkans Trade and Transport Facilitation Project (IPF, US$30 million)		Fiscal Efficiency and Competitiveness (DPF/PBG – US$70 million)	US$100 million
Proposed lending FY20–FY21	Local Roads Connectivity Project and/or National and Regional Roads Rehabilitation Additional Financing (IPF) Agriculture Modernization (IPF) Digital Macedonia – high-speed broadband (IPF)	Pension Modernization Project (IPF)	Energy Efficiency (IPF)	About US$120 million
Proposed lending FY22–FY23	Innovation and/ or Competitiveness Project (IPF)	Primary Education and/or Health Care Project (IPF)	Fiscal and Growth (DPF/PBG) Sustainable Municipal Development (IPF/ PforR) and/or Waste Water Project (IPF)	About US$120 million

- Note: IPF = Investment Project Financing; PforR = Program for Results.

STATISTICAL ISSUES

(As of December 13, 2019)

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings but is broadly adequate for surveillance. Areas that would benefit most from further improvement are national accounts and government finance statistics.
National accounts: The quality of national account measurement needs to be improved. In 2013, by Decision of the Government of the Republic of North Macedonia, amendments were made to the National Classification of Activities—NKD Rev.2 and entailed significant changes in the decomposition of historical data. The primary objective of the Classification of Activities is to provide a basis for comparing statistical data of the Republic of North Macedonia on European and world level, i.e. in its content and structure is completely harmonized with the European Classification of Activities NACE Rev.2. Financial accounts and balance sheets statistics are now being compiled. The NBRM has an objective to publish annual balance sheet data in 2020. **Price statistics:** Improvements to the CPI have been introduced in accordance with international standards and EU regulations to align the Classification of Individual Consumption According to Purpose (COICOP).
Government finance statistics: North Macedonia's GFS data has been improving over recent years, assisted by ongoing GFS Technical Assistance. The authorities disseminate both monthly central government operations, and quarterly general government operations, as well as quarterly debt data on their own website and on their SDDS National Summary Data Page. While this data is disseminated in a national presentation, on a cash basis, and does not cover the whole of general government as defined in GFSM 2001/14, the data is of generally good quality. The authorities report detailed data on revenues and expenditures of general government and its subsectors for inclusion in the Annual GFS database (formerly the *Government Finance Statistics Yearbook*) and are taking steps toward publishing general government data in the GFSM 2014 presentation for inclusion in *International Finance Statistics*. The authorities report central government debt data to the *IMF / World Bank Quarterly Public Sector Debt Database*.
Monetary and financial statistics: North Macedonia regularly reports to the IMF's Statistics Department monetary data for the central bank, other depository corporations, and other financial corporations using the standardized report forms. North Macedonia reports data on several series indicators of the Financial Access Survey (FAS) including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).

Financial sector surveillance: North Macedonia reports to the IMF's Statistics Department, on a quarterly frequency and with one quarter timeliness, all core FSIs for deposit takers as well as eight encouraged FSIs for deposit takers.	
External sector: External sector statistics meet international standards. In additional to quarterly balance of payments data, the authorities compile and disseminate quarterly international investment position (IIP) data, reserve assets and foreign currency liquidity data, and external debt statistics. Also, North Macedonia participates in the Coordinated Direct Investment Survey and in the Coordinated Portfolio Investment Survey.	
II. Data Standards and Quality	
The Republic of North Macedonia has adhered to the Special Data Dissemination Standard (SDDS) Plus since January 2019.	Data ROSC published on September 29, 2004.

Republic of North Macedonia: Table of Common Indicators Required Surveillance

(As of December 12, 2019)

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	12/06/19	12/06/19	D	W	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Nov. 19	12/13/19	M	M	M
Reserve/Base Money	Nov. 19	12/13/19	M	M	M
Broad Money	Oct. 19	11/21/19	M	M	M
Central Bank Balance Sheet	Nov. 19	12/13/19	M	M	M
Consolidated Balance Sheet of the Banking System	Oct. 19	11/21/19	M	M	M
Interest Rates[2]	Oct. 19	11/29/19	M	M	M
Consumer Price Index	Nov. 19	12/10/19	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Sep. 19	11/15/19	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Oct. 19	11/25/19	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Sep. 19	10/31/19	Q	Q	Q
External Current Account Balance	Sep. 19	11/29/19	M	Q	Q
Exports and Imports of Goods and Services	Oct. 19	12/05/19	M	Q	Q
GDP/GNP	Sep. 19	12/06/19	Q	Q	Q
Gross External Debt	Jun. 19	Sep. 19	Q	Q	Q
International Investment Position[6]	Jun, 19	Sep. 19	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

[2] Weighted interest rates on loans and deposits in domestic banks. Separately, data is submitted on the rates on central bank bills (policy rate) and treasury bills, notes, and bonds.

[3] Foreign, domestic bank and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments. Data including local governments is normally published quarterly but is also received on an ad-hoc basis during missions.

[5] Currency and maturity composition is reported only on request.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).

INTERNATIONAL MONETARY FUND

REPUBLIC OF NORTH MACEDONIA

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION–SUPPLEMENTARY INFORMATION

January 14, 2020

Prepared By The European Department

This supplement updates the staff report (SM/19/288).

This supplement provides information that has become available since the issuance of the staff report. The information does not alter the thrust of the staff appraisal.

Preliminary 2019 fiscal outcome. Preliminary numbers received from the authorities indicate that the overall fiscal deficit for 2019 amounted to 13.6 billion denars, or 2 percent of staff's projected GDP. This is somewhat higher than staff's projection (1.8 percent) and is mostly due to an increase in capital spending in December, which nonetheless continues to be below budgeted yearly amounts. The deficit outcome is considerably below what was envisaged in the supplementary budget approved in October 2019 (2.5 percent). These developments do not materially affect staff's baseline projections.

Revised composition of 2018 GDP. Although nominal GDP and real GDP growth for 2018 remained unchanged in the latest data update published by the State Statistical Office, the composition of real expenditures was revised. According to the update, real investment contracted by 7.3 percent in 2018 (versus 0.9 percent growth previously) with a contribution to growth of -2.6 percentage points, while net exports now have a positive contribution of 2 percentage points (versus -0.3 points previously), reflecting postponement of large infrastructure projects and falling construction in 2018.

INTERNATIONAL MONETARY FUND

REPUBLIC OF NORTH MACEDONIA

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION–SUPPLEMENTARY INFORMATION

January 15, 2020

Prepared By The European Department

This supplement updates the staff report (SM/19/288).

This supplement provides information that has become available since the issuance of the staff report. The information does not alter the thrust of the staff appraisal.

Monetary policy decision by the National Bank of the Republic of North Macedonia (NBRNM). On January 15, the NBRNM reduced the policy rate by 25 basis points to 2 percent, amid continuous favorable developments in the foreign exchange market and lower-than-projected inflation. The rate cut does not materially alter the staff's assessment. The NBRNM accumulated more reserves than projected by staff in December 2019 (reserves stood at €3,263 million versus staff's projection of €3,123 million at end-December 2019) and is projected to continue accumulating reserves in 2020. Moreover, inflation, at 0.4 percent year-on-year in December 2019, has declined in past months, and is below euro area HICP inflation, estimated at 1.3 percent in the same period.