INTERNATIONAL MONETARY FUND

IMF Country Report No. 22/47

REPUBLIC OF NORTH MACEDONIA

February 2022

2021 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; STAFF STATEMENT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF 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 2021 Article IV consultation with the Republic of North Macedonia, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its February 14, 2022 consideration of the staff report that concluded the Article IV consultation with the Republic of North Macedonia.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 14, 2022, following discussions that ended on December 10, 2021, with the officials of the Republic of North Macedonia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 28, 2022.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for the Republic of North Macedonia.

The documents listed below will be separately released.

- Selected Issues

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
Washington, D.C.

PRESS RELEASE

PR22/41

IMF Executive Board Concludes 2021 Article IV Consultation with North Macedonia

Washington, DC – February 16, 2022: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with North Macedonia.

Forceful policy support has cushioned the economic impact of the pandemic. Fiscal lifelines helped prevent large job losses and protect the most vulnerable, while monetary and financial measures kept credit flowing to the economy.

After a 6 percent drop in real GDP in 2020, the economy recovered by an estimated 4 percent in 2021, driven by domestic consumption, reflecting improved mobility, a return of the diaspora, and continued policy support. Private investment continues to lag, and while external trade has recovered, certain export-oriented sectors remain negatively impacted by global supply disruptions, which, along with rising energy and food prices, weakened the external position and pushed up inflation to 3.2 percent in 2021.

The recovery is expected to continue in 2022, although the year starts out on a weaker footing than previously anticipated due to the global resurgence of the pandemic. Real GDP is expected to grow by 4 percent. The sharp rise in Covid-19 cases, combined with low vaccination rates, pose downside risks to the near-term outlook. Inflation is expected to rise to 4.3 percent in 2022, before stabilizing around 2 percent in 2023.

Fiscal policy remains supportive. As fiscal lifelines were gradually unwound and revenues performed strongly, the fiscal deficit was reduced from 8.2 percent of GDP in 2020 to 5.5 percent of GDP in 2021. Private sector credit growth is solid, helped by an accommodative monetary policy stance. The banking system remains well-capitalized, with a low rate of non-performing loans.

Executive Board Assessment[2]

Executive Directors welcomed the rebound in the economy reflecting improved mobility and continued policy support. Looking ahead, Directors stressed the importance of

[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] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

700 19th Street NW
Washington, DC 20431
USA

increasing vaccine coverage and limiting scarring from the pandemic while making progress on long-standing reform priorities.

Directors agreed that fiscal support should be targeted and gradually scaled down while maintaining its flexibility given still high pandemic-related uncertainty. They emphasized that a credible medium-term fiscal strategy will help anchor efforts to rebuild buffers and create room for more priority investment. In this context, they recommended focusing consolidation on tax policy and revenue administration. Further improvement in public financial management is also needed to support the authorities' investment plan and limit fiscal risks. Directors looked forward to the adoption of the Organic Budget Law and further progress in strengthening the transparency and accountability of public spending.

Directors noted that the de facto exchange rate peg has served the country well. They encouraged the central bank to stand ready to tighten monetary policy if inflation is expected to become persistently higher than in the euro area, or sustained pressures on foreign currency reserves materialize. Directors underscored the importance of preserving the operational autonomy of the central bank.

Directors noted that the banking system is well-capitalized but emphasized the need for continued vigilance. They welcomed the authorities' efforts to ensure that banks recognize problem assets in a timely manner. The growth in foreign currency lending should also be closely monitored. Directors highlighted the need to continue strengthening the macroprudential policy framework and the financial safety net, including the bank resolution framework and deposit insurance. Completing the legislative process is important in this regard.

Directors encouraged policies to facilitate resource reallocation, improve education outcomes, and strengthen the social safety net. Efforts to reduce informality and raise labor participation of women and youth are also important. To preserve employment and competitiveness, Directors considered that minimum wage increases should also be guided by productivity trends. They welcomed the Growth Acceleration Plan, noting that its implementation can boost growth and spur a green and digital transformation.

North Macedonia: Selected Economic Indicators 2019–2023

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

	2019	2020	2021	2022	2023
			Est.	*Projections*	
Output					
Real GDP growth	3.9	-6.1	4.0	4.0	3.8
Contributions to growth					
Domestic demand	6.9	-8.7	7.0	5.3	5.1
Net exports	-2.9	2.6	-3.0	-1.3	-1.3
Labor					
Unemployment rate (percent)	17.3	16.4	15.8	15.6	15.3
Prices					
Consumer prices (period average)	0.8	1.2	3.2	4.3	1.9
Core consumer prices (period average)	0.5	0.9	2.4	2.2	2.4
Public Finance (percent of GDP)					
Revenues	29.4	28.9	31.1	30.7	30.8
Expenditures	31.4	37.1	36.6	35.0	34.3
of which: capital	2.6	2.5	3.3	3.4	3.4
Overall balance	-2.0	-8.2	-5.5	-4.3	-3.5
Gross general government debt	40.4	51.9	54.8	54.1	54.3
Non-financial public and publicly guaranteed debt	48.4	59.6	62.2	62.2	62.7
Money and credit					
Non-performing loans (percent of total loans)	4.6	3.3	3.5[1]	N.A.	N.A.
Private sector credit growth	6.3	4.9	8.0	7.4	7.3
Balance of payments (percent of GDP)					
Current account balance	-3.3	-3.4	-3.5	-3.0	-2.8
Foreign direct investment	3.2	1.5	3.4	3.3	3.3
Gross reserves (percent of IMF ARA Metric[2])	115	108	109	106	106
Gross reserves (in months of prospective imports)	5.1	4.3	4.2	4.1	4.1
External debt	72.4	80.3	80.4	78.9	79.2

Sources: NBRNM; SSO; MOF; World Bank; and IMF staff estimates and projections.

1/ As of Q3–2021.

2/ The Assessment of Reserve Adequacy (ARA) metric is a measure of foreign reserves to risk-weighted short-term financial liabilities. An ARA measure of 100–150 percent is considered adequate.

INTERNATIONAL MONETARY FUND

REPUBLIC OF NORTH MACEDONIA

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

January 28, 2022

KEY ISSUES

The economy is rebounding. After a 6 percent drop in 2020, real GDP is projected to grow at 4 percent both in 2021 and 2022, reflecting improved mobility, a return of the diaspora, and continued policy support. With uncertainty remaining high, including about the course of the pandemic, policies need to be kept flexible. Emphasis should be on limiting the economic scars from the pandemic crisis while making progress on long-standing reform priorities such as further strengthening public financial management and revenue administration and buttressing the financial safety net.

Key Policy Recommendations

- Fiscal support for pandemic relief should become more targeted and, as the impact of the pandemic on the economy diminishes, gradually scaled down. Health spending needs to be maintained at a sufficiently high level. A credible medium-term fiscal plan is key to balancing the need to rebuild fiscal space with the necessity to scale up investment. This can be achieved through tax policy reform and spending rationalization, combined with efforts to improve revenue collection, combat tax evasion, and enhance public financial management.

- Monetary policy is appropriately accommodative, as higher inflation reflects mostly global factors. However, the National Bank of the Republic of North Macedonia (NBRNM) should stand ready to tighten policies if a large and persistent inflation differential with the euro area is expected, or there are sustained pressures on foreign exchange reserves.

- Financial sector policies have helped preserve financial stability. Continued efforts are needed to ensure that banks recognize any problem assets as support measures are phased out. Ongoing reforms of the macroprudential framework and financial safety net are essential. The operational autonomy of the NBRNM should be preserved.

- Structural reforms to support reallocation are important to limit the economic scars from the pandemic crisis. Policies to support job-to-job transitions and strengthen education outcomes would help reverse the decline in the labor force and reduce skill shortages. Efforts to combat informality should continue.

Approved By
Jörg Decressin (EUR) and Natalia Tamirisa (SPR)

Discussions were held by videoconference during November 23–December 10, 2021. The mission discussed with Finance Minister Besimi, Governor Angelovska Bezhoska, Labor and Social Policy Minister Shahpaska, and other senior officials from the Finance, Economy, and Health Ministries, the National Bank of the Republic of North Macedonia, the Public Revenue Office, the Parliamentary Finance and Budget Committee, the State Audit Office, the Development Bank of North Macedonia, the State Statistical Office, the Energy Regulatory Commission, the Deposit Insurance Fund, the Public Enterprise for State Roads, as well as representatives from the banking sector, industry, employers' associations, trade unions, the main opposition party, the European Union, and international financial institutions.

The staff team comprised Ms. Barkbu (head), Messrs. Gade, Mangov, and Roldan (all EUR), and Mses. Eble (Resident Representative) and Kovachevska Stefanova (IMF Local Economist). Messrs. Dresse and Tevdovski (OED) attended most of the meetings. Mses. Lee, Tenali (both EUR), and Davceva Mijoski (IMF Local Office) assisted the mission.

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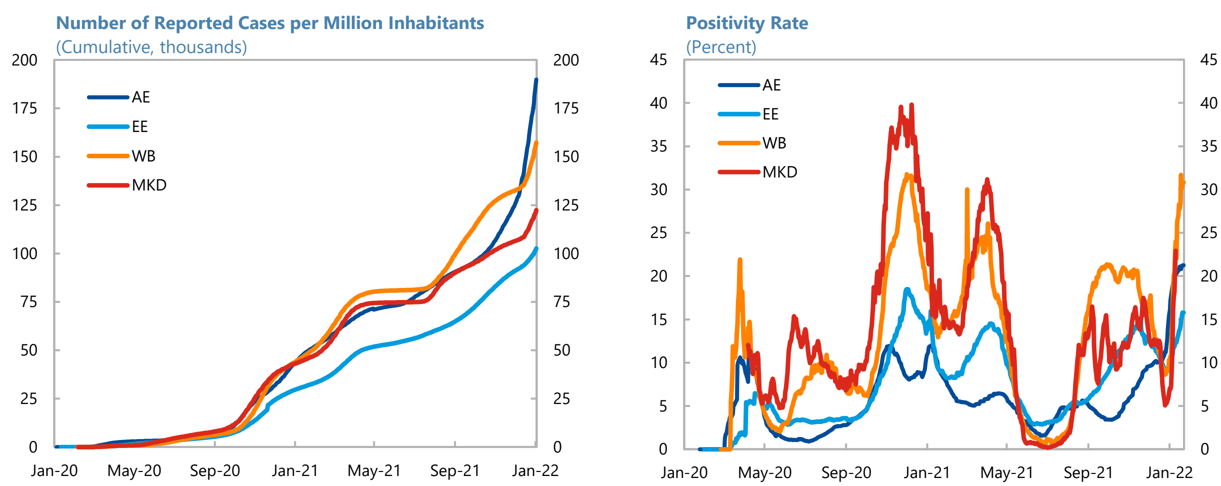
PANDEMIC CONTEXT

1. **The Covid-19 pandemic has taken a dramatic human toll.** Covid cases increased again in recent weeks in North Macedonia, in line with the global spread of the omicron variant. Some mobility restrictions remain in place, with catering facilities operating at a 50 percent capacity and access to such facilities and events as well as travel depending on proof of vaccination or recovery from the disease. Overall, more than 8,000 people have died to Covid-19 since the start of the pandemic, among the highest mortality rates in the world. Vaccine coverage remains low, with only 39 percent of the population fully vaccinated.[1]

2. **Forceful policy support has cushioned the blow to the economy.** The government and the National Bank of the Republic of North Macedonia (NBRNM) have staged a timely and strong economic policy response to the pandemic crisis, initially supported by a disbursement under the Rapid Financing Instrument in April 2020. While policy support has been scaled down and become more targeted over time, it remains accommodative, which coupled with continued social adaptation to the pandemic, has helped the economic rebound and prevented large job losses.

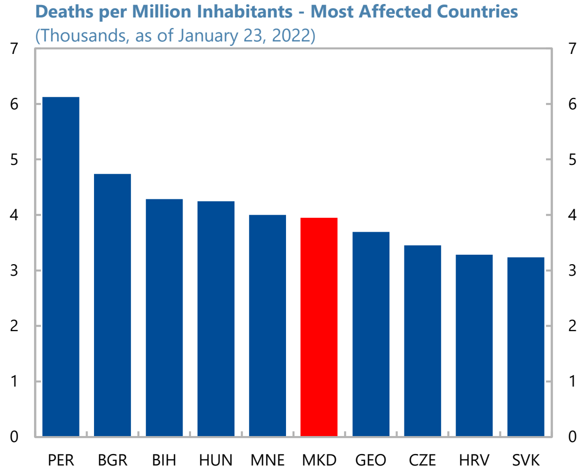
3. **Prospective EU accession continues to shape the political debate.** EU membership is strongly supported by the population and accession prospects have helped spur important reforms in past years, which led EU leaders to agree in March 2020 to start negotiations. However, no specific date has been set due to opposition by Bulgaria. This setback, together with political instability, has impeded progress on the government's legislative agenda. Following a weak result in the municipal elections in October 2021, a new Prime Minister and government were elected by Parliament on January 16. The new government builds largely on the previous government coalition, with support from one new political party. A continuation of economic policies is expected.

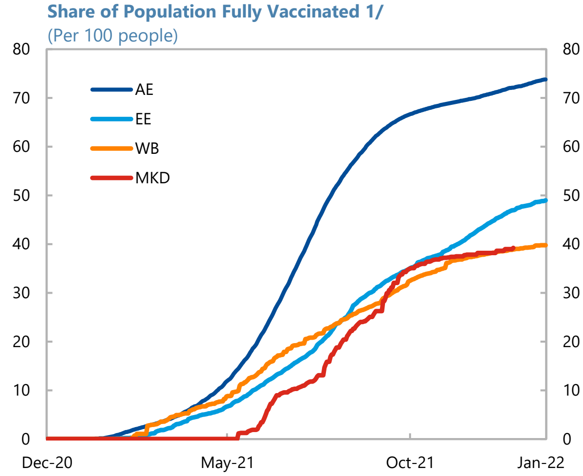
Figure 1. North Macedonia: Covid-19 Pandemic



[1] Vaccination data as of December 26, 2021 (latest available).

Figure 1. North Macedonia: Covid-19 Pandemic (concluded)





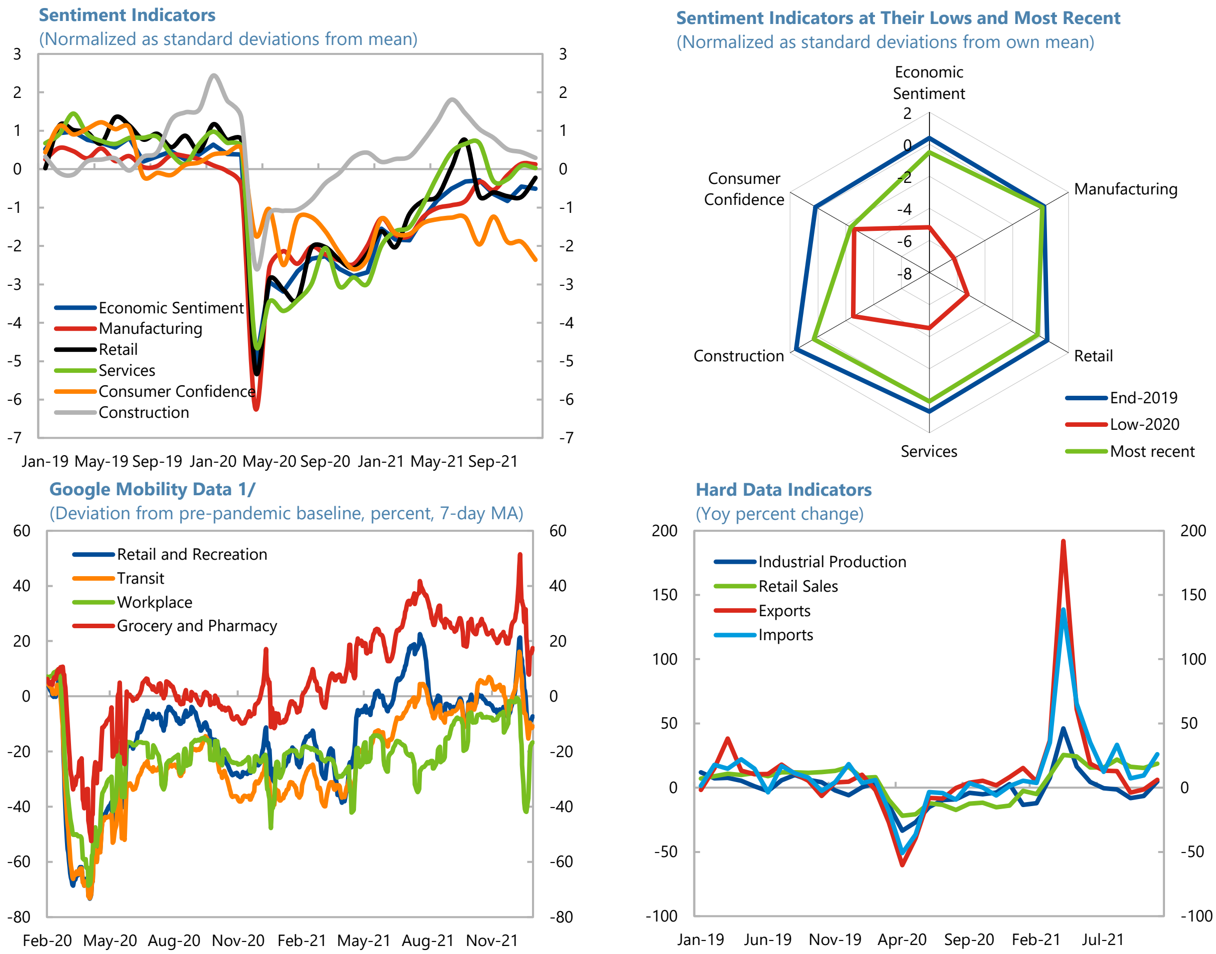
Sources: National Statistics Offices; Our World in Data; and IMF staff calculations.
Note: AE = Advanced Europe; EE = Emerging Europe; WB = Western Balkans.
1/ Data for North Macedonia available until December 26, 2021.

RECENT DEVELOPMENTS

4. The recovery continues, despite the pandemic-induced disruptions. Real GDP grew by about 3 percent (y/y) in the third quarter of 2021. After a large drop in 2020, diaspora travel boosted remittances, contributing to higher demand. Confidence indicators improved from their lows but have softened in recent months. While it may be too early to see the impact of the omicron wave in high-frequency data, mobility overall remains solid. Supply-chain disruptions continued to negatively impact suppliers to the European automotive industry, denting industrial production and exports in late 2021. The unemployment rate was 15.7 percent at end-September, below pre-crisis levels, though the improvement partly reflects a drop in the labor force.

5. As in many other countries, rising energy and food prices have driven up inflation. After remaining at a modest level over the past years, inflation increased to 4.9 percent (y/y) in December. The rise was primarily due to higher global energy and food prices, while higher administered electricity prices were counteracted by a temporary cut in VAT on electricity. Core inflation also rose during 2021, including due to direct effects of higher energy and food prices on core components, and inflation expectations shifted upward. Wage growth was 5.8 percent (y/y) in November, with trend real wages continuing to outpace trend productivity.

Figure 2. North Macedonia: High-Frequency Indicators



Sources: Haver Analytics; Google Mobility Data; and IMF staff calculations.
1/ Mobility trends compared to a baseline defined as the median value, for the corresponding day of the week, during the 5-week period January 3-February 6, 2020. The "Retail and Recreation" category includes places like restaurants, cafes, shopping centers, theme parks, museums, libraries, and movie theaters.

Figure 3. North Macedonia: Inflation and Labor Market Developments

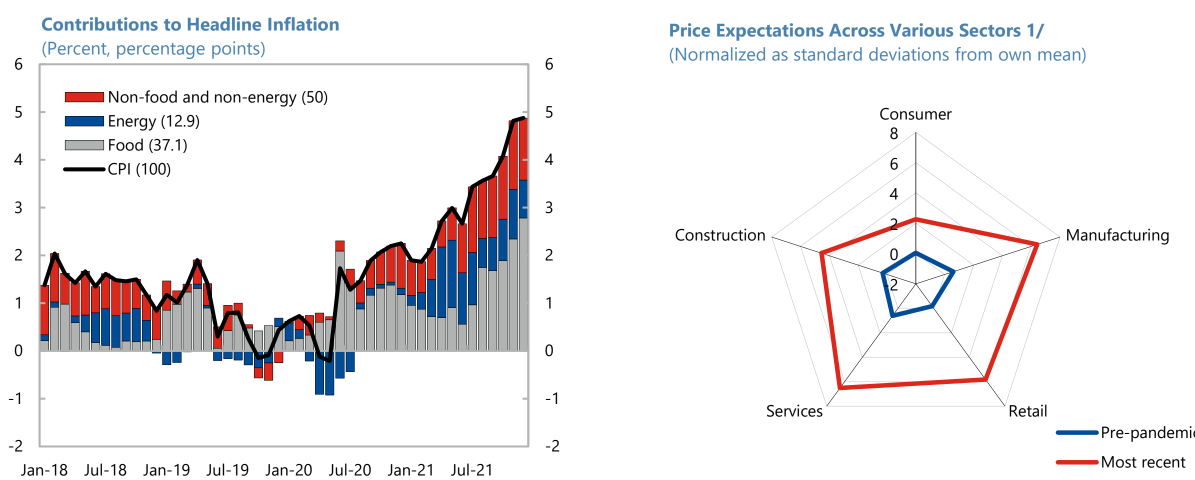
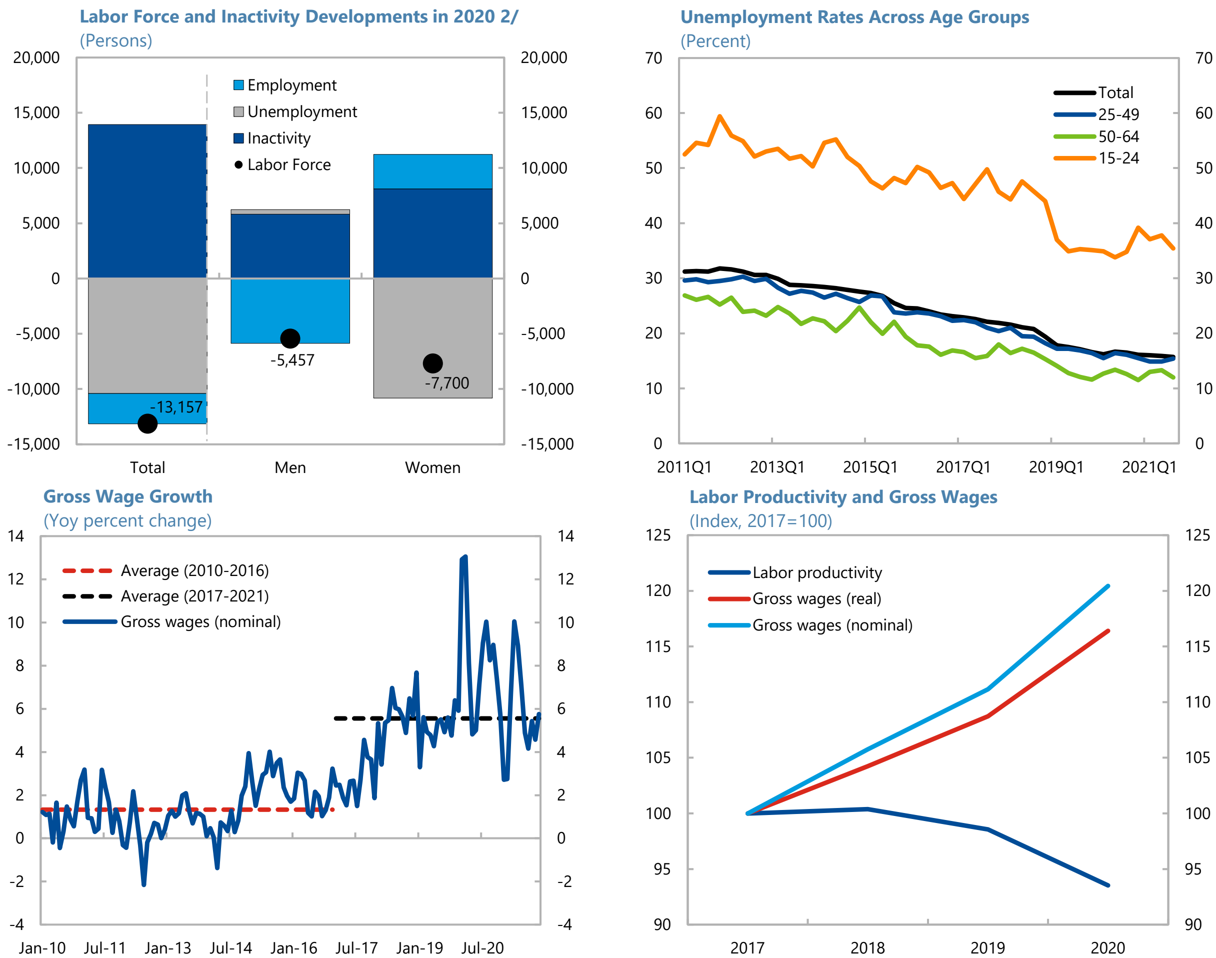


Figure 3. North Macedonia: Inflation and Labor Market Developments (concluded)

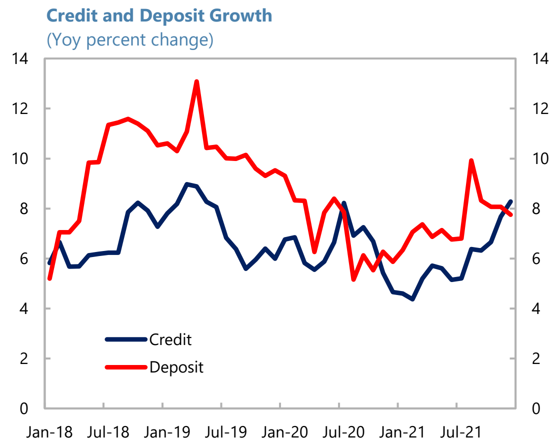


Sources: Haver Analytics; SSO; and IMF staff calculations.
1/ Horizon for price expectations: 12 months ahead for consumers, 1 month ahead for the industry, and 3 months ahead for the remaining categories.
2/ The labor force is also influenced modestly by population dynamics in 2020.

6. Rising import prices combined with supply-chain disruptions have weakened the external position in recent months. In the first half of 2021, the current account deficit shrunk, driven by higher remittances and services trade. In the third quarter, remittances kept a steady pace, but higher prices on imported goods, notably energy, drove up imports. The trade deficit was further widened by supply-chain disruptions, particularly in the automotive sector, which held back exports. The REER depreciated by 2.2 percent in the eleven months through November 2021, after having appreciated by 1.5 percent in 2020. Furthermore, after a period of pressure on the exchange rate in the fall, partly reflecting higher energy imports, FX market conditions normalized. While highly uncertain given the lack of full-year data for 2021, as well as the difficulty in disentangling the impact of the pandemic, these developments suggest that the external position was broadly in line with fundamentals and desirable policies in 2021 (Annex VI).[2]

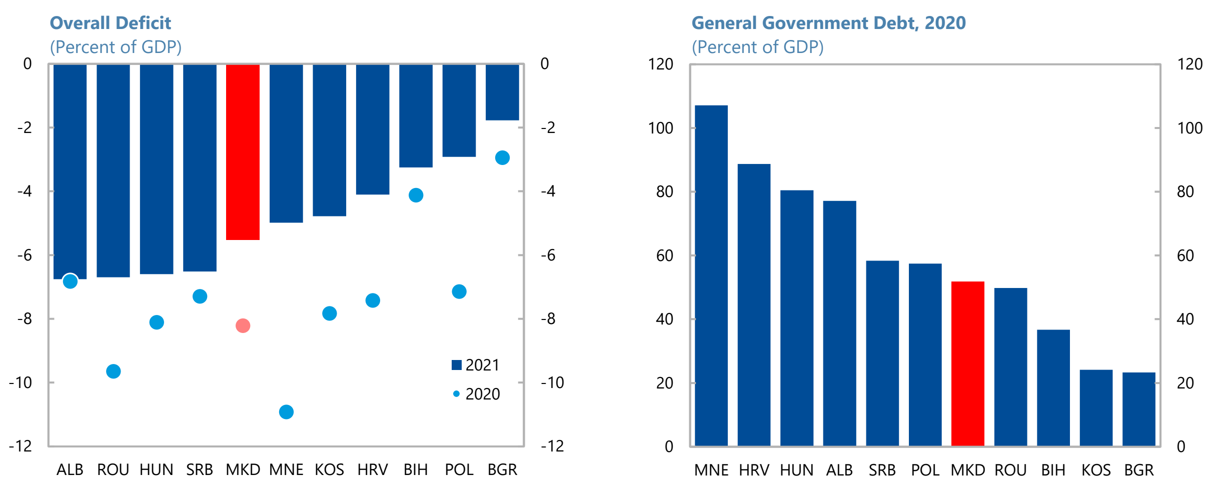
7. The fiscal balance improved in 2021 thanks to a rebound in revenues. The sizeable support provided in the wake of the pandemic, coupled with automatic stabilizers, brought the fiscal deficit above 8 percent of GDP in 2020. Based on preliminary estimates, the deficit improved to 5.5 percent of GDP in 2021, driven by strong revenue performance. While capital spending remained below budgeted levels, it increased noticeably from 2020, reflecting crisis-related measures, a normalization of investment activity, and possibly a new, incentive-based mechanism whereby capital spending appropriations can be reallocated across budget users based on in-year execution. The entire amount of the recent SDR allocation was transferred to the Ministry of Finance in December and covered spending on pandemic-related subsidies, vulnerable households, health and vaccines, and capital projects, in line with IMF advice.

8. Financial conditions remain supportive. Growth in credit to households remains solid and credit to nonfinancial corporations is recovering, supported by strong deposit growth. Lending rates on new loans have remained broadly unchanged during the pandemic. The downward trend in deposit euroization pre-pandemic has been reversed, with the move accelerating in recent months.



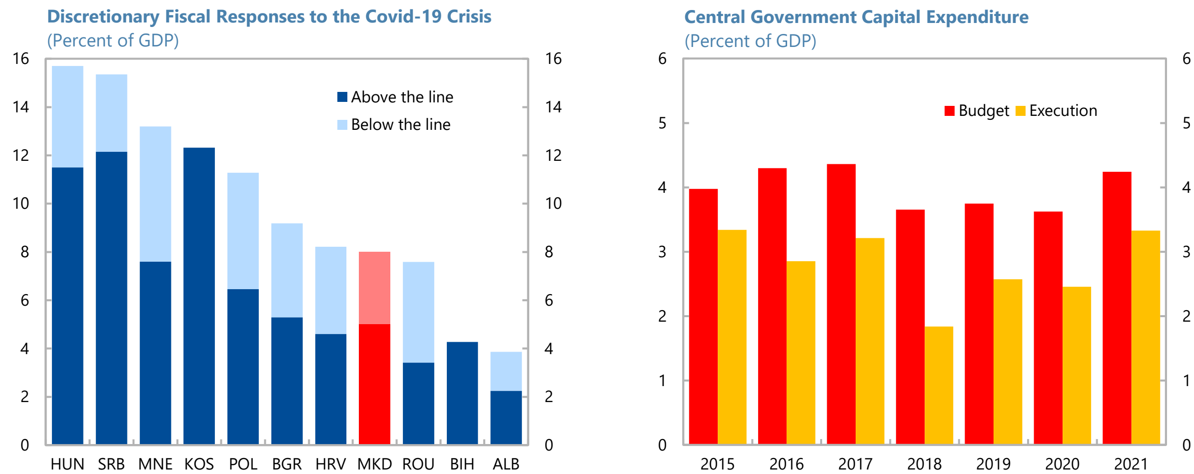
Sources: NBRNM; and IMF staff calculations.

Figure 4. North Macedonia: Fiscal Developments



[2] The EBA-lite norm has changed from a deficit of 1.9 percent of GDP estimated for 2018 to 4.2 percent in 2021. The change is mostly explained by revisions to underlying data, notably the migrant share. Staff note that such a norm is weaker than observed values for the current account balance in North Macedonia in recent years and over the past decades. As upward pressures on the exchange rate have not materialized over that period, staff assess the current account position to be in equilibrium.

Figure 4. North Macedonia: Fiscal Developments (concluded)



Sources: IMF WEO; IMF Fiscal Monitor Database; MoF; and IMF staff calculations.

OUTLOOK AND RISKS

9. The economic recovery is expected to continue in 2022, although it starts the year on a weaker footing than expected due to the global resurgence of the pandemic. The recent rise in omicron cases is assumed to dampen near-term prospects. Growth overall is forecast at 4 percent in 2022, as in 2021, driven mainly by household consumption and investment. While the employment recovery is expected to be more gradual, household consumption would be driven by higher disposable income (reflecting the recovery in remittances and high wage growth) and the release of some pent-up savings. Investment is expected to pick up significantly, driven by both public and private investment. The gradual unwinding of fiscal support comes in response to improving economic prospects, which should dampen the effect on growth.[3] Net exports are expected to contribute negatively to growth, as strong domestic demand leads to high growth in imports. Over the medium term, the growth is forecast to converge to 3½ percent.[4] The cumulative output loss from the pandemic—a measure of scarring—would likely be sizeable, reflecting a persistent effect on capital accumulation and a slow recovery in some high-contact sectors. The current account deficit is projected to reach 2½ percent of GDP by 2026, as improvements in the trade balance are counteracted by slow growth in remittances.

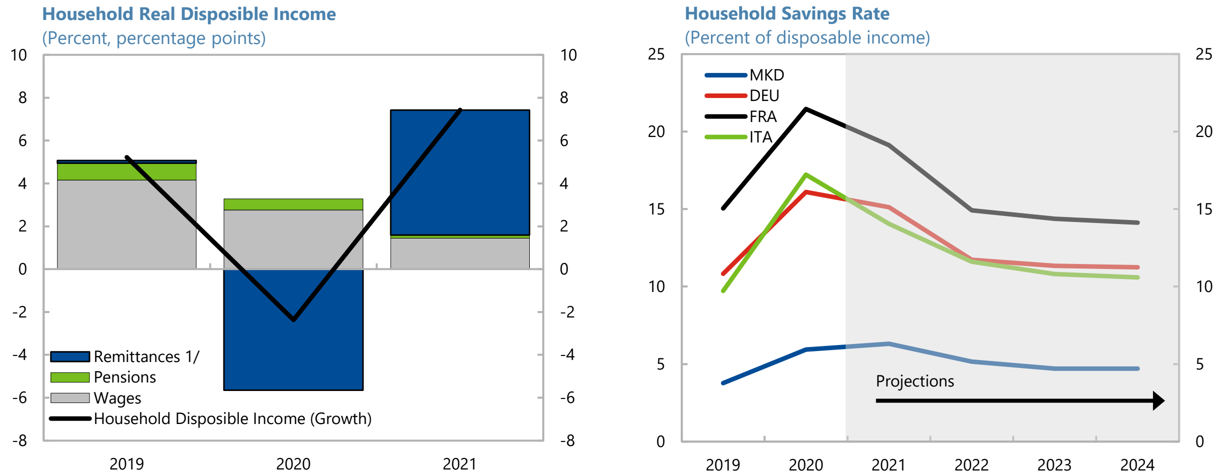
10. In line with global trends, inflation is likely to remain higher for longer than previously thought, coming down in the second half of 2022. Overall, headline inflation is expected to rise

[3] Staff's baseline assumes a contractionary fiscal stance of about ¾ percent of GDP in 2022 and ½ percent of GDP in 2023.

[4] Staff's medium-term projections assume a rebound in investment and employment after the pandemic crisis, as well as a pick-up in total factor productivity growth from pre-crisis years.

to 4.3 percent on average in 2022, from 3.2 percent in 2021. This is based on the projected path of global food and energy prices and the 9.5 percent hike in regulated electricity prices which took effect in January. It also incorporates the temporary price freeze on basic food products decided by the government. Core inflation is expected to ease slightly in 2022, mainly due to base effects, but to remain at about 2½ percent over the forecast horizon. High wage growth, including from ad hoc hikes in the statutory minimum wage, could lead to higher inflation for longer (Annexes I and III).

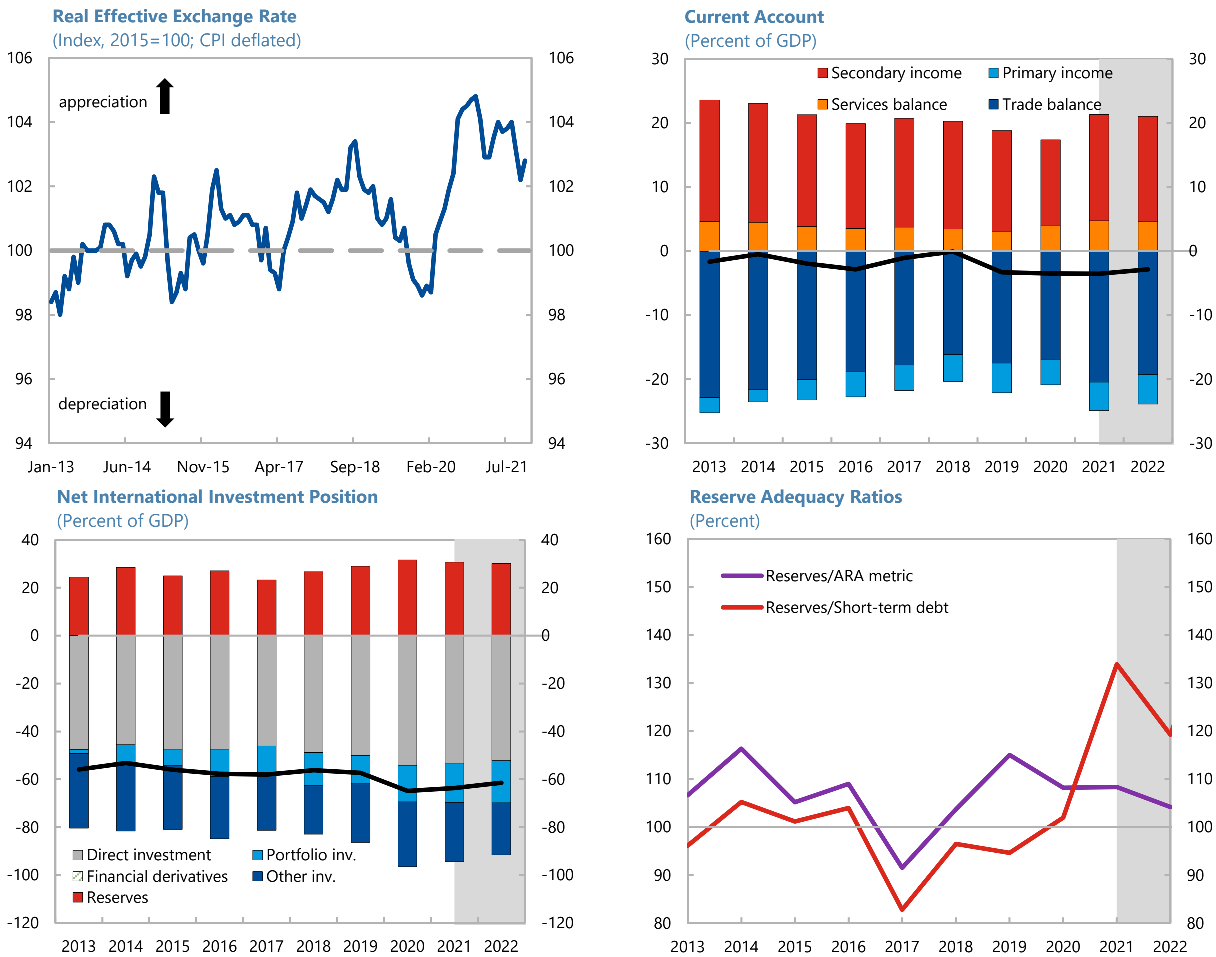
Figure 5. Household Disposable Income and Savings Rate



Sources: IMF WEO; and IMF staff calculations.
1/ Remittances include formal remittances, cash transfers, and other current income.

11. Risks to the outlook are tilted to the downside. In the near term, the omicron wave or new variants that prolong the global pandemic, combined with low vaccination coverage domestically, could deepen economic disruptions, including through supply bottlenecks, and result in lower growth and higher inflation. Rising geopolitical tensions, increased commodity price volatility, and a shift in global financial risk sentiment also represent growing downside risks. Domestically, persistent second-round effects from the higher inflation could dampen demand and hurt competitiveness. A reemergence of political instability could further delay the legislative agenda and delay fiscal consolidation. A slower-than-anticipated recovery in employment, continued emigration, and stagnant productivity also pose downside risks to the medium-term growth outlook. Finally, lack of progress with EU accession may weaken the prospects for economic convergence. On the positive side, a renewed push for reforms, possibly coupled with improved EU accession prospects, could boost capital inflows and confidence. If well implemented, the government's investment plan ("Growth Acceleration Plan") could spur demand and boost growth rates (Box 1).

Figure 6. North Macedonia: External Sector Developments



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

Authorities' Views

12. The authorities project higher growth, especially as public investment is scaled up over the medium term. The government expects the Growth Acceleration Plan to play a significant role in the recovery through higher public infrastructure investment, accompanied by accelerated private capital formation through an improved business environment, higher confidence, and more foreign investment. This would generate positive spillovers on employment and productivity, bringing annual average GDP growth to 5.4 percent over 2022–26. The NBRNM expects annual GDP growth of 4 percent in the medium term.

13. The NBRNM concurred that higher inflation is driven by global factors, pointing to the lack of domestic demand pressure. Headline inflation has surprised on the upside in the past months, as a result of higher-than-anticipated global commodity prices, whereas core inflation has evolved broadly as expected. High wage growth is currently not seen to drive price setting. Uncertainty about the evolution of global commodity prices presents risks to near-term inflation forecasts. Over the medium term, inflation is expected to converge to 2 percent.

14. The NBRNM considers the external position to be in equilibrium, in line with staff's assessment. After the temporary increase in 2021, mainly on the backdrop of higher import prices, the NBRNM expects the deficit to narrow more than assumed in staff's baseline on the back of faster export growth toward the end of the forecast horizon.

POLICY DISCUSSIONS: SUPPORTING THE RECOVERY AND BUILDING FORWARD BETTER

The immediate policy challenge is to sustain the recovery given the still elevated level of uncertainty about the pandemic. Policies need to be flexible, to adjust to the stages of the economic recovery and the strength of domestic demand, while being appropriately calibrated and targeted to foster resource reallocation and contain economic scarring. Efforts to strengthen economic governance are key to lifting the economy's growth potential, including through improvements in revenue administration and public financial management, steps to preserve central bank operational independence, and measures to curb informality.

A. Fiscal Policy: Enabling Higher, More Inclusive, and Greener Growth and Limiting Fiscal Risks

15. The 2022 budget appropriately scales back pandemic-related spending, while allowing some flexibility to address contingencies. The budget targets a headline deficit of 4.3 percent of GDP, in line with staff's baseline. It provides for higher health spending, including for vaccines. It also includes an envelope of 0.6 percent of GDP of non-earmarked funds to allow a flexible response to pandemic-related spending needs. An allocation for targeted assistance to mitigate the impact of higher energy prices on vulnerable groups exists in the budget, but additional funds may be needed, especially when the VAT rate on electricity is normalized starting in July. Continuing to provide subsidies to energy companies or maintaining the reduced VAT rate would be more costly to taxpayers. Overall, fiscal policy should be implemented flexibly as the pandemic evolves, which could require budget reallocations. With the demand for emergency lifelines waning, as expected in the baseline, focus should shift to aiding resource reallocation across sectors including by training and reskilling workers, improving the social safety net, incentivizing hiring, and supporting investment.

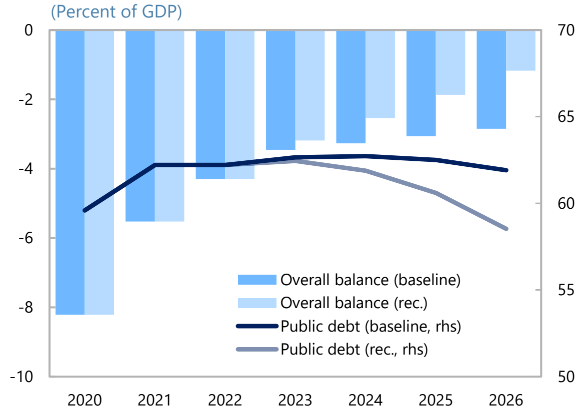
Text Table: Overall Fiscal Balance, 2022, Decomposition
(Percent of GDP)

Overall fiscal balance in 2021	**-5.5**
Cyclical improvement	+0.5
Withdrawal of stimulus measures	+1.2
Other policy measures	-0.5
Interest	+0.1
Overall fiscal balance in 2022	**-4.3**

Source: IMF staff estimates.

16. A gradual fiscal consolidation would help rebuild fiscal buffers and create space for investment. Public sector debt is projected to peak at 63 percent of GDP in 2023. Reducing the deficit to 1 percent of GDP by 2026, from just below 3 percent in the baseline, would increase the space available to counter future shocks and limit risks from high rollover needs (Annex VI). This would imply additional tightening of about 1¾ percent of GDP with respect to the baseline, assumed to be spread over 2023–26, and help ensure that fiscal policy is appropriately counter-cyclical.[5] The proposed path is more ambitious than the government's fiscal strategy, which targets a deficit of about 2 percent of GDP by 2026, and relies on more optimistic revenue and growth assumptions. If domestic demand surprises on the upside, the consolidation should be faster; this would also help dampen potential inflationary pressures.

Fiscal Metrics: Baseline and Recommended
(Percent of GDP)



Sources: MoF; and IMF staff calculations.

17. A credible and comprehensive medium-term fiscal strategy, focused on revenue mobilization, can help anchor the consolidation.[6] Tax policy measures could focus on increasing progressivity, reducing preferential treatments as appropriate, and making more and better use of property and environmental taxes. This should go hand in hand with improved revenue collection, a critical success factor for an overhaul of the tax system. Expenditure measures could include rationalization of agricultural subsidies and re-organization of public administration.

18. Steps have been taken to ensure transparency and accountability of the pandemic-related spending, but some shortcomings should be addressed. Measures taken include creating a web-based portal to track payments and their recipients and enforcing conditions for state assistance such as wage subsidies. Information on crisis-related procurements is also publicly available. All procurements conducted through the dedicated electronic portal include the contract as a part of the award notification. These measures are in line with IMF advice. However, the state audit office found that most of the audited pandemic-related contracts had been awarded without public calls, with some cases of significant price differences for similar goods across contracts. To further enhance transparency in public procurement, the disclosure of the beneficial ownership of entities contracting with the government should be required.

[5] The proposed adjustment trajectory (¼ percent of GDP in 2023, ½ percent per year in 2024–26) is assessed to result in a fiscal contraction of about ¾ percent of GDP in 2023 (when also considering the phasing out of remaining crisis-related stimulus) and ½ percent of GDP in the outer years.

[6] See Selected Issues Paper on boosting revenue collections.

Text Table: North Macedonia: Menu of Possible Fiscal Policy Measures
(Percent of GDP)

Reinstate progressive personal income tax	0.2
Streamline VAT preferential treatments, increase and unify reduced rates	0.5–1
Raise property taxes	0.3–0.5
Introduce carbon pricing	0.2–0.75
Strengthen revenue administration 1/	0–1
Rationalize agricultural subsidies	0.5
Total	**1.7–3.9**

Sources: IMF; WB.
1/ While estimating the impact of administration reforms is intrinsically challenging, staff analysis suggests sizeable scope for potential revenue gains (see Selected Issues Paper on boosting revenue collections).

19. **Further improvements in public financial management would support the government's investment plan and limit fiscal risks.** In particular, it is essential to fully implement the action plan formulated in response to the Public Investment Management (PIM) Assessment and operationalize the PIM unit in the Ministry of Finance. Relatedly, public-private partnerships (PPPs) should be fully integrated into the PIM framework, with the Ministry of Finance retaining control over decisions regarding the fiscal impact of PPPs, as currently planned in the new PPP law under preparation. Safeguards are needed to manage fiscal risks related to state-owned enterprises and local government finances.

20. **A new Organic Budget Law (OBL) is expected to be adopted during 2022.** The new law brings significant changes to fiscal policymaking, budget preparation and execution, and fiscal reporting. In line with the EU framework, it introduces numerical rules for the overall fiscal deficit and public debt, capped at respectively 3 and 60 percent of GDP, and an independent fiscal council tasked with assessing the government's macroeconomic and budgetary projections and monitoring fulfillment of the rules. To bolster the credibility of fiscal policy, the scope for temporary deviations from the rules should be limited and well specified, and the government should stay clear of the deficit ceiling in normal times (targeting, for example, a 1 percent of GDP deficit at full employment, as recommended by staff in paragraph 16). It will also be important to ensure operational independence of the fiscal council.

Authorities' Views

21. **The 2022 budget aims to address the health crisis and accelerate growth while ensuring fiscal sustainability.** The authorities emphasized the additional funds for health and vaccine-related spending foreseen in the budget, including for higher wages of medical staff. Their focus is on cutting nonessential costs, better supporting the private sector, innovation, and competitiveness, and ensuring sufficient funds for social transfers. No general increases in public sector wages are included in the budget. The authorities expect additional revenues from measures to reduce informality, prevent and fight corruption, and strengthen inspections. To increase local

governments' fiscal capacity and incentivize revenue collections, a greater share of personal income and value added tax receipts will be allocated to municipalities, including through two newly created funds ("Performance Fund" and "Equalization Fund"). The authorities intend to introduce new sources of financing, including development, "green", and project bonds, and agreed with staff's recommendation to hold sizeable deposits as a buffer.

22. The authorities target a gradual improvement in the overall fiscal balance in their medium-term fiscal strategy. This is planned to be achieved through public sector reorganization, reduced operating costs, and better targeted subsidies and transfers, including for social assistance and local governments. They agreed with staff that tax policy reform and enhanced revenue administration is key to strengthening public finances and achieving higher, more inclusive, and sustainable growth. However, given a more favorable growth outlook than projected by staff, the underlying consolidation need is smaller. As recommended by staff, the draft OBL now provides for a cap on temporary deviations from the fiscal rules for investment. The authorities emphasized recent improvements in public financial management such as steps to improve the consistency between policy priorities and budget planning, the introduction of performance indicators, and the pledge to undertake regular public finance reviews. They are also undertaking efforts to increase fiscal discipline and enhance transparency and accountability at the municipal level.

23. The authorities highlighted their commitment to accountability and transparency in public spending. A comprehensive report on the fiscal impact of the economic measures implemented in 2020 was made public in the first half of 2021. A package of transparency measures, including the disclosure of information on crisis-related funds and their recipients, has also been implemented. 1,181 Covid-19 contract awards (including the contracts) have been published to date, of which 615 contracts were awarded through competitive procedures. There are discussions to connect the public procurement system with the newly created register of ultimate beneficial owners, as recommended by staff.

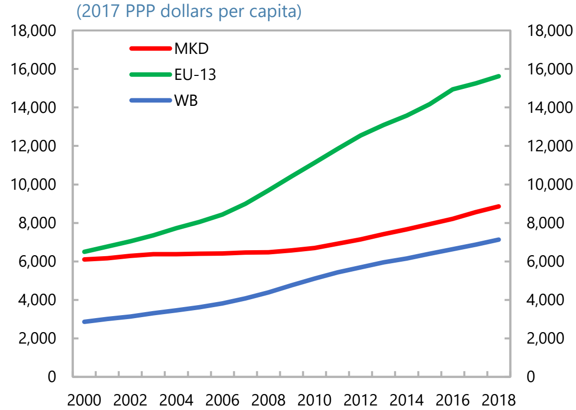
24. Scaling up investment and improving public investment management remain key priorities, in line with staff advice. The authorities highlighted the recent increase in central government capital spending and introduction of a new, incentive-based mechanism ("CAPEF"). Under the Growth Acceleration Plan, the authorities intend to move forward with important infrastructure projects, such as road and railway, as well as several "green" projects. They agreed with staff on the need to improve the PIM framework, emphasizing recent progress through the adoption of a PIM action plan, the setup of working groups including on the establishment of a PIM unit in the Ministry of Finance, and the planned adoption of the new OBL and PPP laws.

Box 1. Scaling Up Public Investment[1]

The government has announced a large-scale investment plan. The plan will combine public and private funds for projects in sectors such as energy, roads and railways, health, municipal infrastructure, and environment. Several of these projects could contribute to the green and digital transformation of the economy.

North Macedonia lags EU countries in the quantity and quality of capital. The country's per capita stock of public capital has a nearly 50 percent gap with new EU member countries. Physical measures of infrastructure—such as kilometers of roads and railways, kilowatts of power generation capacity, and digital economy indicators—reveal similar deficiencies. North Macedonia also lags the EU in terms of the quality of infrastructure.

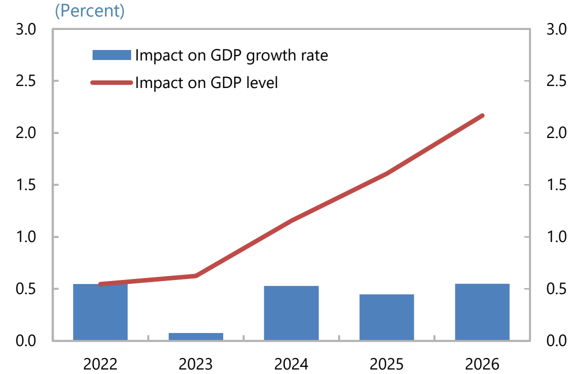
Publick Capital Stock
(2017 PPP dollars per capita)



Sources: IMF Investment and Capital Stock Dataset; and IMF staff calculations.

An appropriately designed investment plan could lift output and speed up income convergence. Empirical estimates indicate a significant and long-lasting effect of higher public investment, especially in the context of strong governance frameworks. Using estimates from Ari et al. (2020)[2] and the projections for capital spending in the government's most recent medium-term fiscal strategy, which includes a 0.8 percent of GDP increase in public investment in 2022, and a further scaling-up from 2024, we find a positive impact on GDP growth of 0.5 percentage points in 2022 and 0.4 percentage points on average through 2026.[3]

Impact of Rise in Investment on Real GDP
(Percent)



Sources: MoF; and IMF staff calculations.
Note: Potential effects of scaling up public investment as foreseen in the Dec. 2021 MTFS, relative to keeping investment constant as a share of GDP.

Improvements to the PIM framework could maximize the benefits of higher investment while limiting fiscal risks. Currently, governance weaknesses hamper the efficiency of public investment. The IMF's 2020 Public Investment Management Assessment found that, despite some pockets of strong performance, many of the country's policies and procedures governing public investment are either not aligned or only partially aligned with good practices. Public investment and risk management need to be strengthened significantly, including monitoring of PPPs. This, coupled with initiatives to mobilize private capital, an expressed goal of the government, could lead to substantial efficiency gains.

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[1] See Selected Issues Paper on scaling up investment.

[2] Ari, Bartolini, Boranova, Di Bella, Dybczak, Honjo, Huidrom, Jobst, Jovanovic, Ozturk, Papi, Sola, Stone, and Topalova (2020) "Infrastructure in Central, Eastern, and Southeastern Europe: benchmarking, macroeconomic impact, and policy issues," Departmental Paper No. 20/11, International Monetary Fund.

[3] Staff's baseline assumes some continued under-execution, with central government capital spending projected to increase from 3.3 percent of GDP in 2021 to 3.6 percent in 2026, and thus a lower impact on growth.

B. Monetary Policy: Supporting the Economy While Keeping Inflation in Check

25. Monetary policy remains accommodative, with international reserves in the comfort zone. The spread with the policy rate for the euro, the reference currency for the de facto exchange rate peg, has narrowed substantially. However, the rate cuts undertaken during the pandemic have not passed through to market and lending rates. Following pressures on the exchange rate in 2020, reserves were replenished thanks to a normalization of foreign inflows, a large Eurobond placement, and the SDR allocation. A higher trade deficit from elevated energy prices contributed to renewed pressures in the fall.

26. The de facto peg has served as an anchor of stability over the past decades, and the level of international reserves remains appropriate to support the peg. None of the global factors driving inflation would respond to changes in domestic monetary policy. However, clear communication about the persistence of inflation drivers and any changes in views about inflation will be critical to shaping expectations, thereby preventing second-round effects through wages. The NBRNM should stand ready to tighten policies if inflation in North Macedonia is expected to become persistently higher than inflation in the euro area, which is currently not the case, or significant and sustained pressures materialize on foreign currency reserves.

Authorities' Views

27. The NBRNM considered that the current monetary policy stance is appropriate, as it supports solid credit growth and inflation is in line with the euro area. International reserves are at a comfortable level, and foreign currency liquidity in the banking system remains appropriate. Given the uncertainty regarding the future path of inflation, the NBRNM concurred with staff's recommendation to continue closely monitoring developments and potential risks, emphasizing its preparedness to act as needed to support the peg.

Figure 7. North Macedonia: Monetary Policy Stance

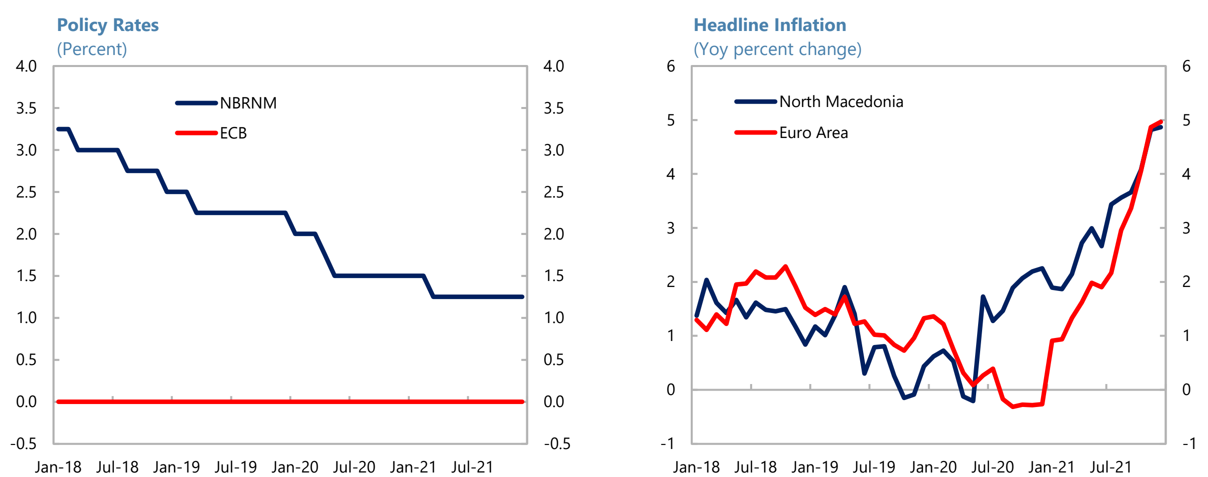
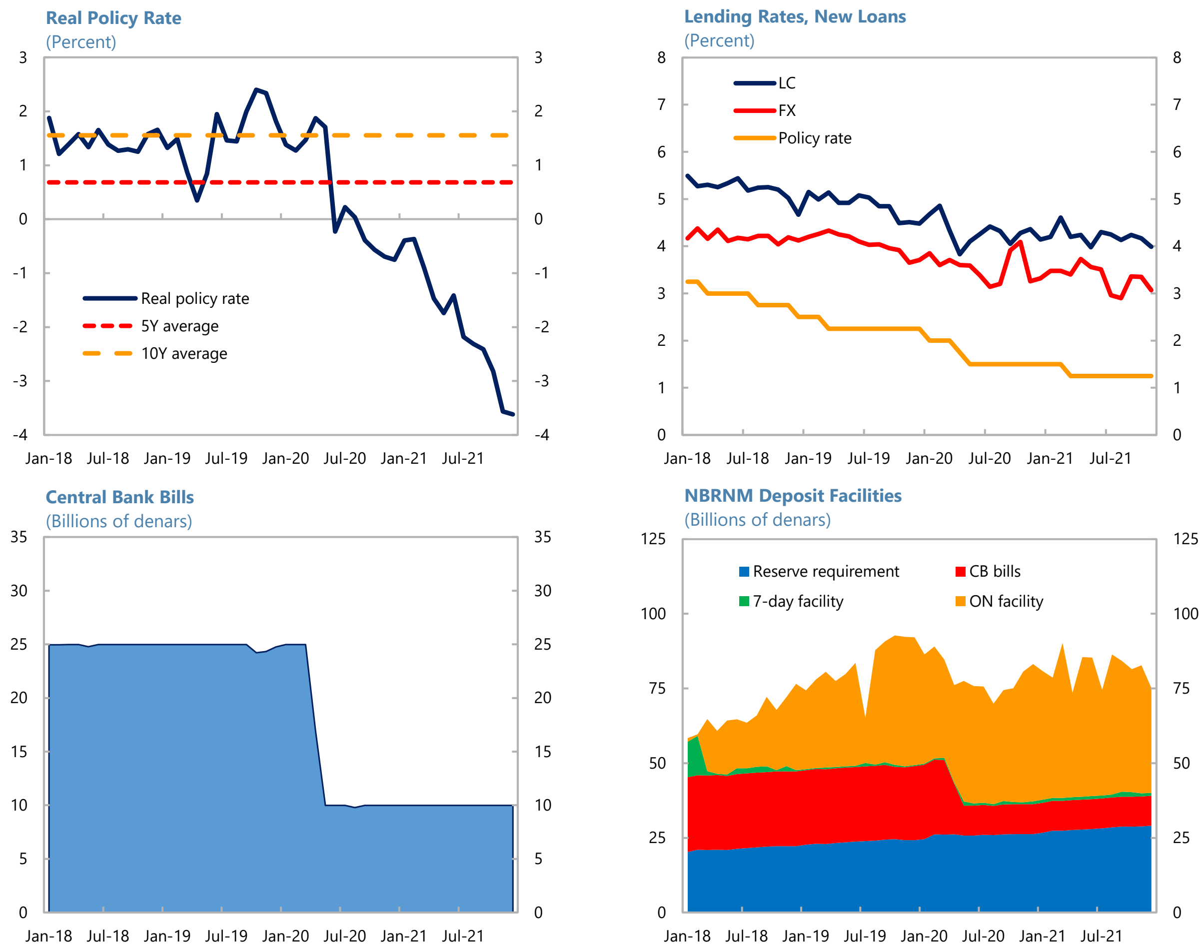


Figure 7. North Macedonia: Monetary Policy Stance (concluded)



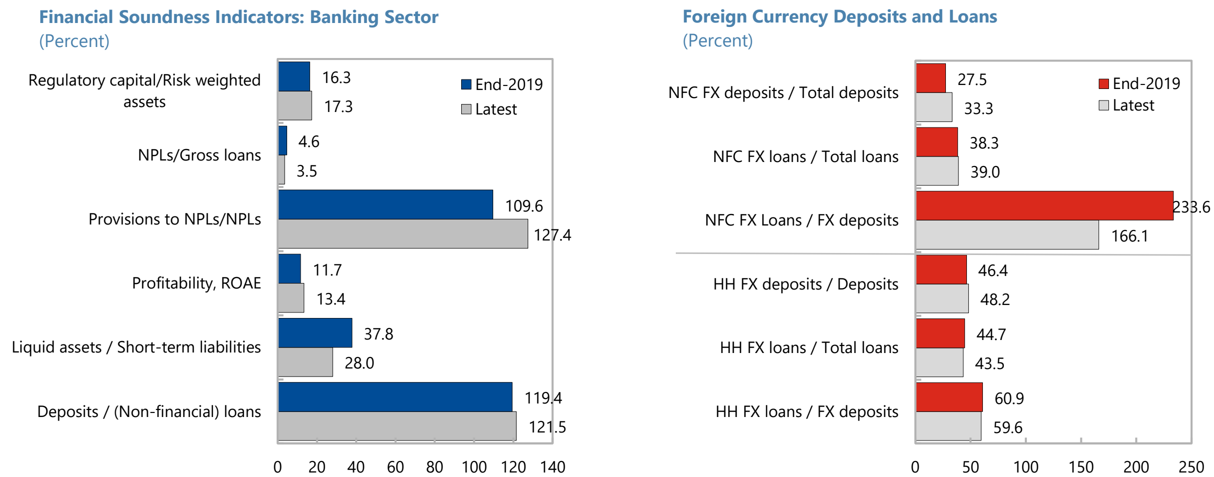
Sources: NBRNM; SSO; Eurostat; and IMF staff calculations.

C. Financial Sector Policies: Bolstering Confidence and Strengthening the Financial Safety Net

28. The banking system remains well capitalized and profitable. Helped by prudent capital levels pre-pandemic and temporary restrictions on dividend payments, capital adequacy ratios exceeded 17 percent at end-September. NPLs reached historically low levels in 2020 but have since edged slightly higher to 3.5 percent. The banking sector appears overall well positioned to meet a potential rise in NPLs as policy support is phased out. NBRNM stress tests released in August found that the banking system's capital levels would remain above the minimum requirements through 2022 in a stressed scenario, reflecting prudent provisioning and sound profitability.

29. Continued efforts to ensure that banks recognize any problem assets will help bolster confidence. The regulatory flexibility provided during the pandemic had a large uptake and helped borrowers and banks. It is important now that banks fully recognize any problem assets and, if needed, ensure a timely clean-up of their balance sheets. The NBRNM is benefitting from IMF technical assistance to strengthen its stress-testing capacity. This, together with increased supervisory dialogue, as part of an improved Supervisory Review and Evaluation Process, and full IFRS9 implementation, should strengthen the assessment of individual banks' capital needs. The NBRNM should also consider publishing its guidance to banks.

Figure 8. North Macedonia: Financial Sector Developments



Sources: Haver Analytics; and IMF staff calculations.
Note: FX loans include loans in denars with an FX clause.

30. The NBRNM should take the lead on macroprudential issues. The forthcoming amendments to the National Bank Law are expected to grant the NBRNM a more formal macroprudential mandate. A large share of possibly unhedged FX or FX-linked loans to households remains a key risk, and the NBRNM should maintain measures to limit FX lending and implement its 2018 denarization strategy. Rising debt, albeit from low levels, and the debt structure among households and corporates needs close monitoring. Mortgage lending and real estate prices picked up significantly in 2021, requiring further scrutiny to assess lending practices.

31. Upgrading the financial safety net remains a priority. The Eurostandard bank failure in 2020 underscored the need to modernize the bank resolution framework and strengthen deposit insurance. Moreover, in June 2021, the Constitutional Court revoked Article 163(3) of the Banking Law granting priority to the claims of the deposit insurance fund on a failed bank. While there are no immediate financial stability concerns from this decision, introducing depositor preference in line with EU law should be considered to the extent it is consistent with the Constitution (Annex II), and as part of the large package of financial legislation to be adopted in 2022 (Annex VIII).

32. Maintaining central bank operational independence, along with transparency and accountability, is critical to supervisory decision-making. A pilot review of the NBRNM under the IMF's Central Bank Transparency code found that the NBRNM is transparent and accountable. To ensure timely decisions and preserve the operational autonomy of the NBRNM as a supervisor, operational supervisory decisions should be taken by the executive part of the NBRNM Council, rather than the full Council. Also, in line with the 2018 FSAP recommendations, the NBRNM staff should be excluded from the law on administrative staff.

33. Efforts to preserve financial integrity are critical. The anti-money laundering and combating the financing of terrorism (AML/CFT) regime was last assessed by the Council of Europe's Committee of Experts on the Evaluation of AML/CFT (MONEYVAL) in 2008, and significant deficiencies were identified in the legal framework, the competencies of the financial intelligence unit, and criminal enforcement efforts. Recent amendments to the legislative framework addressed some deficiencies, including with the establishment of a beneficial ownership register, which entered into force in 2021. However, further efforts will be needed to ensure the effective implementation of legal provisions. The planned formalization of cryptocurrency trading would require a strategy to prevent their use for criminal purposes and mitigate risks to financial integrity, including through an effective AML/CFT framework. North Macedonia will undergo another evaluation by MONEYVAL in 2022.

34. A safeguards assessment of the NBRNM was completed in August 2020. While the assessment concluded that the NBRNM has a relatively strong safeguards framework and independent oversight practices in place, legal amendments are needed to strengthen its autonomy. The NBRNM is making progress in implementing the recommendations.

Authorities' Views

35. The authorities emphasized that the health and stability of the banking system has been preserved through the pandemic, and they continue to closely monitor risks. Regulatory flexibility, temporary restrictions on dividend payments, and economic policy support helped maintain credit to the economy during the pandemic. The NBRNM has strengthened the reporting frequency and data requirements for monitoring credit quality, introduced a comprehensive and consistent bottom-up stress testing, and increased the focus on risks such as cyber risks, which are being taken into account when setting bank-specific Pillar-II capital requirements. Given high growth in new mortgages and rising house prices, a targeted assessment is underway. Moreover, the NBRNM is closely monitoring deposit-driven euroization, which increased during the pandemic, against the plan set out in the denarization strategy.

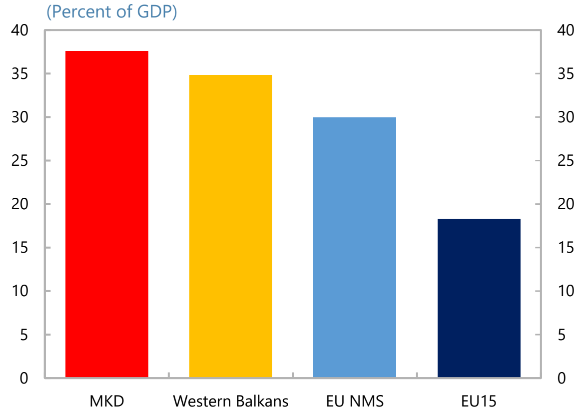
36. Efforts to update financial sector legislation are essential, and endeavors to put the process on a faster track are warranted. The pandemic and the political situation have further delayed implementation. The Financial Stability Law has been submitted to parliament for adoption. The remaining legislative package on deposit insurance, resolution, the banking law, and the national bank law are intertwined, and are expected to be submitted during 2022.

37. The authorities are preparing for the upcoming MONEYVAL assessment of the AML/CFT framework. A final report is scheduled for 2023, following submission of questionnaires and on-site visits. As part of the national strategy on AML/CFT, supervisory procedures for offsite inspections and supervisory strategy, is under preparation. A new payments law is being developed. There are no concerns on correspondent banking relations in terms of regular operations.

D. Structural Policies: Facilitating Reallocation and Transformation

38. The government's support measures aimed at reducing the size of the informal economy. Based on an IMF study, the informal economy could represent up to 38 percent of GDP in North Macedonia.[7] Registration requirements under the fiscal support packages have likely reduced the informal economy. A comprehensive set of policies—combining governance measures to strengthen tax compliance, improve tax morale, and fight corruption with policies to incentivize more formal job opportunities—are needed to continue lowering the informal economy and ensure that workers have adequate protection under labor laws and social policies.[8]

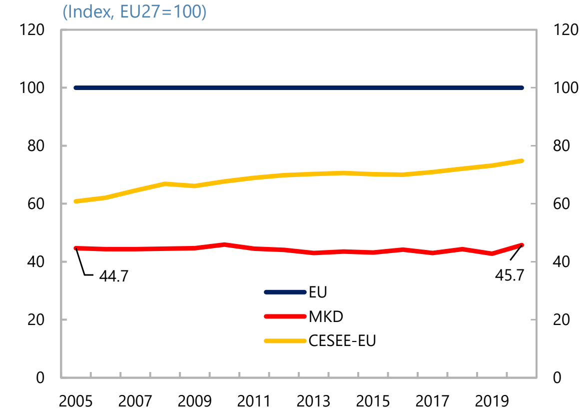
Size of the Shadow Economy in Europe, 2016
(Percent of GDP)



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

39. Efforts to increase labor force participation, reallocate labor, and boost labor productivity are important to limit the economic scars from the pandemic and speed up income convergence. The drop in labor force participation during the pandemic was more pronounced for women and youth, while participation rates were already declining for men. At the same time, as wage subsidies are phased out, job-to-job transitions need to be supported. Policies to support reskilling and retraining of the labor force and strengthen education outcomes are critical to facilitating economic transition and reducing skill shortages.

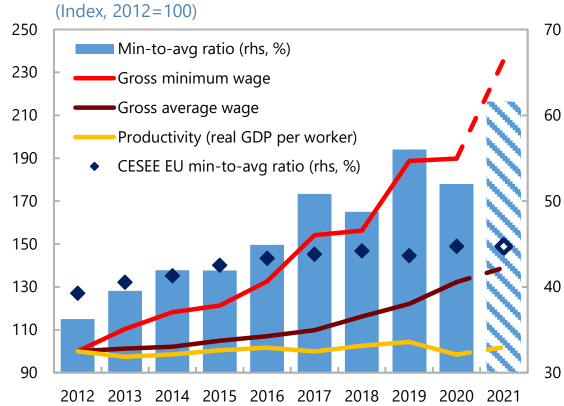
Productivity Levels Per Employee
(Index, EU27=100)



Sources: Eurostat; and IMF staff calculations.

40. To preserve competitiveness, minimum wage increases should also be guided by productivity developments. A 18.5 percent hike in the minimum wage has recently been debated. If implemented, the gross minimum wage would reach 62 percent of the average wage as of end-2021, which is high by regional standards. The current mechanism for minimum wage increases takes into account the average of consumer price inflation, GDP growth, and growth in average wages, thereby preserving purchasing power and providing a link to general wage

Wages and Productivity Growth
(Index, 2012=100)



Sources: Eurostat; SSO; and IMF staff calculations.

[7] Kelmanson, Kirabaeva, Medina, Mircheva, and Weiss (2019) "Explaining the shadow economy in Europe: size, causes and policy options," Working Paper No. 19/278, International Monetary Fund.

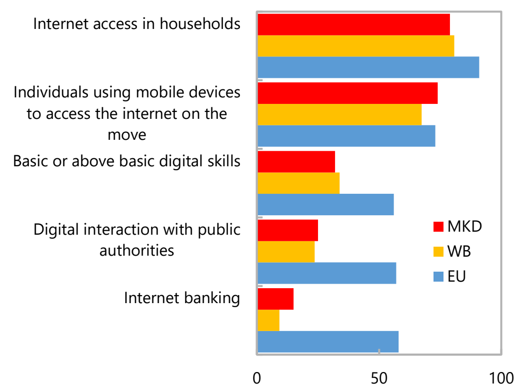
[8] See Selected Issues Paper on boosting revenue collections.

and economic developments. However, it does not explicitly take into account productivity developments. While a higher minimum wage can reduce poverty among the working population, it may not be effective in reducing overall poverty because most of those at risk are not working. In addition, it could increase informal employment and hurt competitiveness.

41. A further strengthening of the bankruptcy and insolvency framework can help resource reallocation. As the pandemic fades, bankruptcies could increase, and it will be important to avoid lengthy court procedures and backlogs of cases. This may require larger resources for courts but can also entail more use of out-of-court restructuring mechanisms. Progress is underway on a new bankruptcy law and an early identification system. While adoption of the new bankruptcy law is planned for the first half of 2022, implementation of the early identification system will take longer.

42. Public investment and economic policies should support the green and digital transformation. North Macedonia, along with the Western Balkan region, is lagging the EU on both climate and digital indicators. The government's investment plan aims, inter alia, at financing renewable energy, which will help the country's commitment to reduce carbon emissions and close coal power plants by 2030. The digital infrastructure is generally less lagging the EU, but usage of the digital economy and services, including public services, as well as digital skills, should be enhanced.

Digital Indicators
(Percent of individuals)



Sources: Eurostat; and IMF staff calculations.

Authorities' Views

43. The authorities are committed to reducing informality. The authorities included registration requirements to obtain financial support through the pandemic, and attribute lower informal employment and strongly performing tax collections in part to this. The informal economy in the national accounts is estimated to have declined to 13 percent, from previously 18 percent. Moreover, information campaigns and inspections have been strengthened. The authorities do not expect that a higher minimum wage would increase the share of informal workers, but instead considered it as a way to increase living standards. The 18.5 percent rise in the minimum wage is in the government's program, although the existing minimum wage mechanism would imply a more moderate rise.

44. The authorities acknowledged the importance of increasing labor force participation, with a focus on women. They are aiming to encourage women to join the labor market, and to motivate gender equality. The authorities also pointed to the need to maintain youth and skilled labor in the domestic labor market, preventing a continuation of emigration trends, including through a youth guarantee, supported internship programs, and educational reform. The results of the population census, expected to be published in March 2022, will provide greater clarity on the extent of emigration.

45. **The Growth Acceleration Plan includes elements and financing for both the green and digital transitions.** The authorities put the emphasis on the Growth Acceleration Plan to provide specific financing for the green transition, including additional electricity production capacity, possibly through issuance of green bonds, as well as other financing vehicles targeting green and digital transitions.

STAFF APPRAISAL

46. **The economic recovery is expected to continue in 2022.** The economy rebounded in 2021, reflecting improved mobility, a return of the diaspora, and continued policy support. Although 2022 starts on a weaker footing than previously anticipated due to the global resurgence of the pandemic, growth is expected to remain solid, at 4 percent. Investment is expected to recover strongly, in part due to an ambitious public investment plan, and supply-chain disruptions would gradually ease, boosting exports. Adverse pandemic developments, amid low vaccine coverage, could imply a lower growth trajectory.

47. **Inflation is forecast to remain higher for longer than previously thought, coming down in the second half of 2022.** Global factors, such as rising energy and food prices as well as supply disruptions, pushed up inflation in 2021. More recently, measures of inflation which strip out volatile prices such as food and energy prices have also increased, suggesting that higher inflation is becoming more broad-based. Inflation is expected to reach 4.3 percent in 2022, before stabilizing at around 2 percent in 2023 and thereafter. While there is considerable uncertainty regarding the future path of inflation, higher wage growth poses upside risks.

48. **The 2022 budget appropriately scales back pandemic-related spending, while continuing to support the economy.** Fiscal policy should be implemented flexibly in the short run as the pandemic evolves, which could require budget reallocations. As the demand for emergency lifelines wanes, focus should increasingly be on supporting the transformation of the economy including by training and reskilling workers, incentivizing hiring and investment, and strengthening the social safety net.

49. **A credible medium-term fiscal strategy is key to rebuilding buffers while creating more room for investment.** A cumulative consolidation of 1¾ percent of GDP by 2026, relative to the baseline, would bring the overall fiscal deficit closer to 1 percent of GDP in the medium term, which would ensure that the authorities have adequate fiscal space to respond to future shocks and address investment needs. The consolidation efforts should focus on tax policy and revenue administration measures.

50. Further improvements in public financial management would support the government's plan to scale up investment and limit fiscal risks. The framework for public investment should be strengthened by completing the plans to set up a dedicated unit in the Ministry of Finance as soon as possible and by fully integrating public-private partnerships in the overall investment framework. A steadfast adoption and implementation of the Organic Budget Law, as well as efforts to combat tax evasion and increase public procurement transparency and accountability further, would reduce fiscal risks and buttress public finances.

51. The de facto exchange rate peg has served the country well for decades, and international reserves remain appropriate to support the peg. None of the global factors driving inflation would respond to changes in domestic monetary policy. However, inflation pressures are becoming more broad-based, and the NBRNM needs to continue to carefully communicate its assessment of inflation developments, while standing ready to tighten policies if inflation in North Macedonia is expected to become persistently higher than inflation in the euro area, or significant and sustained pressures materialize on foreign currency reserves.

52. Banking system strength has held up well during the pandemic, but continued vigilance is essential. The banking system overall remains well capitalized and profitable. Initiatives to improve the framework for stress tests of banks are welcome, together with intensified supervisory efforts to ensure that banks recognize any problem assets and provision adequately for potential loan losses on a forward-looking basis. Given the still high share of FX or FX-linked loans in household loans, with possibly limited hedging of borrowers, the NBRNM should maintain carefully calibrated measures to limit FX lending. Moreover, rising private sector debt, albeit from low levels, and the high growth in mortgage lending, coupled with an acceleration in house prices, warrant further scrutiny.

53. The frameworks for macroprudential policy and the financial safety net should be strengthened. Preparations have been ongoing since the 2018 FSAP and the legislative process should be completed without further delays. Priorities include improving macroprudential oversight and coordination across institutions and ensuring that macroprudential instruments are available. Modernized frameworks for bank resolution and deposit insurance are crucial to bolstering the financial safety net. The operational autonomy of the NBRNM should be preserved.

54. Efforts to support reallocation are important to limit the economic scars from the pandemic crisis. The drop in labor force participation accelerated during the crisis and needs to be counteracted, including by policies to support job-to-job transitions, through reskilling and retraining, and to strengthen education outcomes to reduce skill shortages. Increases in the minimum wage should be guided by the agreed mechanism and productivity trends, to preserve jobs and competitiveness. A further strengthening of the bankruptcy and insolvency framework, including through implementation of the new bankruptcy law, can also help resource reallocation going forward.

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

Table 1. North Macedonia: Macroeconomic Framework, 2018–2026

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

	2018	2019	2020	2021	2022	2023	2024	2025	2026
				Est.			Projections		
Output									
Real GDP	2.9	3.9	-6.1	4.0	4.0	3.8	3.7	3.5	3.5
Domestic demand	2.8	5.2	-6.9	6.4	4.3	4.1	4.3	4.0	3.9
Exports	12.8	8.9	-10.9	8.8	10.5	7.7	7.6	7.0	6.9
Imports	10.7	10.1	-10.9	10.0	9.1	7.1	7.3	6.7	6.5
Contributions to growth 1/									
Domestic demand	3.9	6.9	-8.7	7.0	5.3	5.1	5.3	5.0	4.9
Net exports	-1.0	-2.9	2.6	-3.0	-1.3	-1.3	-1.6	-1.5	-1.4
Output gap (percent of potential GDP)	0.9	1.8	-3.8	-2.3	-1.2	-0.5	-0.2	-0.1	0.0
Consumer prices									
Period average	1.5	0.8	1.2	3.2	4.3	1.9	1.7	2.0	2.1
End-period	0.8	0.4	2.3	4.9	1.8	2.3	1.5	2.2	2.1
Central government operations (percent of GDP)									
Revenues	28.5	29.4	28.9	31.1	30.7	30.8	30.8	30.8	30.8
Expenditures	30.3	31.4	37.1	36.6	35.0	34.3	34.0	33.9	33.7
Of which: capital expenditures	1.8	2.6	2.5	3.3	3.4	3.4	3.5	3.5	3.6
Balance	-1.8	-2.0	-8.2	-5.5	-4.3	-3.5	-3.3	-3.1	-2.9
Gross general government debt 2/	40.4	40.4	51.9	54.8	54.1	54.3	54.5	54.5	54.3
Public and publicly guaranteed debt 2/ 3/	47.4	48.4	59.6	62.2	62.2	62.7	62.7	62.5	61.9
Savings and investment (percent of GDP)									
National saving	32.3	31.0	25.6	25.5	26.7	27.8	28.5	29.2	29.9
Public	0.1	0.6	-5.8	-2.2	-0.9	-0.1	0.2	0.5	0.7
Private	32.2	30.4	31.3	27.7	27.7	27.9	28.3	28.7	29.2
Foreign saving	0.1	3.3	3.4	3.5	3.0	2.8	2.7	2.6	2.6
Gross investment	32.3	34.3	29.0	29.0	29.8	30.6	31.2	31.8	32.5
Credit									
Private sector credit growth	7.3	6.3	4.9	8.0	7.4	7.3	7.0	6.7	6.3
Balance of payments									
Current account balance (percent of GDP)	-0.1	-3.3	-3.4	-3.5	-3.0	-2.8	-2.7	-2.6	-2.6
Foreign direct investment (percent of GDP)	5.6	3.2	1.5	3.4	3.3	3.3	3.4	3.5	3.5
External debt (percent of GDP)	73.0	72.4	80.3	80.4	78.9	79.2	78.1	78.5	77.6
Gross official reserves (millions of euros)	2,867	3,263	3,360	3,542	3,761	4,011	4,091	4,407	4,568
in percent of IMF ARA Metric	104	115	108	109	106	106	102	103	103
in percent of ST debt	96	95	102	135	120	150	130	133	153
in months of prospective imports	4.0	5.1	4.3	4.2	4.1	4.1	3.9	3.9	3.3
Memorandum items:									
Nominal GDP (billions of denars)	661	693	656	703	764	811	860	910	965
Nominal GDP (millions of euros)	10,744	11,262	10,635	11,406	12,393	13,164	13,947	14,772	15,659

Sources: NBRNM; 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 components.

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 2a. North Macedonia: Central Government Operations, 2018–2026
(Billions of denars)

	2018	2019	2020	2021		2022		2023	2024	2025	2026
				Revised Budget	Est.	Budget	Proj.	Projections			
Total Revenues	188.4	203.9	189.8	222.5	218.5	238.9	234.3	250.0	264.6	280.7	297.6
Tax Revenues and Contributions	171.0	178.9	173.5	193.1	196.3	210.8	211.1	225.5	238.3	252.9	268.0
PIT	17.6	18.7	18.6	20.8	20.6	21.1	21.6	23.2	24.2	25.7	27.2
CIT	14.7	11.6	10.5	12.0	10.9	12.3	12.3	14.1	14.9	16.3	17.3
VAT (net)	49.3	52.1	46.9	54.2	58.2	62.2	62.7	67.8	71.8	76.1	80.7
Excises	25.1	26.1	22.5	27.7	25.5	28.8	29.2	31.0	32.9	34.8	36.9
Custom Duties	5.6	6.0	6.7	6.5	8.5	9.0	9.1	9.7	10.2	10.9	11.5
Other Taxes	2.2	2.3	1.7	2.7	2.0	3.1	2.2	2.4	2.5	2.6	2.8
Social Contributions	56.5	62.2	66.6	69.2	70.6	74.4	74.0	77.3	81.7	86.5	91.7
Non-Tax Revenues	12.3	18.8	11.4	17.6	14.4	19.2	15.8	16.8	18.1	19.1	20.3
Capital Revenues	2.2	2.4	1.8	3.2	1.9	3.3	2.1	2.2	2.4	2.5	2.6
Grants	3.0	3.9	3.1	8.7	5.9	5.6	5.2	5.5	5.9	6.2	6.6
Expenditures	200.0	217.5	243.6	268.8	257.4	272.4	267.1	278.1	292.7	308.6	325.1
Current Expenditures	187.9	199.7	227.5	239.0	234.0	234.2	241.3	250.7	262.8	276.5	290.5
Wages and salaries	26.4	27.8	29.8	31.6	31.0	32.7	32.7	33.7	34.9	36.2	37.6
Goods and services	14.6	16.3	15.4	22.0	20.1	20.7	21.2	21.9	22.6	23.3	24.0
Transfers	139.3	147.6	174.3	176.0	173.8	170.8	177.9	184.6	194.6	205.3	215.7
Pension fund expenditures	61.2	65.2	69.0	71.9	72.0	74.2	76.7	81.6	85.9	90.5	95.5
Health	28.9	30.8	34.7	35.0	35.1	36.1	36.6	38.4	40.5	42.9	45.2
Other	49.1	51.5	70.6	69.1	66.7	60.5	64.7	64.7	68.2	72.0	75.1
Interest	7.7	8.1	8.0	9.4	9.1	10.1	9.4	10.4	10.7	11.7	13.1
Capital Expenditures	12.1	17.8	16.1	29.8	23.4	38.2	25.8	27.3	29.9	32.1	34.5
Lending minus repayment 1/	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall fiscal balance	-11.6	-13.6	-53.9	-46.2	-38.8	-33.5	-32.8	-28.0	-28.1	-27.9	-27.5
Primary fiscal balance	-3.9	-5.5	-45.8	-36.9	-29.8	-23.5	-23.4	-17.6	-17.4	-16.2	-14.4
Financing	11.6	13.6	53.9	46.2	38.8	33.5	32.8	28.0	28.1	27.9	27.5
Domestic, net	-5.3	9.9	14.2	19.7	13.8	18.3	17.7	12.4	28.1	14.6	24.2
Central Bank deposits	-9.6	1.2	-6.9	0.4	-3.2	-3.3	4.9	0.3	0.2	-0.1	0.2
Other net domestic financing	4.3	8.7	21.1	19.3	17.0	21.6	12.8	12.0	28.0	14.7	24.0
Privatization receipts	0.3	0.7	1.0	0.0	0.6	0.0	0.0	0.0	0.0	0.0	0.0
Foreign, net	16.6	3.0	38.7	26.5	24.5	15.2	15.2	15.7	0.0	13.3	3.3
Memo items:											
Gross general government debt (percent of GDP) 2/	40.4	40.4	51.9	52.0	54.8	53.4	54.1	54.3	54.5	54.5	54.3
Nominal GDP (billions of denars)	661	693	656	707	703	774	764	811	860	910	965
Stock of Central Bank deposits (billions of denars eop)	35	32	41		44		39	39	38	39	38
Public and publicly guaranteed debt (percent of GDP) 2/ 3/	47.4	48.4	59.6		62.2		62.2	62.7	62.7	62.5	61.9

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, 2018–2026

(Percent of GDP)

	2018	2019	2020	2021 Revised Budget	2021 Est.	2022 Budget	2022 Proj.	2023 Projections	2024 Projections	2025 Projections	2026 Projections
Total Revenues	28.5	29.4	28.9	31.5	31.1	30.9	30.7	30.8	30.8	30.8	30.8
Tax Revenues and Contributions	25.9	25.8	26.4	27.3	27.9	27.3	27.6	27.8	27.7	27.8	27.8
PIT	2.7	2.7	2.8	2.9	2.9	2.7	2.8	2.9	2.8	2.8	2.8
CIT	2.2	1.7	1.6	1.7	1.5	1.6	1.6	1.7	1.7	1.8	1.8
VAT (net)	7.5	7.5	7.1	7.7	8.3	8.0	8.2	8.4	8.4	8.4	8.4
Excises	3.8	3.8	3.4	3.9	3.6	3.7	3.8	3.8	3.8	3.8	3.8
Custom Duties	0.8	0.9	1.0	0.9	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Other Taxes	0.3	0.3	0.3	0.4	0.3	0.4	0.3	0.3	0.3	0.3	0.3
Social Contributions	8.6	9.0	10.1	9.8	10.0	9.6	9.7	9.5	9.5	9.5	9.5
Non-Tax Revenues	1.9	2.7	1.7	2.5	2.0	2.5	2.1	2.1	2.1	2.1	2.1
Capital Revenues	0.3	0.3	0.3	0.5	0.3	0.4	0.3	0.3	0.3	0.3	0.3
Grants	0.4	0.6	0.5	1.2	0.8	0.7	0.7	0.7	0.7	0.7	0.7
Expenditures	30.3	31.4	37.1	38.0	36.6	35.2	35.0	34.3	34.0	33.9	33.7
Current Expenditures	28.4	28.8	34.7	33.8	33.3	30.3	31.6	30.9	30.6	30.4	30.1
Wages and salaries	4.0	4.0	4.5	4.5	4.4	4.2	4.3	4.2	4.1	4.0	3.9
Goods and services	2.2	2.3	2.4	3.1	2.9	2.7	2.8	2.7	2.6	2.6	2.5
Transfers	21.1	21.3	26.6	24.9	24.7	22.1	23.3	22.8	22.6	22.6	22.4
Pension fund expenditures	9.3	9.4	10.5	10.2	10.2	9.6	10.0	10.1	10.0	9.9	9.9
Health	4.4	4.4	5.3	5.0	5.0	4.7	4.8	4.7	4.7	4.7	4.7
Other	7.4	7.4	10.8	9.8	9.5	7.8	8.5	8.0	7.9	7.9	7.8
Interest	1.2	1.2	1.2	1.3	1.3	1.3	1.2	1.3	1.2	1.3	1.4
Capital Expenditures	1.8	2.6	2.5	4.2	3.3	4.9	3.4	3.4	3.5	3.5	3.6
Lending minus repayment 1/	0.0										
Overall fiscal balance	-1.8	-2.0	-8.2	-6.5	-5.5	-4.3	-4.3	-3.5	-3.3	-3.1	-2.9
Primary fiscal balance	-0.6	-0.8	-7.0	-5.2	-4.2	-3.0	-3.1	-2.2	-2.0	-1.8	-1.5
Financing	1.8	2.0	8.2	6.5	5.5	4.3	4.3	3.5	3.3	3.1	2.9
Domestic, net	-0.8	1.4	2.2	2.8	2.0	2.4	2.3	1.5	3.3	1.6	2.5
Central Bank deposits	-1.5	0.2	-1.0	0.1	-0.5	-0.4	0.6	0.0	0.0	0.0	0.0
Other domestic financing	0.7	1.3	3.2	2.7	2.4	2.8	1.7	1.5	3.3	1.6	2.5
Privatization receipts	0.0	0.1	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Foreign, net	2.5	0.4	5.9	3.7	3.5	2.0	2.0	1.9	0.0	1.5	0.3
Memo items:											
Gross general government debt (percent of GDP) 2/	40.4	40.4	51.9	52.0	54.8	53.4	54.1	54.3	54.5	54.5	54.3
Nominal GDP (billions of denars)	661	693	656	707	703	774	764	811	860	910	965
Stock of Central Bank deposits (billions of denars eop)	35	32	41		44		39	39	38	39	38
Public and publicly guaranteed debt (percent of GDP) 2/ 3/	47.4	48.4	59.6		62.2		62.2	62.7	62.7	62.5	61.9

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 3a. North Macedonia: Balance of Payment, 2018–2026
(Millions of euros, unless otherwise indicated)

	2018	2019	2020	2021	2022	2023	2024	2025	2026
				Est.			Projections		
Current account	-7	-368	-366	-399	-376	-371	-377	-390	-411
Trade balance	-1,736	-1,949	-1,805	-2,334	-2,418	-2,489	-2,575	-2,712	-2,812
Exports	4,883	5,347	4,817	5,917	6,568	7,148	7,768	8,390	9,066
Imports	6,619	7,296	6,622	8,251	8,985	9,637	10,343	11,102	11,878
Services (net)	371	336	427	538	565	600	628	702	737
Primary Income (net)	-451	-520	-411	-505	-568	-604	-640	-678	-718
Secondary Income (transfers, net)	1,809	1,764	1,423	1,903	2,045	2,122	2,209	2,298	2,382
Of which									
Official	109	43	110	87	80	102	90	72	70
Private	1,700	1,721	1,313	1,816	1,965	2,020	2,120	2,225	2,312
Capital account (net)	12	8	11	12	12	11	11	11	12
Net lending (+) / Net borrowing (-)	4	-360	-355	-387	-363	-360	-366	-379	-400
Financial account	-536	-682	-443	-407	-582	-610	-446	-695	-561
Direct investment (net)	-604	-363	-155	-389	-409	-434	-474	-517	-548
Portfolio investment (net)	-320	151	-284	-248	-310	-293	-46	-248	-49
Other investment	388	-470	-5	229	137	117	74	70	36
Trade credits (net)	109	-318	-224	91	25	26	42	44	47
MLT loans (net)	-1	-209	-276	-55	-49	-96	-149	-149	-192
Public sector	100	-62	-116	-79	4	-4	1	-16	-54
Disbursements	69	177	378	178	96	142	190	195	216
of which : IMF credit	0	0	166	0	0	0	0	0	0
Amortization	-166	-99	-259	-99	-100	-138	-191	-179	-162
of which : Repayment to the IMF	0	0	0	0	0	-41	-83	-41	0
Banks	19	-43	-51	-21	-56	-5	-26	-29	-32
Other sectors	-120	-104	-109	45	3	-87	-124	-105	-106
ST loans (net)	-6	-16	7	-7	-6	-8	-7	-8	-7
Currency and deposits (net)	286	73	489	200	168	194	187	183	188
Other (net)	0	0	-1	0	0	0	0	0	0
Errors and omissions	8	54	26	0	0	0	0	0	0
Overall Balance	549	376	114	20	218	251	80	316	161
Memorandum items:									
ST debt at residual maturity (year-end)	2,971	3,447	3,295	2,619	3,129	2,667	3,148	3,315	2,983
Gross foreign exchange reserves	2,867	3,263	3,360	3,542	3,761	4,011	4,091	4,407	4,568
Percent of IMF ARA Metric	103.7	115.0	108.3	108.7	105.6	106.2	101.9	103.3	103.3
Months of prospective imports of G&S	4.0	5.1	4.3	4.2	4.1	4.1	3.9	3.9	3.3
Percent of short-term debt (residual maturity)	96.5	94.7	102.0	135.2	120.2	150.4	130.0	133.0	153.1
External debt (percent of GDP)	73.0	72.4	80.3	80.4	78.9	79.2	78.1	78.5	77.6
External debt service	2,228	2,468	3,023	2,826	2,161	2,681	2,227	2,720	2,897
Percent of exports of G&S	34	35	48	37	26	30	23	26	25
Percent of exports of G&S and transfers	27	28	40	30	21	24	19	21	21

Sources: NBRNM; and IMF staff estimates.

Table 3b. North Macedonia: Balance of Payments, 2018–2026
(Percent of GDP, unless otherwise indicated)

	2018	2019	2020	2021	2022	2023	2024	2025	2026
				Est.			Projections		
Current account	-0.1	-3.3	-3.4	-3.5	-3.0	-2.8	-2.7	-2.6	-2.6
Trade balance	-16.2	-17.3	-17.0	-20.5	-19.5	-18.9	-18.5	-18.4	-18.0
Exports	45.4	47.5	45.3	51.9	53.0	54.3	55.7	56.8	57.9
Imports	61.6	64.8	62.3	72.3	72.5	73.2	74.2	75.2	75.9
Services (net)	3.5	3.0	4.0	4.7	4.6	4.6	4.5	4.7	4.7
Primary Income (net)	-4.2	-4.6	-3.9	-4.4	-4.6	-4.6	-4.6	-4.6	-4.6
Secondary Income (transfers, net)	16.8	15.7	13.4	16.7	16.5	16.1	15.8	15.6	15.2
Of which									
Official	1.0	0.4	1.0	0.8	0.6	0.8	0.6	0.5	0.4
Private	15.8	15.3	12.4	15.9	15.9	15.3	15.2	15.1	14.8
Capital account (net)	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net lending (+) / Net borrowing (-)	0.0	-3.2	-3.3	-3.4	-2.9	-2.7	-2.6	-2.6	-2.6
Financial account	-5.0	-6.1	-4.2	-3.6	-4.7	-4.6	-3.2	-4.7	-3.6
Direct investment (net)	-5.6	-3.2	-1.5	-3.4	-3.3	-3.3	-3.4	-3.5	-3.5
Portfolio investment (net)	-3.0	1.3	-2.7	-2.2	-2.5	-2.2	-0.3	-1.7	-0.3
Other investment	3.6	-4.2	0.0	2.0	1.1	0.9	0.5	0.5	0.2
Trade credits (net)	1.0	-2.8	-2.1	0.8	0.2	0.2	0.3	0.3	0.3
MLT loans (net)	0.0	-1.9	-2.6	-0.5	-0.4	-0.7	-1.1	-1.0	-1.2
Public sector	0.9	-0.6	-1.1	-0.7	0.0	0.0	0.0	-0.1	-0.3
Disbursements	0.6	1.6	3.6	1.6	0.8	1.1	1.4	1.3	1.4
of which : IMF credit	0.0	0.0	1.6	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-1.5	-0.9	-2.4	-0.9	-0.8	-1.0	-1.4	-1.2	-1.0
of which : Repayment to the IMF	0.0	0.0	0.0	0.0	0.0	-0.3	-0.6	-0.3	0.0
Banks	0.2	-0.4	-0.5	-0.2	-0.5	0.0	-0.2	-0.2	-0.2
Other sectors	-1.1	-0.9	-1.0	0.4	0.0	-0.7	-0.9	-0.7	-0.7
ST loans (net)	-0.1	-0.1	0.1	-0.1	0.0	-0.1	0.0	-0.1	0.0
Currency and deposits (net)	2.7	0.7	4.6	1.8	1.4	1.5	1.3	1.2	1.2
Other (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	0.1	0.5	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance	5.1	3.3	1.1	0.2	1.8	1.9	0.6	2.1	1.0
				(Percentage change, year-on-year)					
Exports of G&S (Value)	17.3	7.9	-10.2	21.1	10.5	8.3	8.3	7.7	7.9
Volume	12.8	8.9	-10.9	8.8	10.5	7.7	7.6	7.0	6.9
Price	4.0	-0.9	0.8	11.3	0.0	0.5	0.6	0.7	0.9
Imports of G&S (Value)	13.1	9.7	-11.0	22.7	9.1	7.1	7.4	7.0	7.1
Volume	10.7	10.1	-10.9	10.0	9.1	7.1	7.3	6.7	6.5
Price	2.1	-0.4	-0.1	11.6	0.0	0.0	0.0	0.3	0.5

Sources: NBRNM; and IMF staff estimates.

Table 4. North Macedonia: Monetary Survey, 2018–2026
(Billions of denars, unless specified otherwise)

	2018	2019	2020	2021	2022	2023	2024	2025	2026
				Est.		Projections			
NFA	180.7	192.4	195.2	195.9	202.0	216.6	221.7	241.4	251.1
Central Bank	171.5	195.7	202.6	202.9	208.0	223.4	228.4	247.8	257.8
Commercial Banks	9.2	-3.3	-7.4	-7.2	-6.0	-6.8	-6.7	-6.5	-6.7
NDA	192.7	211.6	241.1	278.8	303.7	326.9	362.7	387.6	426.5
Credit to Government (net)	5.9	17.0	35.4	48.0	58.9	65.9	80.0	87.3	99.5
From Banks (net)	35.4	42.7	70.1	75.8	82.6	89.2	103.2	110.5	122.6
of which: Credit	37.0	44.2	71.7	77.5	84.1	90.7	104.8	112.1	124.2
From Central Bank (net)	-29.5	-25.7	-34.7	-27.8	-23.6	-23.3	-23.1	-23.3	-23.1
of which: Deposits	-35.4	-31.8	-40.5	-43.0	-38.9	-38.6	-38.4	-38.5	-38.4
Credit to Private Sector (gross)	322.9	343.4	360.1	388.9	417.7	448.2	479.5	511.6	543.8
From Banks	322.0	342.5	359.2	388.1	416.9	447.3	478.7	510.8	543.0
Denars	191.8	200.7	210.5	230.7	247.8	265.9	284.6	303.6	322.8
FX	130.2	141.9	148.7	157.4	169.0	181.4	194.1	207.1	220.2
From Central Bank	0.9	0.8	0.9	0.8	0.8	0.8	0.8	0.8	0.8
Other Items (net)	-136.0	-148.7	-154.4	-158.1	-158.0	-167.2	-171.9	-186.2	-191.8
Broad Money (M3)	373.4	404.0	436.2	474.8	505.7	543.5	584.4	629.0	677.6
Currency in Circulation	32.2	36.1	43.7	44.5	48.3	51.3	54.4	57.6	61.1
Total Deposits	341.2	367.9	392.5	430.3	457.4	492.1	530.0	571.4	616.5
Denars	205.2	225.5	235.5	245.5	260.9	280.8	302.4	326.0	351.7
FX	136.0	142.5	157.1	184.8	196.4	211.4	227.6	245.4	264.8
	(Percentage change, year-on-year)								
Private Sector Credit	7.3	6.3	4.9	8.0	7.4	7.3	7.0	6.7	6.3
Broad Money	10.8	8.2	8.0	8.8	6.5	7.5	7.5	7.6	7.7
Private Sector Deposits	11.1	7.8	6.7	9.6	6.3	7.6	7.7	7.8	7.9
	(Contribution to annual growth in broad money)								
NFA	10.9	3.1	0.7	0.2	1.3	2.9	0.9	3.4	1.5
NDA	-0.1	5.1	7.3	8.7	5.2	4.6	6.6	4.3	6.2
	(Percent of GDP)								
Private Sector Credit	48.9	49.6	54.9	55.3	54.7	55.2	55.8	56.2	56.4
Broad Money	56.5	58.3	66.5	67.5	66.2	67.0	68.0	69.1	70.2
Private Sector Deposits	51.6	53.1	59.8	61.2	59.9	60.7	61.7	62.8	63.9
Memorandum items:									
Money Multiplier	3.5	3.1	3.1	3.3	3.3	3.3	3.6	3.4	3.5
Reserve Requirement Ratio (percent of deposits)									
Denars	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0
FX Indexed	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0
FX	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0
Velocity	1.8	1.7	1.5	1.5	1.5	1.5	1.5	1.4	1.4

Sources: NBRNM; and IMF staff estimates.

Table 5. North Macedonia: Central Bank Survey, 2018–2026

(Billions of denars, unless specified otherwise)

	2018	2019	2020	2021	2022	2023	2024	2025	2026
				Est.		Projections			
Net foreign assets	171.5	195.7	202.6	202.9	208.0	223.4	228.4	247.8	257.8
Assets	176.4	200.7	207.4	226.7	231.8	247.3	252.2	271.7	281.6
Liabilities	-4.9	-5.0	-4.8	-23.8	-23.8	-23.8	-23.8	-23.8	-23.8
Net domestic assets	-64.9	-65.7	-62.7	-59.5	-55.4	-59.1	-64.3	-65.4	-65.6
Central Government (net)	-29.5	-25.7	-34.7	-28.5	-23.6	-23.3	-23.1	-23.3	-23.1
of which:									
Deposits at Central Bank	-35.4	-31.8	-40.5	-43.8	-38.9	-38.6	-38.4	-38.5	-38.4
Denar	-15.5	-18.2	-18.0	-21.7	-19.5	-19.4	-19.3	-19.3	-19.3
FX	-19.9	-13.6	-22.5	-22.1	-19.4	-19.2	-19.1	-19.2	-19.1
Banks (net)	-25.9	-27.3	-14.1	-17.3	-18.5	-23.4	-28.6	-29.1	-29.3
Other items (net)	-9.6	-12.7	-13.9	-13.7	-13.2	-12.5	-12.6	-13.1	-13.2
Monetary base	106.6	129.9	139.9	143.6	152.6	164.3	164.0	182.4	192.2
Currency in circulation	39.8	43.3	50.0	51.4	54.6	57.6	60.6	63.8	67.3
Liabilities to banks	57.2	78.1	81.5	85.1	89.8	98.6	95.3	110.4	116.7
Required reserves	43.0	48.5	36.2	48.3	51.2	55.1	59.3	63.9	69.0
Excess reserves	14.2	29.6	45.3	36.1	38.6	43.5	36.0	46.5	47.8
Liabilities to other sectors	9.5	8.5	8.4	7.9	8.3	8.2	8.1	8.2	8.1
(Contribution to annual growth in monetary base)									
Net foreign assets	38.6	22.7	5.3	0.2	3.5	10.1	3.0	11.9	5.4
Net domestic assets	-12.2	-0.8	2.3	2.3	2.9	-2.5	-3.2	-0.7	-0.1
(Percentage change, year-on-year)									
Monetary base	26.4	21.9	7.6	2.7	6.2	7.7	-0.2	11.2	5.4
Memorandum items: (Percent of GDP)									
Central Bank bills	3.8	3.6	1.5	1.4	2.0	2.5	2.9	2.7	2.6
Central government deposits at Central Bank	5.4	4.6	6.2	6.2	5.1	4.8	4.5	4.2	4.0

Sources: NBRNM; and IMF staff estimates.

Table 6. North Macedonia: Financial Soundness Indicators, 2013–2021

(Percent)

	2013	2014	2015	2016	2017	2018	2019	2020	2021Q3
Capital adequacy									
Regulatory capital/risk weighted assets	16.9	15.7	15.5	15.2	15.7	16.5	16.3	16.7	17.3
Tier I capital/risk weighted assets	14.5	13.7	13.9	13.9	14.2	15.0	14.8	15.3	15.9
Equity and reserves to Assets	11.3	10.8	10.8	10.6	10.8	10.8	11.0	11.6	12.4
Asset composition									
Structure of loans									
Enterprises (loans to enterprises/total loans)	55.4	55.2	53.9	51.3	50.2	49.3	47.6	46.2	45.8
Households (loans to households/total loans)	37.7	38.7	40.0	42.9	44.8	46.4	48.4	49.7	50.5
Lending with foreign currency component to private sector	52.7	49.4	46.5	44.9	42.5	41.4	42.3	42.3	41.8
Foreign currency lending/total credit to private sector	23.8	22.5	20.5	18.0	16.5	15.5	14.8	14.6	14.7
Foreign currency indexed lending/total credit to private sector	28.9	27.0	26.0	27.0	26.1	25.9	27.5	27.7	27.1
NPLs 1/									
NPLs/gross loans	10.9	10.8	10.3	6.3	6.1	5.0	4.6	3.3	3.5
NPLs net of provision/own funds	-1.8	-3.0	-5.3	-5.5	-3.7	-5.2	-2.4	-6.9	-4.8
Provisions to NPLs	80.1	81.9	86.7	80.9	77.2	76.3	67.7	73.2	65.3
Large exposures/own funds	188.5	233.1	212.5	185.4	176.3	218.2	256.2	281.5	227.4
Connected lending									
Banking system exposure to subsidiaries and	4.2	4.3	3.4	8.4	3.8	3.8	4.0	3.9	3.1
Banking system equity investments/own funds	1.7	2.6	2.6	2.0	1.9	1.2	1.3	0.8	0.9
Earning and profitability									
ROAA 2/	0.6	0.8	1.1	1.5	1.5	1.7	1.3	1.3	1.6
ROAE 2/	5.7	7.4	10.4	13.6	13.5	16.0	11.7	11.3	13.4
Interest margin/gross income 3/	62.2	63.5	62.8	62.7	60.6	57.9	58.3	56.8	53.9
Noninterest expenses/gross income 4/	62.8	58.1	54.7	53.2	52.5	50.5	55.0	53.0	52.7
Personnel expenses/noninterest expenses	35.0	35.5	35.8	35.2	34.8	37.4	36.7	36.7	34.1
Interest Rates									
Local currency spreads	3.9	4.3	4.6	4.3	4.2	3.9	3.7	3.7	3.7
Foreign currency spreads	5.2	5.3	4.8	4.5	4.3	3.9	3.7	3.6	3.6
Interbank market interest rate	2.2	1.5	1.2	1.0	1.1	1.1	1.1	1.1	1.0
Liquidity									
Highly liquid assets/total assets 5/	27.3	25.5	24.3	25.7	23.2	22.6	24.0	21.5	20.0
Highly liquid assets/total short-term liabilities 6/	47.6	45.5	42.4	44.6	40.1	39.2	41.3	35.7	32.7
Liquid assets/total assets	31.2	29.8	28.2	28.9	27.1	26.7	26.9	23.3	22.0
Liquid assets/total short-term liabilities	54.5	53.2	49.2	50.1	46.9	46.4	46.2	38.6	35.9
Customer deposits/total (noninterbank) loans	112.7	113.4	110.3	114.9	114.0	116.0	119.4	121.9	121.5
Foreign currency deposits/total deposits	44.9	42.3	42.1	43.0	42.7	42.3	40.7	41.8	43.4
Including foreign exchange-indexed 7/	45.5	42.8	42.4	43.1	43.1	42.5	40.8	41.9	43.5
Sensitivity to market risk									
Net open foreign exchange position/own funds	15.6	17.5	11.1	14.5	6.2	3.8	6.0	10.1	4.7

Source: NBRNM.

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).

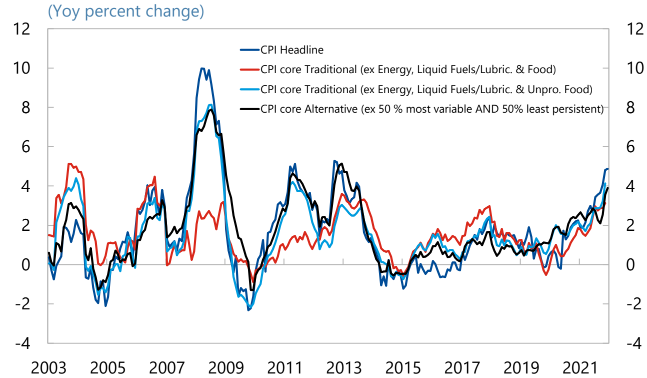
7/ FX indexed deposits include deposits and other FX indexed liabilities.

Annex I. Is the Recent Increase in Inflation Likely to be Sustained?

Inflation in North Macedonia rose sharply during 2021, like in other countries in Europe and globally. This annex develops various measures of core inflation, and a framework to assess the pass-through to and from inflation expectations. The various core measures suggest that inflation is becoming more broad-based. Moreover, inflation expectations have risen significantly in recent months. The pass-through of inflation to inflation expectations and vice versa is significant but short-lived. However, higher inflation expectations could give rise to higher wage growth, leading to higher inflation for longer.

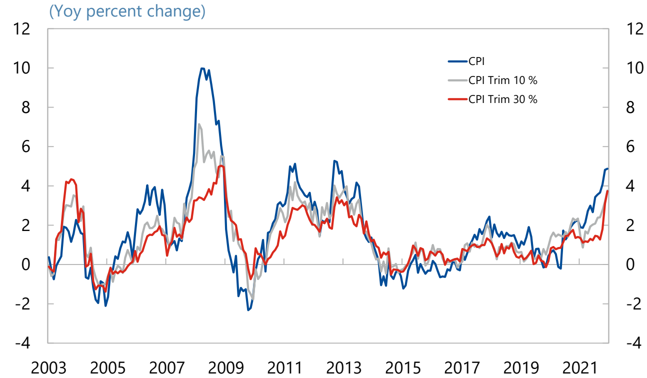
1. **Core inflation has risen in past months, although somewhat less than headline rates.** Traditional core measures, so-called permanent exclusion measures that exclude energy and food, show an upward movement over the past months. However, because the weight of food is close to 40 percent of the CPI basket in North Macedonia, removing food prices changes the composition of the CPI basket significantly. Calculating an alternative core measure, which excludes the consumption categories that are highly variable and have low persistence, allows to look at less volatile and more persistent categories, while maintaining almost 90 percent of the CPI basket. This measure confirms an upward movement in the inflation rate of non-volatile and persistent price categories.

CPI: Headline, Traditional Core, and Alternative Core
(Yoy percent change)



Sources: Haver Analytics; and IMF staff calculations.
Note: Latest observation is December 2021.

CPI and Trimmed-Mean Underlying Measures
(Yoy percent change)



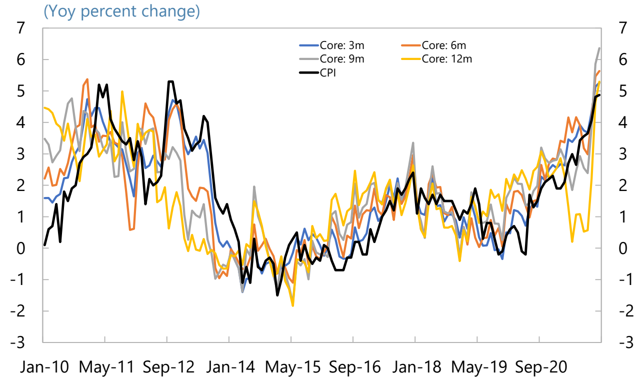
Sources: Haver Analytics; SSO; and IMF staff calculations.
Note: Latest observation is December 2021.

2. **Trimmed-mean measures suggest that the price increases are becoming more broad-based.** Trimmed-mean measures, so-called temporary exclusion measures, "trim" price changes below and above a certain percentile of the inflation distribution, yielding a more stable measure of inflation. The trimmed components below and above the 15–85 percentiles are mainly related to food (oils and fats, fruits, and vegetables), energy (housing energy and fuels), and some core components (e.g., passenger transport by air and accommodation services), which may be sharply rebounding from the pandemic. Overall, price increases are increasingly broad-based.

3. **Predictive measures suggest that inflation will remain at the current level throughout the year.** We develop predictive measures in a purely statistical way, inspired by the core inflation measures. In this case, from the set of inflation indices for all the subcomponents of the CPI basket, we find the linear combination of them which best predicts inflation h periods out. By varying h and repeating the exercise, we trace out an estimate of the future dynamics of inflation based solely on the structure of the current level. Despite the simplicity of the exercise, such predictive core measures have provided accurate predictions: the 12-month predictive core attains a correlation of 87 percent with actual inflation 12 months ahead. Core measures suggest that inflation may accelerate somewhat during 2022, before reaching a peak in the second half of the year.

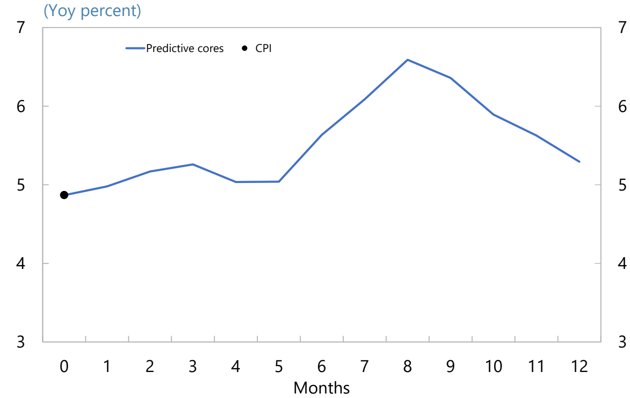
4. **Inflation expectations have also increased significantly, albeit from a low level in the past decade.** The increase in inflation is to a large extent reflecting temporarily higher food and energy prices, suggesting that the increase will be short-lived. Using a local projections framework (based on Jordà (2005)), we observe that while in the past increases in inflation have affected inflation expectations, the effect is short-lived. However, higher inflation expectations could feed into the wage- and price-setting processes, triggering higher inflation for a longer period.

CPI and Predictive Cores
(Yoy percent change)



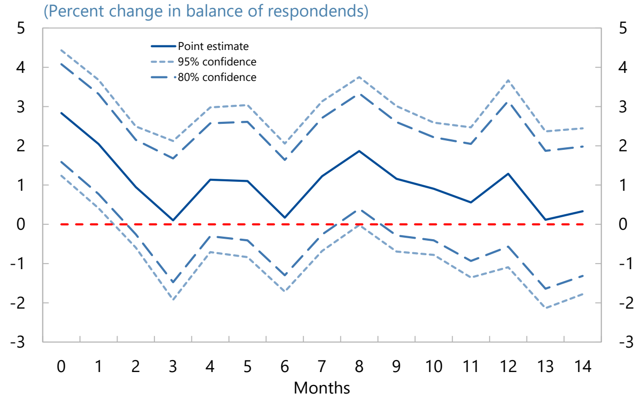
Sources: Haver Analytics; and IMF staff calculations.

Predictive Core Measures as of December 2021
(Yoy percent)



Sources: Haver Analytics; and IMF staff calculations.

Response of Expectations to Innovations in Inflation
(Percent change in balance of respondends)



Sources: Haver Analytics; and IMF staff calculations.

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Annex II. Depositor Preference––A Key Pillar of the Financial Safety Net[1]

1. Trust in the deposit insurance scheme and in the protection of insured deposits is a key pillar of the financial safety net. While North Macedonia has a deposit insurance scheme in place, it has no depositor preference arrangements, leaving deposits to rank pari passu with other senior unsecured liabilities in the winding-up of a bank. The absence of depositor preference could increase the risk of a bank run in a period of stress, especially if there are doubts about the adequacy of funding available through the Deposit Insurance Fund.

2. Depositor preference is an important building block of the financial safety net, supporting financial stability and inducing market discipline. The hierarchy of creditor claims applicable in bank insolvency establishes the order in which creditors should be paid from the assets of a failed bank. With depositor preference, deposit liabilities are given a more senior (or higher) position than other unsecured creditor claims. Depositor preference enforces market discipline by placing a larger burden on financial investors being informed about the riskiness of their investments than on small firms and households that are less financially sophisticated. By increasing the depositors' recoveries, depositor preference may reduce the costs of protecting deposits in a deposit insurance payout, enhancing a country's financial safety net.

3. Three types of depositor preference could form part of this consideration.

- *Insured depositor preference* provides preferential treatment for insured deposits—those deposits that are eligible and within the specified deposit insurance limit—over other ordinary, senior unsecured creditors (e.g., bondholders, interbank deposits).
- *Tiered depositor preference*, with two tiers, establishes a preference for insured deposits over uninsured eligible deposits, with a further preference of both categories over other senior unsecured, general creditors.
- *General depositor preference* gives preference to all deposit liabilities of a deposit-taking institution, regardless of their eligibility and coverage under the Deposit Insurance Scheme, over other senior unsecured creditors.

4. In all three types, the Deposit Insurance Fund would normally be granted subrogation to insured depositor claims to the extent of its payouts of insured deposits. Such provisions of the Deposit Insurance Fund should be formulated in line with best practice in deposit insurance laws as part of a broader design with other financial legislation, not to question the depositor preference and the subrogation rights of the Deposit Insurance Fund.

[1] "The Case for Depositor Preference," IMF Technical Notes and Manuals, December 2020.

5. **Depositor preference is incorporated in the EU frameworks for deposit guarantee schemes and recovery and resolution of banks.** The International Association of Deposit Insurers' Core Principles for Effective Deposit Insurance Schemes recommend that deposit insurance funds should be protected from losses in resolution. Most Financial Stability Board (FSB) jurisdictions afford preferential treatment to at least some depositors. Outside of FSB membership, however, depositor preference is not yet universal. The Bank Recovery and Resolution Directive (BRRD) introduced two-tiered depositor preference across the EU.

6. **Depositor preference should be considered as part of the financial legislative package.** Modernizing deposit insurance and resolution legislation, and aligning it with EU law, should be considered an integral part of the current efforts to strengthen the safety net, through the forthcoming laws on deposit insurance, bank resolution, and the updated banking law.

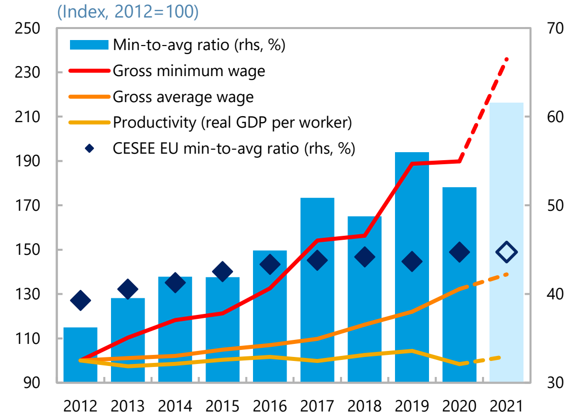
Annex III. Minimum Wages in North Macedonia

Large ad hoc increases to the minimum wage were implemented in recent years, a time when inflation was moderate and productivity growth was stagnant. Another possible 18.5 percent increase has been debated, implying that the minimum wage would reach 62 percent of the average gross wage, which is high in comparison to other European countries. A decision to increase the minimum wage should consider its ability to lower poverty, its impact on informality, its pass-through to other wages and inflation, and the impact on competitiveness and employment. The minimum wage should be guided by the minimum wage mechanism and productivity and ensure that wages can flexibly adjust to an economic shock. This is particularly important in an economy with an exchange rate peg.

1. **The recently announced potential hike in the minimum wage follows successive large ad hoc rises in the minimum wage in recent years.** The minimum wage was increased by 17.5 percent in 2017 and 20 percent in 2019. It has risen by 90 percent in nominal terms, and 83 percent in real terms, since it was adopted in 2012, but the main part of these increases took place in recent years (ILO (2021)).

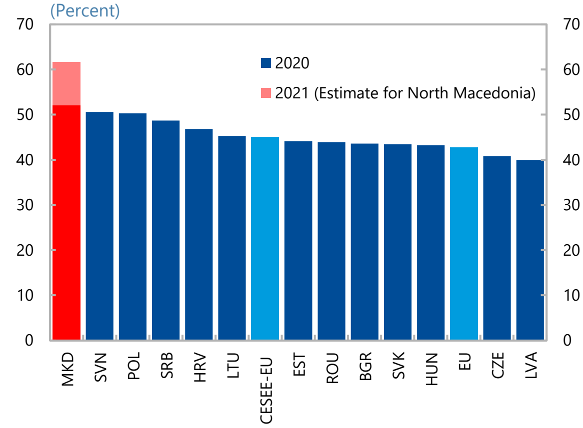
2. **Relative to the average wage, the minimum wage in North Macedonia is high by European standards.** With an ad hoc rise of 18.5 percent in the minimum wage, and assuming average wages rise by 5 percent, the ratio of the minimum-to-average wages would increase to 62 percent[1] and likely closer to 80 percent relative to the median wage.[2] While other countries in the region have announced increases in minimum wages,[3] the ratio would be 30 percent higher than in the EU27 of 42.7 percent, and higher than the CESEE-EU average.

Wages and Productivity Growth
(Index, 2012=100)



Sources: Eurostat; SSO; and IMF staff calculations.

Minimum Wage to Gross Average Wage
(Percent)



Sources: Eurostat; SSO; and IMF staff calculations.

[1] Since 2018, gross wages are recorded through administrative sources, which limits the potential overestimation of the ratio in case of underreporting. The wage levels in the informal sector may still affect the accuracy of the ratio.

[2] Projecting 2020 wage distribution data suggests that the median net wage was between 21–23,000 denars in 2021, indicating that the proposed 18,000 denar minimum net wage would be above 80 percent of the median net wage.

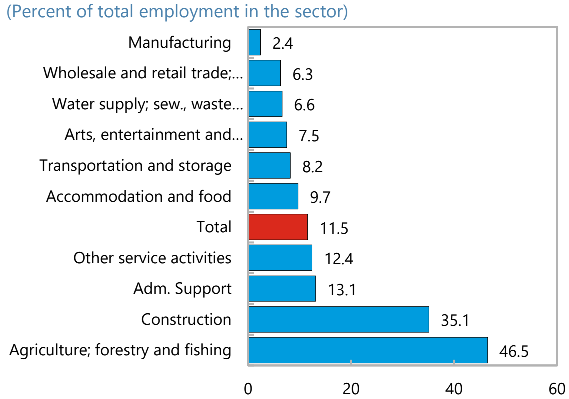
[3] The minimum wage is proposed to rise by 7 percent in 2022 and 33.3 percent by 2025 in Albania, by 42 percent by January 2022 in Kosovo, by 13 percent from October 2021 and 81 percent in 2022 in Montenegro, and by 10 percent by January 2022 in Serbia.

3. The rise in the minimum may reduce in-work poverty, but likely not overall poverty, and risks increasing informality. While a higher minimum wage can reduce poverty among the working population, it may not be effective in reducing overall poverty because most of those at risk of poverty are not working or working in the informal sector. Informal employment was 13.6 percent of total employment in North Macedonia in 2020. The effect of a rise is likely to be smaller for informal workers, where the risk of poverty is high, and which stand to benefit from a "lighthouse effect" only.[4] It may also be that a rise in the minimum wage formalizes previous "envelope payments", which may also explain why employment has not been negatively impacted, and informality has not increased, but this is difficult to detect. Minimum wage hikes should be accompanied by measures to reduce informal employment and strengthen tax compliance.

4. The minimum wage sets a floor for wages and shifts employees previously below the wage distribution above the new floor. There is some evidence of clustering around the minimum wage floor, especially in sectors that have a high concentration of wage earners close to the minimum wage, such as manufacturing, construction, the trade sector, transportation, accommodation, and food services, as well as administration, and other support services. For those sectors, the recent rises in the minimum wage were binding for 60–70 percent of wage earners compared to the initial wage distribution in 2014.

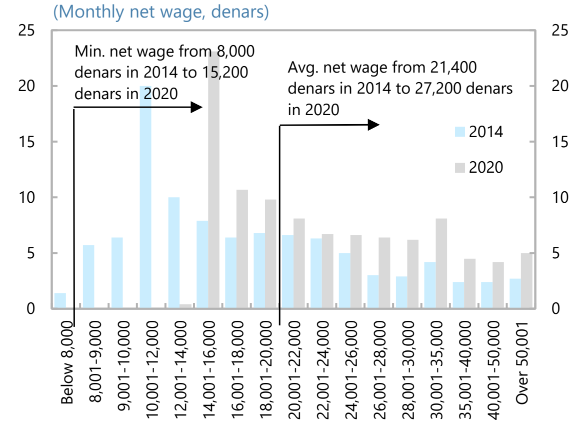
5. Substantial rises in the minimum wage likely also impact other wages. Studies find that a rise in the minimum wage leads mainly to wage compression, with wages adjusting mainly at the

Informal Employment Across Sectors
(Percent of total employment in the sector)



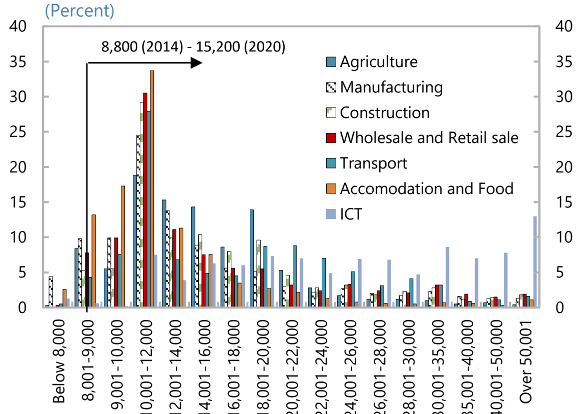
Sources: ILO; and IMF staff calculations.
Note: Total denotes the share of infomal employment out of total employment.

Wage Distribution (All Sectors)
(Monthly net wage, denars)



Sources: SSO; and IMF staff calculations.

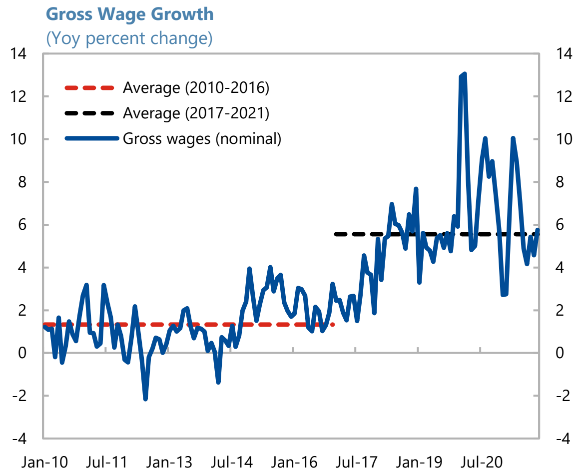
Wage Distribution Across Sectors, 2014
(Percent)

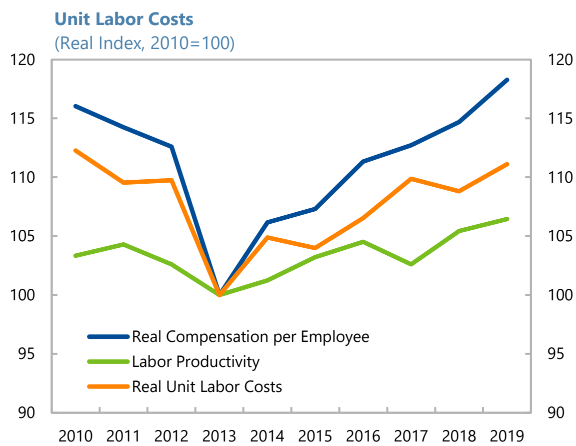


Sources: SSO; MoF; and IMF staff calculations.

[4] The literature describes the "lighthouse effect" on informal wages as a signal effect given to wage setting in the informal sector through either wage demands or labor shifts (IMF (2019)).

lower end of the wage distribution to the new floor for the minimum wage (ILO (2019)). A recent study in North Macedonia found a positive impact on average wages, but that firms in the past had been able to mainly absorb higher labor costs through higher productivity, and lower employment in some sectors (Jovanovic and Naumovski (2021)). The national minimum wage may have spillovers on other wages through the coefficient schemes in collective wage agreements (ILO (2021)). Although the coefficient scheme is in practice in limited use, there may still be an unofficial skill premium for higher wage earners, especially given labor shortages for skilled labor. Anecdotal evidence suggests that the large rises in the minimum wage over time impact the entire wage distribution. Substantial rises in the minimum wage could have an impact on other wages, and the pass-through could be around 0.3–0.5 (IMF (2020)).





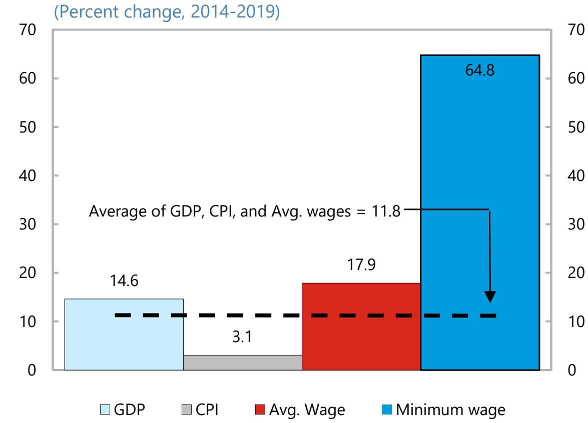
Sources: SSO (National Accounts); and IMF staff calculations.

6. There is little evidence of a negative impact on employment, but the level of minimum wages is increasingly binding on a larger employment share. In recent years (2020 being an exception), North Macedonia has experienced positive employment growth. This is the case across sectors, although there is an early indication up to 2018 that employment growth was lower in sectors with compensation growth significantly outpacing productivity growth. As the minimum wage was subject to large ad hoc rises in 2017 and 2019, in addition to the announced hike in 2021, it has become increasingly binding on the wage distribution and companies. With other costs also rising substantially, it may be increasingly difficult to absorb rising labor costs internally, and a negative employment effect, or a larger pass-through to end-prices, might be more pronounced going forward.

7. Wage and compensation growth has outpaced productivity growth by a significant margin since 2014. Real unit labor costs rose on average by 1.8 percent between 2014 and 2019, reflecting an annual average growth of 2.9 percent in real compensation per employee and annual average labor productivity growth of 1.1 percent. The higher growth rate of average wages kicked in after 2014 at the same time as the initial ad hoc rise in the minimum wage, which was followed by two other large ad hoc rises in 2017 and 2019. Although one can also argue that there was a catch-up in wages relative to productivity growth in the early 2000s, over time, such divergence between wage growth and productivity growth may create inflation pressures, and hurt competitiveness.

8. Minimum wages are outpacing the minimum wage-setting mechanism by a significant margin. Between 2014, when the large increases in the minimum wage began, and 2019, the minimum wage increased by 64.8 percent, while average wages grew by 17.9 percent. The indicative wage-setting mechanism for the minimum wage, which is the average of real GDP growth, CPI inflation, and average wage growth, suggests the minimum wage should have risen by 11.8 percent over the same period. During this period, average wages may also have been impacted by net emigration, a declining labor force, and lower unemployment. More recently, wages may also have been positively influenced by a government subsidy on contributions from compulsory social insurance because of salary increases, which was implemented from 2019.

Wage Mechanism and Minimum Wages
(Percent change, 2014-2019)



Sources: Haver Analytics; SSO; and IMF staff calculations.

9. The minimum wage-setting mechanism should be clearly defined and ensure wage sustainability and flexibility. The wage-setting mechanism should ensure medium-term wage sustainability by also using labor productivity as a guide for suggested wage developments. Further, the mechanism should ensure enough flexibility for wages, including the minimum wage, to adjust to a negative economic shock, which is particularly important in a pegged exchange rate regime. The wage mechanism currently has some flexibility via GDP, but it is limited, and in practice, the floor for minimum wage growth is zero.

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Annex IV. Risk Assessment Matrix[1]

Source of Risks	Relative Likelihood	Impact If Realized	Recommended Policy Response
Global			
Prolonged Global resurgence of the Covid-19 pandemic	Medium	Medium • Potential setback to global trade and mobility could lower exports and net private transfers (remittances)	• Adopt a slower pace of fiscal consolidation, and apply flexibility in terms of spending components depending on the duration and size of the shock • Accelerate structural reforms to enhance productivity and attract FDI
De-anchoring of inflation expectations in the U.S. leads to rising core yields and risk premia	Medium	Medium • Higher debt service costs and refinancing risks • Higher euroization which could put pressure on the peg • More persistently high inflation	• Adopt a more ambitious fiscal consolidation plan to reduce financing needs • Tighten monetary policy to strengthen confidence in the exchange rate peg, if needed
Rising commodity prices amid bouts of volatility	Medium	Medium • Risks of second-round effects • Terms of trade deterioration • Dampened consumption and investment activity	• Support vulnerable households • Implement public investment and structural policies to support the green transition and lower dependence on energy imports, especially fossil fuels
Country-specific			
Negative evolution in the Covid-19 pandemic amid low vaccination coverage	High	Medium • Dampen the evolution of net private transfers (remittances) • Dampen consumption and investment growth given rise in uncertainty and possible restrictions	• Accelerate efforts to increase vaccination rates, which are trailing EU vaccination rates • Stand ready to adopt a slower pace of fiscal consolidation, depending on the size of the shock
Persistent elevation in consumer price inflation with clear	Medium	Medium • Possible deterioration in competitiveness due to further rise in relative unit labor costs • Deterioration in FDI inflows	• Tighten monetary policy if there is a large and persistent inflation differential with the euro area, or severe pressures on the exchange rate

[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 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.

Source of Risks	Relative Likelihood	Impact If Realized	Recommended Policy Response
second-round effects		• Higher sovereign borrowing costs • Some pressure on the peg	• Take advantage of any upside surprises to domestic demand to consolidate faster • Accelerate structural reform efforts to increase the labor force and the flexibility of the labor market • Accelerate structural reforms to enhance productivity
Renewed political instability, triggered for example by further 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
Virtuous cycle following positive EU decision on a date for opening accession	Medium	Medium • A stronger push for structural reforms and higher FDI inflows which could lift both near- and medium-term growth	• Accelerate implementation of the EU's Urgent Reform Priorities to benefit most from the opening of accession negotiations
Full implementation of the government's investment plan	Medium	Medium • Significant impact on investment activity. Short-term impact on aggregate demand. Medium-term impact on potential growth	• Adopt credible medium-term framework • Steadfast implementation of PIMA recommendations

Annex V. Policy Measures in Response to the Pandemic

Table 1. North Macedonia: Selected Policy Responses

Fiscal	Monetary	Financial
• Wage subsidies • Investment incentives • Financial support for low-income households • Subsidized loans and loan guarantees for firms • Tax deferrals • Sector-specific support	• Policy rate cut by a cumulative 75 basis points • Central bank bills reduced by 60 percent • Repo line established with the ECB	• Regulatory flexibility supporting bank restructuring of loans • Temporary relaxation of non-performing loan criteria • Deduction in the reserve requirement for new and restructured loans

Table 2. North Macedonia: Fiscal Policy Measures

	MKD billion	Percent of GDP
Above the line measures		
First package (March 2020)		
Income tax deferrals (March–July)	0.1	0.0
Subsidies on social security contributions (April–June)	0.2	0.0
Second package (March 2020)		
MKD 14,500 wage subsidies (April–June)	5.2	0.8
Social assistance for workers in the informal sector	0.1	0.0
Third package (May 2020)		
MKD 3,000–9,000 payment vouchers for selected groups	1.6	0.2
MKD 6,000 tourism vouchers for minimum wage workers	0.4	0.1
MKD 6,000 contribution to tuition fees	0.4	0.1
Incentives through law on financial support of investments	1.1	0.2
Loans and loan guarantees (budget contribution)	0.9	0.1
Incentives for grape processors and wineries	0.5	0.1
Other (including extra unemployment benefits, bonuses for medical staff, and other sector-specific support)	0.6	0.1
Fourth package (September 2020)		
MKD 14,500–21,776 wage subsidies (October–December)	3.3	0.5
MKD 6,000 payment vouchers for selected groups	1.5	0.2

Table 2. North Macedonia: Fiscal Policy Measures (concluded)

New VAT rate for catering sector	0.5	0.1
Other (including additional tax deferrals, support for hospitality and tourism sectors, VAT-free weekend, and other sector-specific support)	0.5	0.1
Fifth package (February 2021)		
MKD 14,500–21,776 wage subsidies (February-March)	1.6	0.2
Loans and loan guarantees (budget contribution)	0.9	0.1
Incentives through law on financial support of investments	0.9	0.1
Creation of dedicated fund for export-oriented firms	0.6	0.1
Temporary reduction of custom duties and harmonization with EU/WTO rules	1.0	0.1
Other (including additional tax deferrals, support for technological development, tobacco growers and other sector-specific support)	1.5	0.2
Sixth package (April 2021)		
Support for catering sector	0.6	0.1
Other sector-specific support	0.4	0.1
Health sector		
Specific pandemic-related funds	4.2	0.6
Below the line measures		
Loans and loan guarantees	20.0	3.0

Sources: MoF; and IMF staff estimates.

Annex VI. External Sector Assessment

Overall Assessment: *In 2021, the external position of North Macedonia was broadly in line with the level implied by fundamentals and desirable policies.*

Potential Policy Responses: *The NBRNM's policy of maintaining a stable exchange rate with the euro as an intermediate target (pursuant to the main objective of price stability) is expected to continue to provide an anchor of stability for the economy, as it has done since the country's independence. The authorities should continue to foster FDI inflows through strong macroeconomic policies and governance reforms.*

Foreign Assets and Liabilities: Position and Trajectory

Background. The net international investment position (NIIP) is projected at -63.9 percent of GDP at end-2021 (up from 64.9 percent in 2020), after deteriorating from -57.6 percent in 2019. This change was mostly driven by an increase in portfolio investment in the form of debt. Gross foreign asset and liability positions are projected at 58.2 percent of GDP and 122.1 percent of GDP for end-2021, respectively.

Assessment. The large negative NIIP poses some risks to external sustainability, though it is mitigated by the large share of Foreign Direct Investment (FDI) (representing 83.4 percent of the NIIP and 50.3 percent of external liabilities). The NIIP is projected to continue to improve over the medium term (-56.4 percent of GDP by 2026).

2021 (% GDP)	NIIP: -63.9	Gross Assets: 58.2	Debt Assets: 0.4	Gross Liabilities: 122.1	Debt Liabilities: 19.7

Current Account

Background. After narrowing strongly during the first half of 2021, the current account (CA) deficit is projected to remain at 3.5 percent of GDP in 2021, mainly due to upward surprises in import prices, including energy and food prices. Notwithstanding these developments, exports of services and remittances are projected to have recovered their pre-pandemic share of GDP, perhaps on the back of some pent-up demand. Over the medium term, as trade recovers and remittances growth remains slower than output growth, the CA deficit is expected to narrow to 2.6 percent of GDP by 2026.

Assessment. The EBA-lite CA model suggests a multilaterally consistent cyclically-adjusted CA norm of - 4.2 percent of GDP for 2021, which is higher than the projected cyclically-adjusted CA balance of - 3.5 percent of GDP. This suggests a CA gap of 0.7 percent of GDP, implying a small real effective exchange rate (REER) undervaluation of 1.4 percent. However, in the past, North Macedonia has persistently run current account balances stronger than the EBA-lite estimate of the norm, which has not resulted in upward pressures on its exchange rate. In the context of the de facto peg, such pressures would have materialized as an overaccumulation of reserves, which have instead hovered around 100 percent of the ARA metric. Staff therefore assess the medium-term current account position to be in equilibrium.

Republic of North Macedonia	CA model (2020)	CA model (2021p)	REER model
CA-Actual	**-3.5**	**-3.5**	
Cyclical contributions (from model) (-)	0.4	0.4	
COVID-19 adjustor (+) 1/	0.4	0.4	
Additional temporary/statistical factors (+)	0.0	0.0	
Natural disasters and conflicts (-)	0.0	-0.1	
Adjusted CA	**-3.4**	**-3.5**	
CA Norm (from model) 2/	**-3.8**	**-4.2**	
Adjustments to the norm (+)	0.0	0.0	
Adjusted CA Norm	**-3.8**	**-4.2**	
CA Gap	**0.4**	**0.7**	**0.0**
o/w Relative policy gap	3.0	2.9	
Elasticity	-0.48	-0.48	
REER Gap (in percent)	**-0.8**	**-1.4**	**0.0**

1/ Additional cyclical adjustment to account for the temporary impact of the pandemic on tourism (0.37 percent of GDP).

2/ Cyclically adjusted, including multilateral consistency adjustments.

Real Exchange Rate

Background. The CPI-based REER had a mild appreciation in 2020 (1.49 percent increase) as the NBRNM successfully maintained the de facto peg to the euro. It then depreciated slightly (2.19 percent) in the first eleven months of 2021 as pressures on the exchange rate abated.

Assessment. The REER EBA-lite approach points to no misalignment in 2021 (0 percent), close to the 1.4 percent undervaluation suggested by the CA model.

Capital and Financial Accounts: Flows and Policy Measures

Background. North Macedonia experienced net capital inflows in both 2020 and 2021 as the interruption in FDI was more than compensated by a large Eurobond issuance, a purchase under the Rapid Financing Instrument, lower acquisitions of foreign assets, and the accumulation of trade credit.

Assessment. Capital and financial flows are expected to still be dominated by FDI flows and portfolio flows due to sovereign issuance. Other private flows have been small until the pandemic amid stable external corporate borrowing and the reduction in banks' external funding. In 2021, there were no significant changes in capital flow measures (CFMs), which remain in line with the IMF's Institutional View on the Liberalization and Management of Capital Flows.

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 are projected to cover 109 percent of the ARA metric and 135 percent of short-term debt at end-2021. Coverage improved in 2021 as a result of the SDR allocation and is expected to remain broadly stable around that level (103 percent and 153 percent, respectively, by 2026).

Annex VII. Public Debt Sustainability Analysis

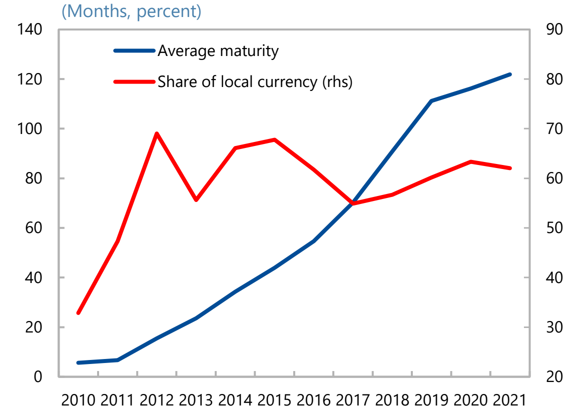
Public debt is projected to peak at 63 percent of GDP, reflecting the impact of the pandemic crisis, before gradually declining over the medium term. Debt is assessed as sustainable under staff's baseline projections. However, high gross financing needs and potential macroeconomic shocks constitute major risks, and decisive policy action to rebuild fiscal space and place debt more firmly on a downward path would reduce vulnerabilities.

Background

1. **Sizeable policy support helped dampen the economic impact of the pandemic crisis, but also led to higher public sector debt.** Nonfinancial public sector debt, which includes guaranteed debt of state-owned enterprises, increased to close to 60 percent of GDP in 2020, an 11- percentage point rise from a year earlier.[1] In the decade leading up to the pandemic, public debt had more than doubled, on the back of high primary deficits and rapid increases in the debt of state-owned enterprises.

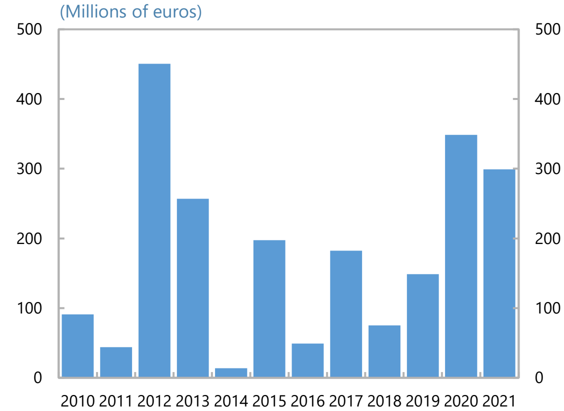
2. **Nevertheless, the composition of debt continues to improve, and interest payments remain contained.** In 2021, the average maturity at issuance of outstanding domestic government securities increased by a further 6 months, to 10 years and 2 months, reflecting continued reliance on long-term borrowing, despite elevated uncertainty related to the pandemic. The share of securities denominated in local currency dropped slightly from 2020 but remained above pre-crisis levels, owing to new debt being predominantly issued in local currency. Auction rates across most segments remained on a declining path. Overall, net domestic issuance in 2021 was €300 million, below the level in 2020 but still significantly higher than in previous years. Externally, in addition to a purchase under the Rapid Finance Instrument in April 2020 (about €166 million), the country placed two €700 million Eurobonds, respectively in May 2020 and March 2021, with the latter at a historically low coupon of 1.625 percent. As of end-2020, about 78 percent of public debt was denominated in foreign currency.

Average Maturity and Currency Composition of Debt
(Months, percent)



Sources: MoF; and IMF staff calculations.

Net Domestic Issuance
(Millions of euros)



Sources: MoF; and IMF staff calculations.

[1] Given the high debt of state-owned enterprises, this debt sustainability analysis presents results for both the general government and the nonfinancial public sector.

Baseline and Realism of Projections

3. The fiscal deficit is projected to narrow sharply by 2023, as the economy recovers, followed by a more gradual decrease over the medium term. The baseline scenario is underpinned by the following assumptions:

- *Real GDP growth* is projected to reach 4 percent in both 2021 and 2022, driven by expanding household consumption and investment. In the medium term, the economy is expected to grow at an annual rate close to its potential of about 3½ percent.
- *Headline inflation* accelerated to 3.2 percent in 2021 and is projected to peak at 4.3 percent in 2022, on the back of rising food and energy prices, before returning to about 2 percent in the outer years.
- *The overall fiscal deficit* reached 5.5 percent of GDP in 2021, down from 8.2 percent in 2020, and is projected to further drop to 3.5 percent by 2023. This is predicated upon a rebound in revenues and a gradual phasing out of stimulus measures. The baseline assumes no consolidation beyond 2023, in line with a conventional no-policy change scenario, implying a more gradual reduction of the deficit in the outer years, to just below 3 percent in 2026.

4. Forecast error analysis suggests no systemic bias in historical forecasts 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.

5. Under the baseline, public sector debt is set to remain below the 70 percent of GDP high-risk threshold, though with relatively high gross financing needs. General government debt is projected to further increase before stabilizing at about 55 percent of GDP in the medium term. Public debt is projected to peak at 63 percent of GDP, reflecting continued borrowing to finance public infrastructure projects, before gradually declining toward the end of the projection period. Public gross financing requirements are set to remain high, reflecting a higher post-crisis debt stock and only gradually narrowing fiscal deficits, and peak around the 15 percent benchmark in years with amortization of government Eurobonds. Domestic issuance is projected to remain, on average, close to the levels in 2020 and 2021, peaking in 2024. Baseline ratios are noticeably lower than those in the standardized alternative scenarios ("historical" and "constant primary balance"). However, the standardized scenarios assume that growth and fiscal balances remain in line with past years' observations. Since this includes the pandemic crisis with a sizeable GDP contraction and high fiscal deficit, they can be seen as downside scenarios.

Macro-Fiscal and Additional Stress Tests

6. Macroeconomic and fiscal shocks can significantly increase public debt and gross financing needs relative to the baseline. Among all stress test scenarios, North Macedonia has the highest vulnerability to the real GDP growth shock of one standard deviation in 2022–23, a combined macro-fiscal shock, as well as a contingent liability shock.[2] Under these stress test scenarios, public sector debt would rise slightly above the 70 percent of GDP high-risk benchmark in the medium term, with gross financing needs nearing 20 percent of GDP in 2023. The high sensitivity of public debt to various shocks highlights the vulnerability to shocks. At the same time, the year 2020 is not treated as an outlier in the scenarios, which influences the size of the simulated shocks (e.g., for real GDP growth and the primary balance).

7. 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-2026 would be above 68 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 70 percent in 25 percent of simulations.

Conclusion

8. The crisis has accentuated the need to create fiscal space to counter shocks and for reforms to boost growth. While still at a moderate level, public debt increased noticeably as a result of the pandemic, following steady debt accumulation before the pandemic. Gross financing needs hover around the 15 percent of GDP benchmark in the baseline scenario, and adverse shocks could push public sector debt above 70 percent of GDP. The general government primary deficit is projected to narrow to 1.5 percent of GDP by 2026, just above the debt-stabilizing primary balance. Measures to reduce the primary balance to zero would increase the space for fiscal policy to react in the event that shocks materialize. A scaling-up of investment could help boost growth but should be accompanied by improvements in public financial management to durably improve the debt outlook. Continued progress on institutional and structural issues would also help unlock the economy's growth potential and reduce its vulnerability to shocks.

9. Efforts to strengthen public debt management should continue. Regarding domestic debt, the debt management strategy should aim to strike a balance between further lengthening the average maturity of securities, increasing the share of local currency-denominated debt, and reducing interest payments, while sustaining higher issuance as planned. Deepening the secondary market would help achieve these objectives. The strategy should also continue to assess the mix of external and domestic financing with a view to maintaining overall macroeconomic stability.

[2] Stress tests include individual shocks to macro variables (real GDP growth, real interest rate, real exchange rate) and primary balance. The combined macro-fiscal shock incorporates the largest effect of individual shocks on all relevant variables (real GDP growth, inflation, primary balance, exchange rate, and interest rate). The contingent liability shock focuses on the risk of banking crises and related bailouts. It also incorporates the effects of a growth shock.

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

(in percent of GDP unless otherwise indicated)

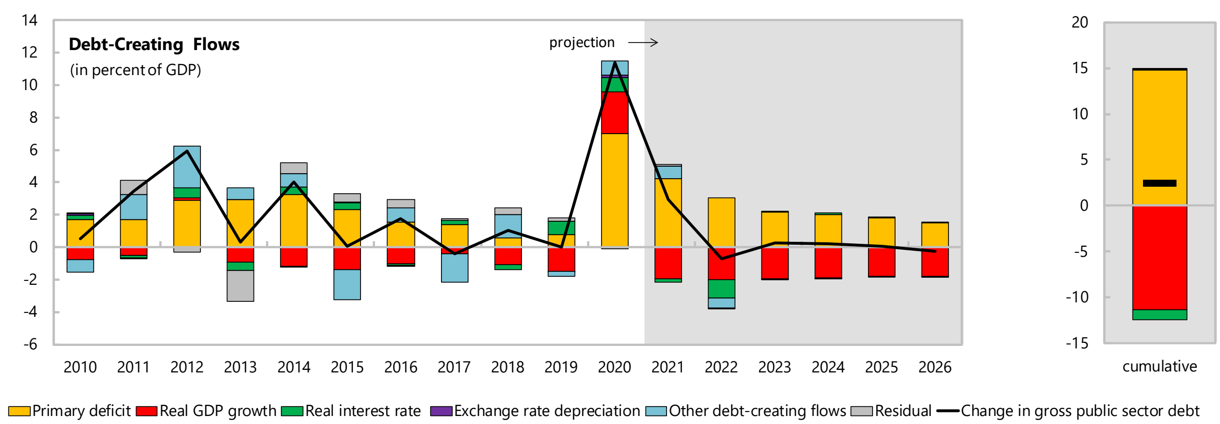
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2010-2018 [2/]	2019	2020	2021	2022	2023	2024	2025	2026
Nominal gross public debt	35.0	40.4	51.9	54.8	54.1	54.3	54.5	54.5	54.3
Public gross financing needs	13.4	9.1	19.0	16.2	10.2	13.7	10.0	13.9	14.0
Real GDP growth (in percent)	2.5	3.9	-6.1	4.0	4.0	3.8	3.7	3.5	3.5
Inflation (GDP deflator, in percent)	2.8	0.9	0.9	3.0	4.5	2.3	2.2	2.3	2.4
Nominal GDP growth (in percent)	5.3	4.8	-5.3	7.2	8.7	6.2	5.9	5.9	6.0
Effective interest rate (in percent) [4/]	3.2	3.0	2.9	2.7	2.5	2.5	2.4	2.5	2.6

As of January 20, 2022		
Sovereign Spreads		
EMBIG (bp) 3/		244
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							
	2010-2018	2019	2020	2021	2022	2023	2024	2025	2026	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	1.9	0.0	11.4	2.9	-0.7	0.2	0.2	0.0	-0.3	2.4	
Identified debt-creating flows	1.8	-0.2	11.5	2.8	-0.7	0.2	0.2	0.0	-0.3	2.4	
Primary deficit	2.0	0.8	7.0	4.2	3.1	2.2	2.0	1.8	1.5	14.8	-1.7
Primary (noninterest) revenue and grants	28.8	29.4	28.9	31.1	30.7	30.8	30.8	30.8	30.8	185.0	
Primary (noninterest) expenditure	30.8	30.2	35.9	35.3	33.7	33.0	32.8	32.6	32.3	199.8	
Automatic debt dynamics [5/]	-0.7	-0.7	3.6	-2.2	-3.1	-1.9	-1.8	-1.8	-1.7	-12.5	
Interest rate/growth differential [6/]	-0.7	-0.7	3.5	-2.2	-3.1	-1.9	-1.8	-1.8	-1.7	-12.5	
Of which: real interest rate	0.1	0.8	0.9	-0.2	-1.1	0.1	0.1	0.0	0.1	-1.1	
Of which: real GDP growth	-0.8	-1.5	2.6	-1.9	-2.0	-1.9	-1.9	-1.8	-1.8	-11.4	
Exchange rate depreciation [7/]	0.0	0.0	0.1	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.4	-0.3	0.9	0.8	-0.6	0.0	0.0	0.0	0.0	0.1	
Privatization receipts (negative)	0.0	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	-0.1	
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	0.4	-0.2	1.0	0.9	-0.6	0.0	0.0	0.0	0.0	0.2	
Residual, including asset changes [8/]	0.1	0.2	-0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.1	



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).

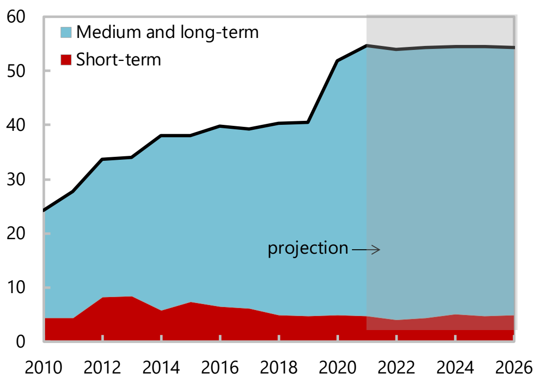
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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.

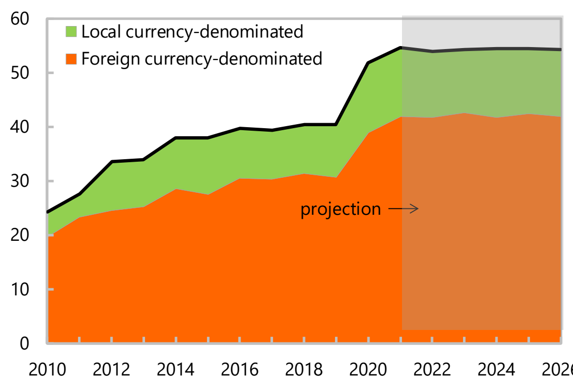
Figure 2. North Macedonia: General Government DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



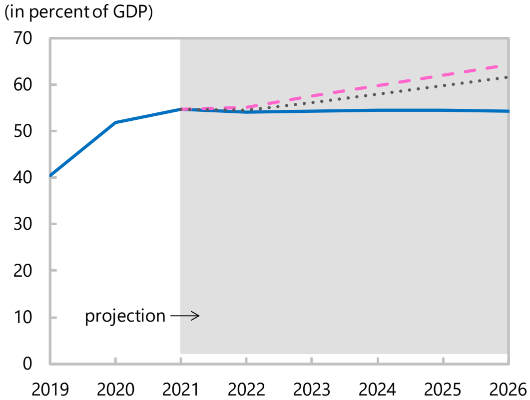
By Currency
(in percent of GDP)



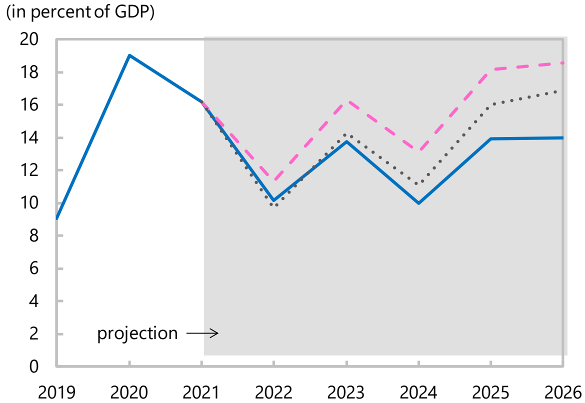
Alternative Scenarios

Baseline Historical Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



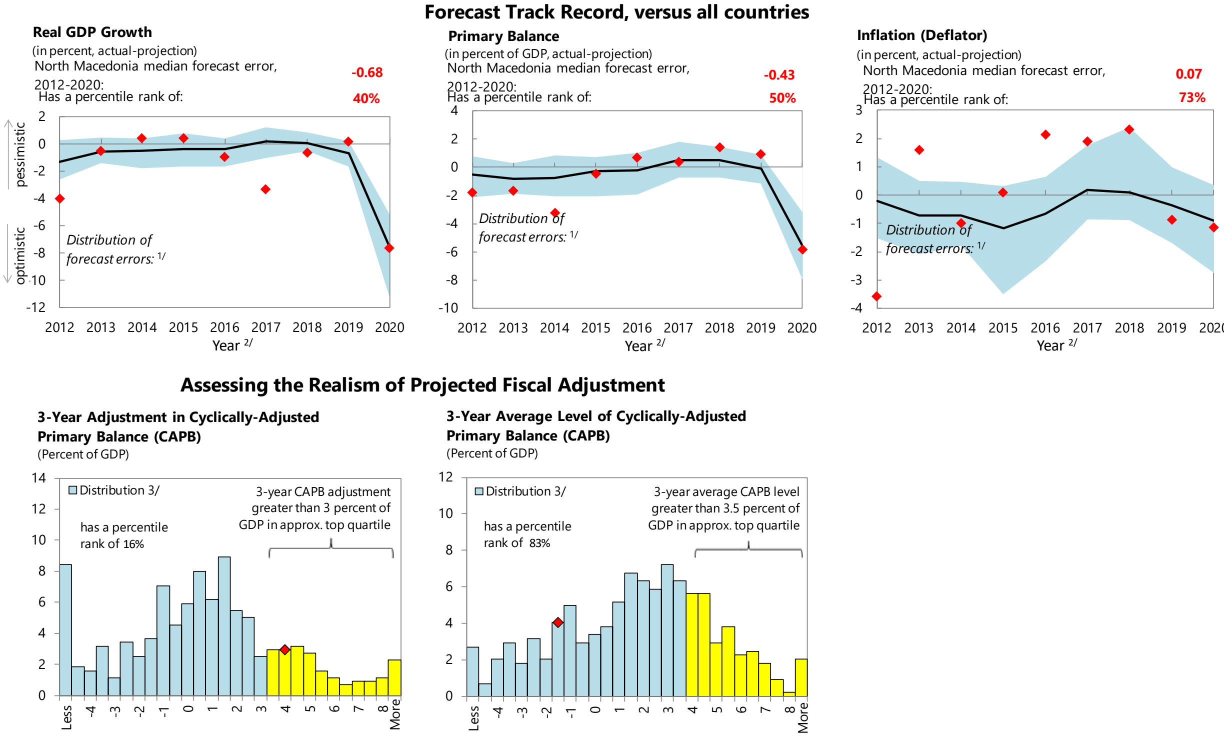
Underlying Assumptions
(in percent)

Baseline Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	4.0	4.0	3.8	3.7	3.5	3.5
Inflation	3.0	4.5	2.3	2.2	2.3	2.4
Primary Balance	-4.2	-3.1	-2.2	-2.0	-1.8	-1.5
Effective interest rate	2.7	2.5	2.5	2.4	2.5	2.6
Constant Primary Balance Scenario						
Real GDP growth	4.0	4.0	3.8	3.7	3.5	3.5
Inflation	3.0	4.5	2.3	2.2	2.3	2.4
Primary Balance	-4.2	-4.2	-4.2	-4.2	-4.2	-4.2
Effective interest rate	2.7	2.5	2.5	2.4	2.5	2.6

Historical Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	4.0	1.7	1.7	1.7	1.7	1.7
Inflation	3.0	4.5	2.3	2.2	2.3	2.4
Primary Balance	-4.2	-2.4	-2.4	-2.4	-2.4	-2.4
Effective interest rate	2.7	2.5	2.7	2.8	2.9	3.2

Source: IMF staff.

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



Source : IMF Staff.

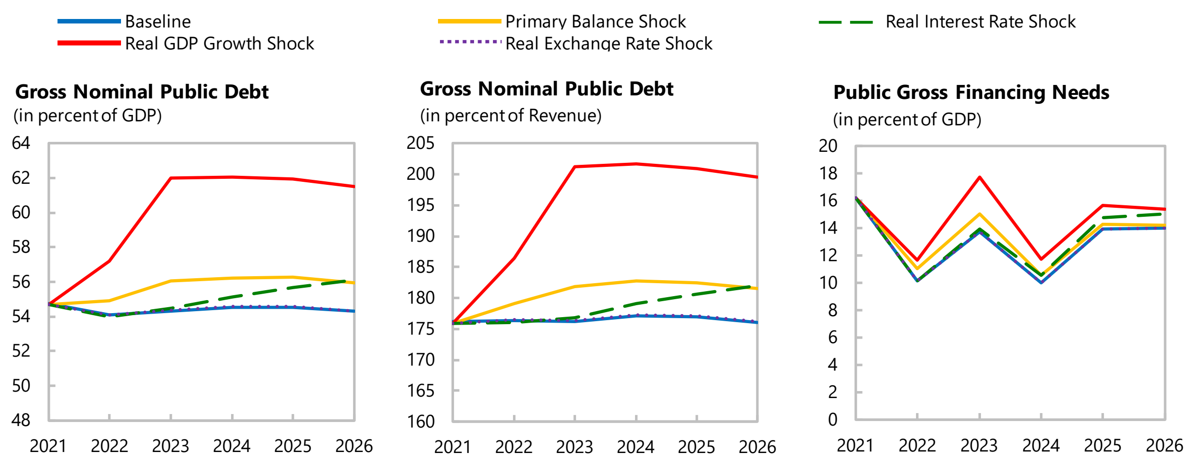
1/ Plotted distribution includes all countries, percentile rank refers to all countries.

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

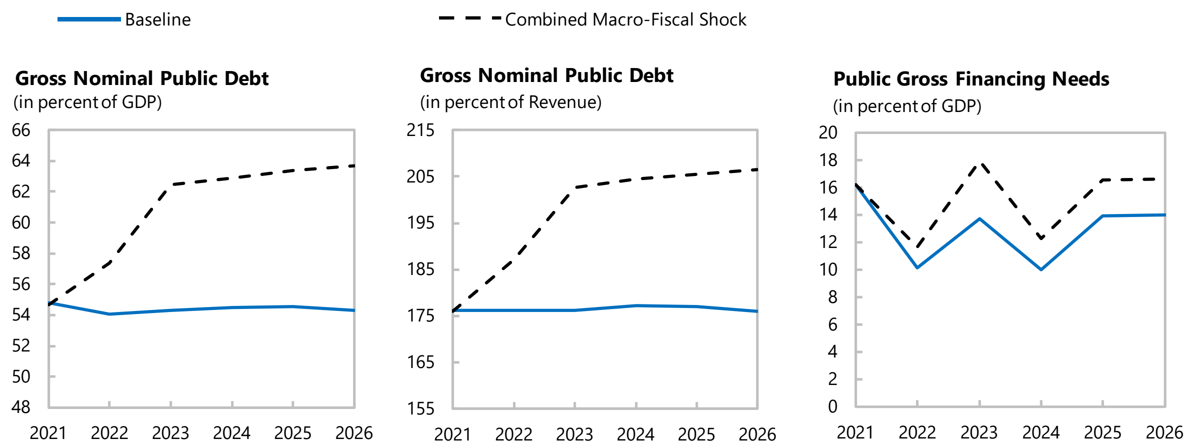
3/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

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

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2021	2022	2023	2024	2025	2026
Real GDP growth	4.0	4.0	3.8	3.7	3.5	3.5
Inflation	3.0	4.5	2.3	2.2	2.3	2.4
Primary balance	-4.2	-4.0	-3.1	-2.0	-1.8	-1.5
Effective interest rate	2.7	2.5	2.6	2.5	2.5	2.7
Real Interest Rate Shock						
Real GDP growth	4.0	4.0	3.8	3.7	3.5	3.5
Inflation	3.0	4.5	2.3	2.2	2.3	2.4
Primary balance	-4.2	-3.1	-2.2	-2.0	-1.8	-1.5
Effective interest rate	2.7	2.5	3.0	3.3	3.6	4.0
Combined Shock						
Real GDP growth	4.0	0.9	0.7	3.7	3.5	3.5
Inflation	3.0	3.7	1.6	2.2	2.3	2.4
Primary balance	-4.2	-4.3	-4.7	-2.0	-1.8	-1.5
Effective interest rate	2.7	2.5	3.0	3.4	3.6	4.1

Real GDP Growth Shock	2021	2022	2023	2024	2025	2026
Real GDP growth	4.0	0.9	0.7	3.7	3.5	3.5
Inflation	3.0	3.7	1.6	2.2	2.3	2.4
Primary balance	-4.2	-4.3	-4.7	-2.0	-1.8	-1.5
Effective interest rate	2.7	2.5	2.6	2.6	2.6	2.8
Real Exchange Rate Shock						
Real GDP growth	4.0	4.0	3.8	3.7	3.5	3.5
Inflation	3.0	4.6	2.3	2.2	2.3	2.4
Primary balance	-4.2	-3.1	-2.2	-2.0	-1.8	-1.5
Effective interest rate	2.7	2.5	2.5	2.4	2.5	2.6

Source: IMF staff.

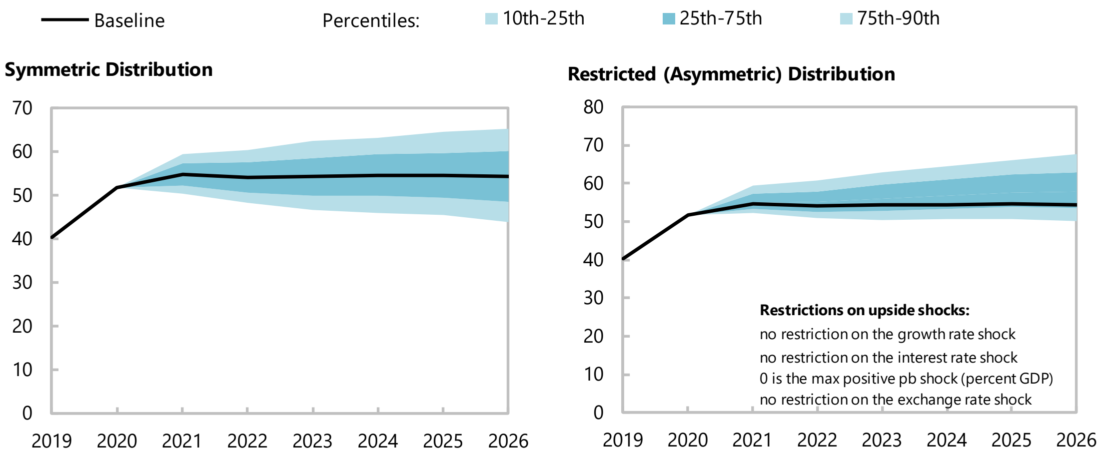
Figure 5. North Macedonia: General Government DSA—Risk Assessment

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

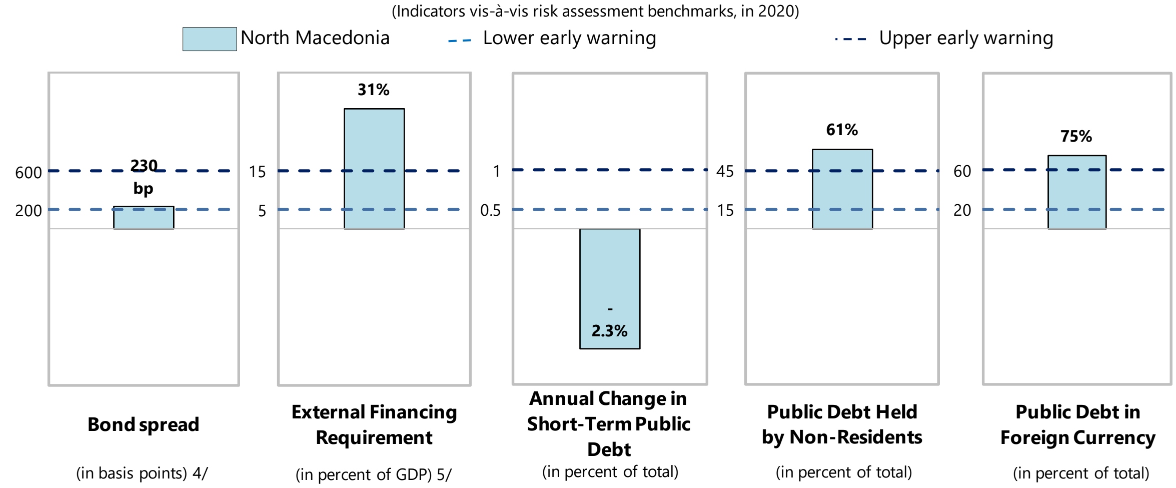
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2020)



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, 22-Oct-21 through 20-Jan-22.

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 DSA—Baseline Scenario

(in percent of GDP unless otherwise indicated)

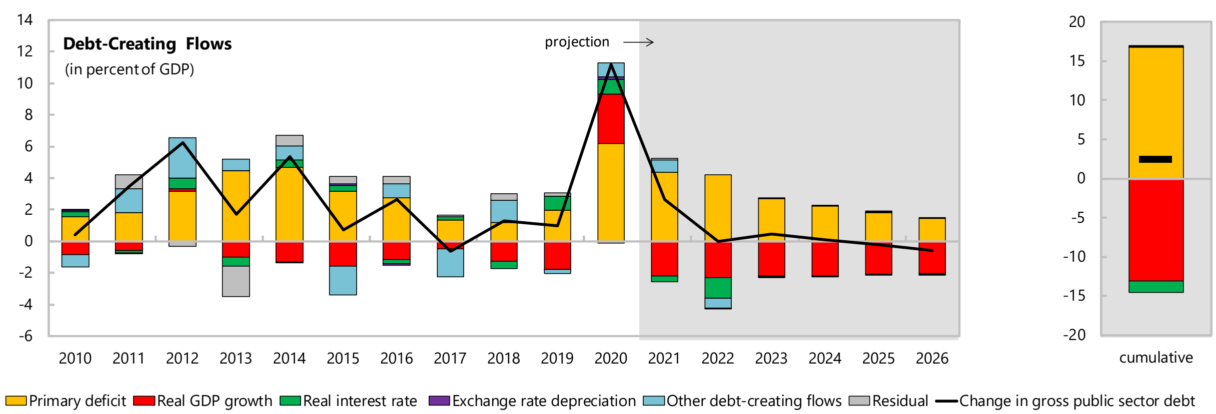
Debt, Economic and Market Indicators [1]

	Actual			Projections					
	2010-2018 [2]	2019	2020	2021	2022	2023	2024	2025	2026
Nominal gross public debt	39.9	48.4	59.6	62.2	62.2	62.7	62.7	62.5	61.9
Public gross financing needs	14.6	10.8	19.2	17.1	12.3	15.3	11.2	15.0	14.8
Real GDP growth (in percent)	2.5	3.9	-6.1	4.0	4.0	3.8	3.7	3.5	3.5
Inflation (GDP deflator, in percent)	2.8	0.9	0.9	3.0	4.5	2.3	2.2	2.3	2.4
Nominal GDP growth (in percent)	5.3	4.8	-5.3	7.2	8.7	6.2	5.9	5.9	6.0
Effective interest rate (in percent) [4]	3.0	2.8	2.6	2.5	2.4	2.4	2.4	2.4	2.6

As of January 20, 2022		
Sovereign Spreads		
EMBIG (bp) 3/		244
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							
	2010-2018	2019	2020	2021	2022	2023	2024	2025	2026	cumulative	debt-stabilizing primary balance [9]
Change in gross public sector debt	2.3	1.0	11.2	2.7	0.0	0.4	0.1	-0.2	-0.6	2.4	
Identified debt-creating flows	2.3	0.8	11.3	2.6	0.0	0.4	0.1	-0.2	-0.6	2.3	
Primary deficit	2.7	2.0	6.2	4.4	4.2	2.7	2.2	1.8	1.5	16.8	-2.0
Primary (noninterest) revenue and grants	28.8	29.4	28.9	31.1	30.7	30.8	30.8	30.8	30.8	185.0	
Primary (noninterest) expenditure	31.5	31.4	35.1	35.5	34.9	33.5	33.0	32.7	32.3	201.8	
Automatic debt dynamics [5]	-0.8	-0.9	4.2	-2.6	-3.6	-2.2	-2.1	-2.1	-2.0	-14.6	
Interest rate/growth differential [6]	-0.8	-0.9	4.1	-2.6	-3.6	-2.2	-2.1	-2.1	-2.0	-14.6	
Of which: real interest rate	0.1	0.9	0.9	-0.4	-1.3	0.0	0.1	0.0	0.0	-1.5	
Of which: real GDP growth	-0.9	-1.8	3.1	-2.2	-2.3	-2.2	-2.2	-2.1	-2.1	-13.1	
Exchange rate depreciation [7]	0.0	0.0	0.1	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.4	-0.3	0.9	0.8	-0.6	0.0	0.0	0.0	0.0	0.1	
Privatization receipts (negative)	0.0	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	-0.1	
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	0.4	-0.2	1.0	0.9	-0.6	0.0	0.0	0.0	0.0	0.2	
Residual, including asset changes [8]	0.1	0.2	-0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.1	



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 $ae(1+r)$.

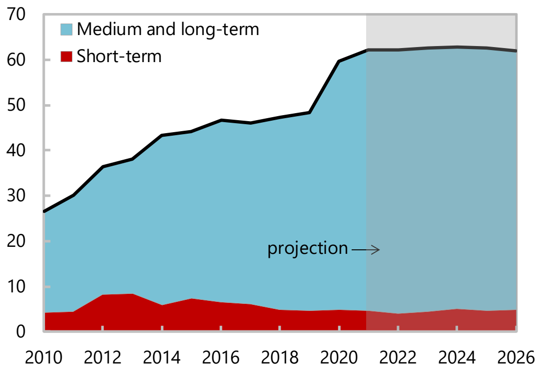
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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.

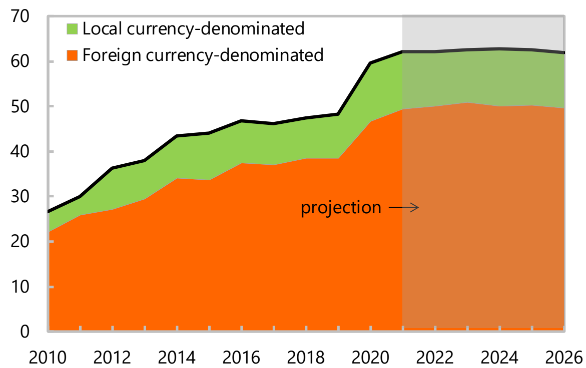
Figure 7. North Macedonia: Public Sector DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)

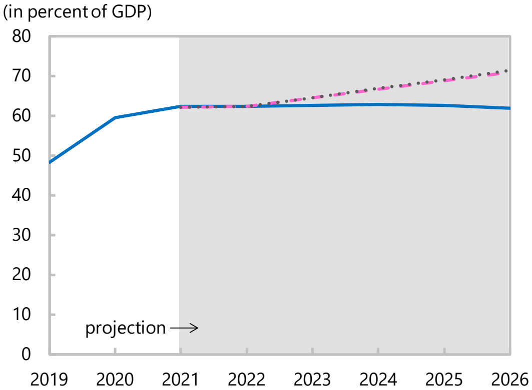


By Currency
(in percent of GDP)

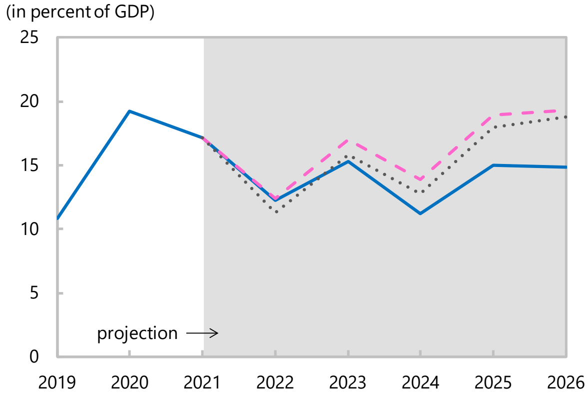


Alternative Scenarios

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

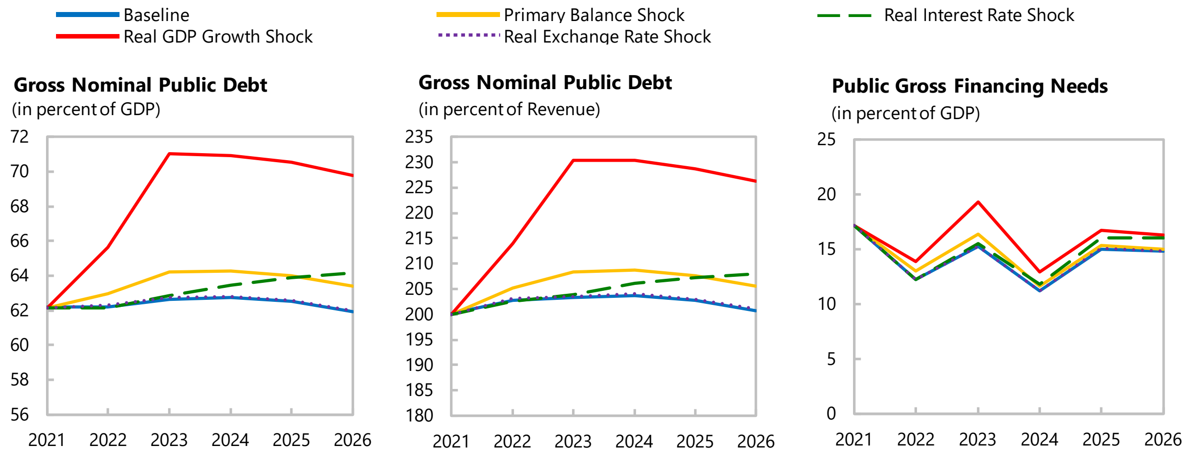
Baseline Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	4.0	4.0	3.8	3.7	3.5	3.5
Inflation	3.0	4.5	2.3	2.2	2.3	2.4
Primary Balance	-4.4	-4.2	-2.7	-2.2	-1.8	-1.5
Effective interest rate	2.5	2.4	2.4	2.4	2.4	2.6
Constant Primary Balance Scenario						
Real GDP growth	4.0	4.0	3.8	3.7	3.5	3.5
Inflation	3.0	4.5	2.3	2.2	2.3	2.4
Primary Balance	-4.4	-4.4	-4.4	-4.4	-4.4	-4.4
Effective interest rate	2.5	2.4	2.4	2.4	2.4	2.6

Historical Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	4.0	1.7	1.7	1.7	1.7	1.7
Inflation	3.0	4.5	2.3	2.2	2.3	2.4
Primary Balance	-4.4	-3.1	-3.1	-3.1	-3.1	-3.1
Effective interest rate	2.5	2.4	2.6	2.7	2.8	3.1

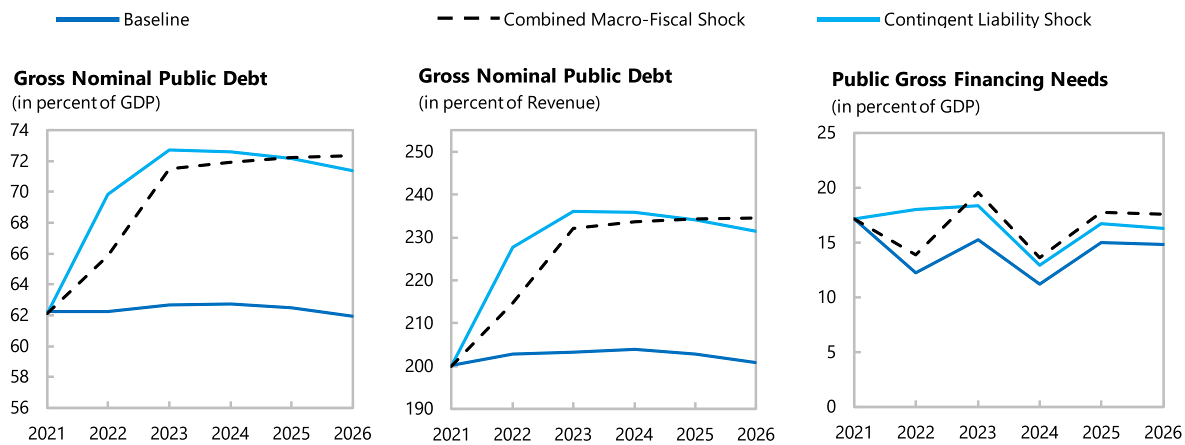
Source: IMF staff.

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

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2021	2022	2023	2024	2025	2026
Real GDP growth	4.0	4.0	3.8	3.7	3.5	3.5
Inflation	3.0	4.5	2.3	2.2	2.3	2.4
Primary balance	-4.4	-5.0	-3.5	-2.2	-1.8	-1.5
Effective interest rate	2.5	2.4	2.5	2.4	2.5	2.6
Real Interest Rate Shock						
Real GDP growth	4.0	4.0	3.8	3.7	3.5	3.5
Inflation	3.0	4.5	2.3	2.2	2.3	2.4
Primary balance	-4.4	-4.2	-2.7	-2.2	-1.8	-1.5
Effective interest rate	2.5	2.4	2.9	3.3	3.6	4.0
Combined Shock						
Real GDP growth	4.0	0.9	0.7	3.7	3.5	3.5
Inflation	3.0	3.7	1.6	2.2	2.3	2.4
Primary balance	-4.4	-5.6	-5.3	-2.2	-1.8	-1.5
Effective interest rate	2.5	2.4	2.9	3.3	3.6	4.1

Real GDP Growth Shock	2021	2022	2023	2024	2025	2026
Real GDP growth	4.0	0.9	0.7	3.7	3.5	3.5
Inflation	3.0	3.7	1.6	2.2	2.3	2.4
Primary balance	-4.4	-5.6	-5.3	-2.2	-1.8	-1.5
Effective interest rate	2.5	2.4	2.5	2.6	2.6	2.7
Real Exchange Rate Shock						
Real GDP growth	4.0	4.0	3.8	3.7	3.5	3.5
Inflation	3.0	4.6	2.3	2.2	2.3	2.4
Primary balance	-4.4	-4.2	-2.7	-2.2	-1.8	-1.5
Effective interest rate	2.5	2.4	2.4	2.4	2.4	2.6
Contingent Liability Shock						
Real GDP growth	4.0	0.9	0.7	3.7	3.5	3.5
Inflation	3.0	3.7	1.6	2.2	2.3	2.4
Primary balance	-4.4	-9.6	-2.7	-2.2	-1.8	-1.5
Effective interest rate	2.5	2.6	2.7	2.6	2.6	2.7

Source: IMF staff.

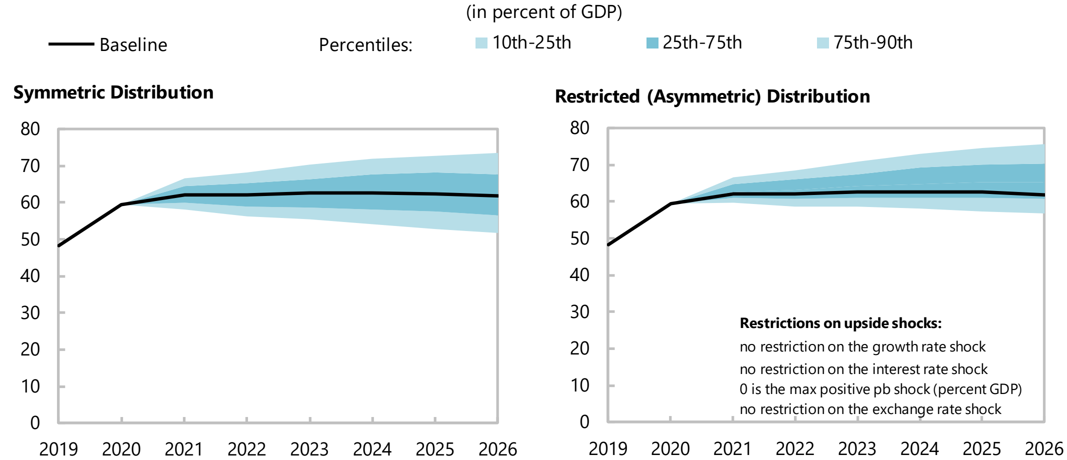
Figure 9. North Macedonia: Public Sector DSA—Risk Assessment

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

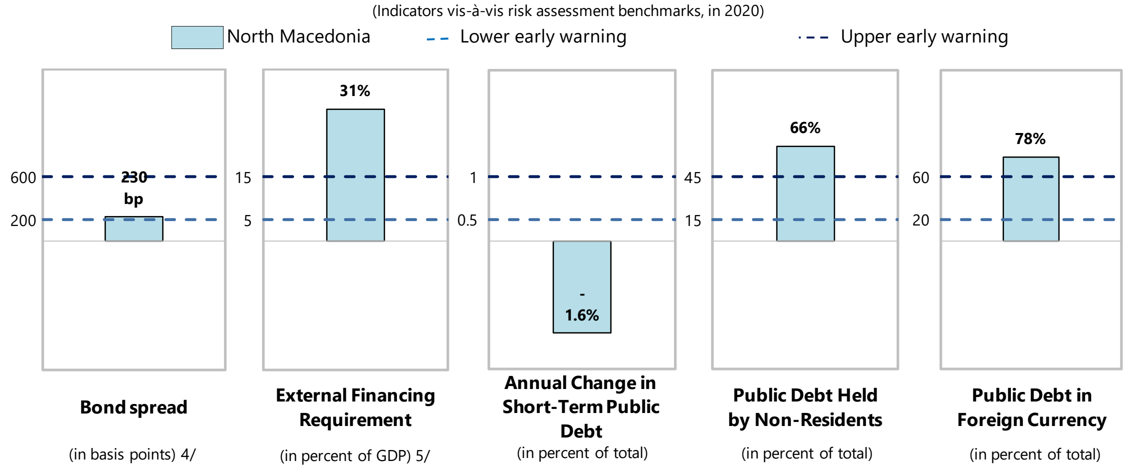
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2020)



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, 22-Oct-21 through 20-Jan-22.

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.

Annex VIII. Financial Legislative Agenda and Implementation of Key 2018 FSAP Recommendations

North Macedonia has a substantive agenda of legislative changes to safeguard financial stability and strengthen the financial safety net. This new or amended legislation is expected to address many of the recommendations of the IMF's 2018 Financial Sector Assessment Program (FSAP) and ensuring swift approval is essential. Below is an overview of the financial legislative agenda, and the authorities' actions in response to the key 2018 FSAP recommendations.

- **The Financial Stability Law will strengthen policy coordination on macroprudential policy and crisis management.** The Financial Stability Law regulates the goals, status, tasks, and manner of work of the Financial Stability Committee, as well as the instruments and implementation of macroprudential policy. The law identifies the NBRNM as the competent authority on macroprudential policy. It has been approved by the government and is currently in the Parliament for adoption.

- **The Bank Resolution Law will aim to modernize the framework for bank resolution.** The authorities are currently drafting the law, which will establish a new framework for the recovery and resolution of banks and provides instruments that could be used by the competent bank resolution body, the NBRNM, in line with EU law (the Bank Recovery and Resolution Directive, BRRD). Since the banking system is largely funded by household deposits, it will be critical to calibrate adequate bailinable instruments given the intention to align the law with the BRRD. The law is expected to be submitted to parliament by end 1H-22.

- **Amendments to the Law on Deposit Insurance will aim to align deposit insurance with the EU.** The authorities are currently preparing the draft law, with the aim to move closer to EU law with respect to the size of deposits covered as well as the types covered and extending it to legal entities. To the extent that the Constitution allows, the law should consider introducing depositor preference. The law is expected to be adopted by end 1H-22.

- **The amendments to the Banking Law also aim for alignment with EU law, including on bank supervision and prudential standards.** The draft, which is currently being developed, regulates the activity of credit institutions and the prudential supervision and requirements for credit institutions and investment firms. It is important that the law preserves the operational independence of the NBRNM on matters related to operational supervisory decisions, such as bank licensing and resolution. The amendments are expected to be adopted during 2022.

- **Finally, the National Bank Law will be amended to align it with the other set of draft laws as needed.** This includes enhancing the institutional setup for macroprudential policy as well as establishing the NBRNM as competent resolution authority. The amendments are expected to be adopted in 1H-22.

FSAP Recommendations	Time	Authorities' Actions
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 on household income to facilitate systemic risk monitoring. The Ministry of Finance is considering these amendments. The amended NBRNM Law is expected to be submitted to parliament in early 2022.
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 Decision on risk management requires banks to implement an Internal Liquidity Adequacy Assessment Process. A new regulation on liquidity risk management, which closely follows Basel III and EU requirements, was adopted in 2020 and entered into force in early 2021. The new regulation requires banks to maintain minimum levels (100 percent) of LCR and to report 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, banks are not required to maintain minimum levels of LCR (of 100 percent) 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 amended NBRNM Law grants a clear macroprudential mandate to the NBRNM.
Reconstitute the Financial Stability Committee (FSC) as principal domestic coordination body for macroprudential policy and crisis management.	MT	An MoU defining the role and composition of the FSC as the coordinating body for macroprudential policy and crisis management, consisting of all financial regulators, was signed in April 2020. The new Financial Stability Law formalizing the FSC as a macroprudential body has been submitted to parliament for adoption.
Further develop the systemic risk monitoring framework.	ST	Planned amendments to the NBRNM Law and the new Financial Stability Law will allow access to a broader set of data to facilitate systemic risk monitoring. Ongoing capacity development (CD) from development partners is helping further strengthen the monitoring framework (e.g., developing monitoring indicators of systemic risks). The NBRNM received IMF CD to strengthen the capacity for bottom-up bank stress tests in 2021. For the purpose of further enhancement of the macroprudential framework, the NBRNM has altered its organizational structure by dividing the current Department on Financial Stability, Banking Regulation, and Bank Resolution in two separate departments: Department on Financial Stability and Macroprudential Policy and Department on Bank Regulation and Bank Resolution. This will allow for a more focused approach to financial stability issues and for adequate development of macroprudential tools and instruments. The new organizational structure was implemented from January 1, 2022.

FSAP Recommendations	Time	Authorities' Actions
Financial Stability Oversight		
Banking Supervision		
Enhance the NBRNM's independence by excluding it from the scope of the Law on Administrative Officers; and strengthen governance arrangements.	ST	To strengthen governance arrangements, a separate body was established within the NBRNM in 2018 to deal with issues where there are disagreements between the Governor and supervisory staff. Amendments to the NBRNM Law on decision-making are being considered. The new draft Law on Administrative Servants, which is in the process of public consultation, does not exclude NBRNM staff from the law, contrary to what was recommended by the FSAP.
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. Every consecutive year, at least one D-SIB is included in the annual On-site Examination Plan of the banks. Younger on-site supervisory staff has been recruited, but in the meantime more experienced supervisors left the On-site supervision department (transfer to other departments, promotion etc.).
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 draft amendments to the NBRNM Law might include provisions for extending the NBRNM's oversight to all FMIs.
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 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 Bank Resolution Law is being drafted and is expected to be submitted to parliament in 2022. The NBRNM received CD for the preparation of the law and its implementation. In addition, the procedures for providing emergency loans by the NBRNM have been amended. As mentioned above, the new organizational structure of the NBRNM provides for the establishment of a separate Department on Bank Regulation and Bank Resolution, which will be focused on further enhancement of the current banking regulation framework, but also on building adequate resources and capacities for resolution planning and undertaking adequate resolution activities, if needed. Amendments are being considered in the Law on Deposit Insurance by the Ministry of Finance and relatedly to the draft Bank Resolution Law, seeking to align it with EU law.
Establish he NBRNM's new resolution unit, develop resolution toolkit, and	MT	Since May 2019, bank resolution activities have been delegated to the newly created Financial Stability and Banking Regulation Department (formerly a division within the Supervision

FSAP Recommendations	Time	Authorities' Actions
initiate resolvability assessments and resolution planning for at least all D-SIBs.		Department). The Law on Bank Resolution needs to be adopted for the new Department for Bank Regulation and Bank Resolution to reach its full operational capacity.
Financial Efficiency and Inclusion		
Enhance the out-of-court restructuring framework.	ST	The draft Insolvency Law and framework will include early detection and early intervention. The law is expected to be submitted to parliament by the end of 2022.
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 audits are 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 which have a legal obligation for audit of the financial statements and other listed nonfinancial companies. The latest versions of the International Financial Reporting Standards (IFRS9) and International Accounting Standards will be translated in the course of 2022 and will be implemented in 2023.

Statement by the Staff Representative on Republic of North Macedonia

February 14, 2022

This statement provides information that has become available since the issuance of the Staff Report. The thrust of the staff appraisal remains unchanged.

1. On February 8, the government announced that it had reached an agreement with the trade unions and employers on an ad-hoc increase in the statutory net minimum wage to 18,000 denars paid from April 2022. This represents an increase of about 18.5 percent relative to the current level, in line with the potential increase in the minimum wage outlined in the staff report.

2. Future statutory minimum wage increases will be based on an amended mechanism as the average of the annual growth in the cost of living and the growth rate of the average wage, provided that the minimum wage is not less than 57 percent of the average wage.

3. The agreement will need to be adopted by law to become effective.

4. The minimum wage increase was discussed during the mission, as laid out in the staff report. Staff project that the net minimum wage would reach 60 percent of the net average wage in 2022, which is high by regional standards. Staff's view continues to be that minimum wage increases should also consider productivity developments, to preserve competitiveness and employment.

Statement by Mr. Luc Dresse, Alternate Executive Director for North Macedonia and Mr. Dragan Tevdovski, Advisor to the Executive Director
February 14, 2022

The North Macedonia authorities would like to thank the staff team, led by Ms. Barkbu, for the report and constructive discussions during the mission. We highly value the Fund's engagement, particularly in this difficult environment due to the pandemic and we thank staff for the broad range of technical assistance provided to North Macedonia over the years.

The authorities consent to the publication of the Article-IV report. They broadly agree with the staff appraisal and will take staff's recommendations into consideration when designing and implementing future reforms to address the challenges faced by the economy.

The authorities' policy response to the COVID-19 crisis

North Macedonia entered the pandemic with solid macroeconomic fundamentals. In the past decade, the country maintained a track record of low inflation, moderate fiscal deficit, and a stable financial sector. The unemployment rate declined from 32.1 percent in 2010 to 17.3 percent in 2019. Supported by crucial institutional and governance reforms, the economy grew at a strong pace before it was hit by the COVID-19 crisis, 3.9 percent in 2019. These solid macroeconomic fundamentals provided room for adequate policy response to the shock.

Effective policy support helped cushion the economic and social impact of the COVID-19 crisis. Supported by the Rapid Financing Instrument and the use of SDR allocation, the government implemented six packages of fiscal measures to help address firms' liquidity problems, protect jobs, and support the most vulnerable through wage subsidies, tax deferrals, subsidized loans and loan guarantees for firms, sector-specific support, investment incentives and financial support for low-income households. The National Bank of the Republic of North Macedonia (NBRNM) cut its policy rate three times during the crisis, by a cumulative 75 basis points to 1.25 percent. The central bank bills have been reduced by 60 percent, thus providing additional liquidity to the economy. On financial sector measures, the NBRNM successfully used the regulatory flexibility to support temporary banks loans restructuring, the temporary relaxation of non-performing loan criteria and a deduction in the reserve requirement. As a result, the decline of real GDP in 2020 was cushioned to 6 percent. In 2021, more targeted policy support has helped the economy rebound to 4.6 percent up to third quarter of the year and prevented job losses. The unemployment rate declined further to 15.7 percent in the third quarter of 2021.

Fiscal stability and sustainability

The 2022 budget aligns with the authorities' medium-term fiscal strategy that targets gradual fiscal consolidation while supporting the recovery and accelerating growth

rates. The scaling back of fiscal support started in 2021, when the headline deficit decreased to 5.4 percent of GDP from 8.2 percent of GDP in 2020. The 2022 budget further provides consolidation with headline deficit target of 4.3 percent of GDP, while aiming to accelerate growth, intensifies public investment and maintains health spending at a sufficiently high level. The additional funds for health and vaccine-related spending are foreseen in the budget and the government is committed to further increase the vaccination rate. The focus in the budget is on cutting nonessential costs, and better supporting the private sector, innovation and competitiveness.

The authorities are fully committed to public financial management (PFM) reforms, aiming at improving domestic revenue mobilization and expenditure efficiency. Since the first PFM reform program in 2017, designed in line with recommendations of the Fund, World Bank and European Union, the authorities are improving all elements of the system, ranging from improved transparency to digitalizing the processes in Customs administration and Public Revenue Office. Central in the PFM reforms is the new Organic Budget Law (OBL) which is expected to be adopted in 2022. The OBL brings significant changes to fiscal policymaking, budget preparation and execution, and fiscal reporting. In line with the EU framework, it introduces numerical rules for the overall fiscal deficit and public debt, capped at respectively 3 and 60 percent of GDP. Additionally, an independent fiscal council is tasked with assessing the government's macroeconomic and budgetary projections and monitoring the fulfillment of the rules. Moreover, the authorities are committed to fully implement the action plan from the Fund's Public Investment Management (PIM) assessment by the middle of this year which, in combination with recently introduced central government incentive-based mechanism ("CAPEF"), would scale up investment and limit fiscal risks.

Transparency and accountability of public related spending are a high priority. The Fund's Fiscal Transparency Evaluation provided a solid basis for the reform activities. Since 2019, a web portal called "Open finance" is in function which allows the public to track all data for budget transactions by users of the Budget of the Republic of North Macedonia, disbursed by the treasury of the Ministry of Finance. In addition, public procurement contracts must be made publicly available on the dedicated electronic portal. This also includes crisis-related spending, for which additional transparency measures were implemented. The authorities stress that emergency health procurements awarded without public calls, including for vaccines, are in line with the domestic public procurement law, EU directives and practice of other European countries during the pandemic.

Credible monetary policy and stable financial sector

The accommodative monetary policy is appropriate, with international reserves kept at adequate level. The policy stance supports economic recovery and keeps inflation in line with the euro area. The recent surge in inflation is driven by global supply side factors and are expected to ease during 2022. Given the uncertainty regarding the future path of inflation, the NBRNM concurs with staff's recommendation to continue closely monitoring developments and potential risks, and emphasizes its preparedness to act as needed. The de facto fixed exchange rate with the euro, that has served the country well for decades, is supported by an adequate level of international reserves according to the ARA metric threshold. Both staff and the NBRNM consider the external position to be in equilibrium.

The banking system remains well capitalized and liquid, owing to sound prudential policies. The total capital adequacy ratio exceeds 17 percent at end-September 2021, while the overall NPL level is around 3.5 percent. The NBRNM regular stress tests found that the banking system's capital levels would remain above the minimum requirements through 2022 in a stressed scenario.

The recent IMF's Central Bank Transparency Code Assessment found the NBRNM transparent and accountable. Maintaining central bank operational independence, along with transparency and accountability, is critical to supervisory decision-making. Additionally, in line with the 2018 FSAP recommendations, NBRNM staff should be excluded from the law on administrative staff.

The authorities are committed to complete the implementation of the 2018 FSAP recommendations. Important steps have already been taken: the adoption of a new regulation on liquidity risk management, which closely follows Basel III and EU requirements; the NBRNM altered its organizational structure by dividing the Department on Financial Stability, Banking Regulation, and Bank Resolution in two separate departments to further enhance systemic risk monitoring framework; full-scope inspections started in domestic systematically important banks; and bank resolution activities have been delegated to the newly created Banking Regulation and Bank Resolution Department. Regarding the remaining issues, the new Bank Resolution Law, the new Insolvency Law, and the new Law on Deposit Insurance are expected to be submitted to parliament this year, while the new Financial Stability Law is submitted to parliament for adoption at this time. In this light, the European Commission passed in October 2021 the Decision on the equivalence of the supervisory and regulatory requirements for North Macedonia, confirming that the prudential, supervisory, and regulatory requirements applied in North Macedonia are equivalent to those applied in the European Union.

Macro-critical Structural Reforms

The authorities appreciate staff's in-depth analysis of structural policies, which can facilitate reallocation and transformation. This crisis created the opportunity to prepare the next generation of structural reforms.

The authorities concur with staff's analysis that successfully up scaling investments can boost the economy's growth potential and limit scarring from the pandemic. While the country's per capita stock of public capital nearly has a 50 percent gap with new EU member countries, the government's ambitious Growth Acceleration plan will increase public investment and facilitate green- and digital transitions. Moreover, the country's favorable easing of the doing business environment is expected to accelerate private capital formation, mainly through foreign investment.

Increase in labor force participation is another channel to boost potential output and accelerate the country's income convergence. The authorities acknowledge the potential of informal economy reduction and the increase of women participation in the labor force. Various policies have been implemented with mixed effects and staff's recommendations are welcomed. The authorities reiterate the importance and their commitment to maintain youth and skilled labor in the domestic labor market, prevent a continuation of emigration trends, and improve the quality of education.

EU Integration

North Macedonia has made important steps and remains devoted to continue on the EU integration path. After the Prespa agreement with Greece, the country achieved two major milestones at the start of the pandemic: the country joined NATO as its 30th member country, and the EU Council agreed to start accession negotiations. However, no specific date has been set yet, as noted in the staff report. EU membership is strongly supported by the country's population and accession prospects have helped spur important reforms in past. The authorities expect that the start of the accession negotiations can revive reform momentum. They regard international cooperation as a crucial driver for economic development.