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2023 ARTICLE IV CONSULTATION AND FIRST REVIEW UNDER THE PRECAUTIONARY AND LIQUIDITY LINE—PRESS RELEASE; STAFF REPORT AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR REPUBLIC OF NORTH MACEDONIA

In the context of the 2023 Article IV Consultation and First Review Under the Precautionary and Liquidity Line, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 19, 2024, following discussions that ended on November 14, 2023 with the officials of Republic of North Macedonia on economic developments and policies underpinning the IMF arrangement under the Precautionary and Liquidity Line. Based on information available at the time of these discussions, the staff report was completed on January 4, 2024.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Republic of North Macedonia.

The documents listed below have been or 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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IMF Executive Board Concludes the 2023 Article IV Consultation and Completes the First Review Under the Precautionary and Liquidity Line Arrangement for the Republic of North Macedonia

FOR IMMEDIATE RELEASE

- The completion of the review gives the authorities access to SDR161.35 million (equivalent to about €200 million at current exchange rates or 115 percent of quota.) The authorities intend to draw SDR 119.26 million (or 85 percent of quota) and consider the remaining amount as precautionary insurance against external shocks.
- The authorities are progressing towards PLL objectives, encompassing the safeguarding of public finances, reduction of energy subsidies, addressing high inflation, and ensuring financial stability.
- The economy is recovering post the surge in energy and food prices triggered by Russia's war in Ukraine. Economic activity in 2023 was driven by strong exports and reduced energy imports, and it is set to strengthen into 2024.

Washington, DC – **January 19, 2024:** The Executive Board of the International Monetary Fund (IMF) today concluded the 2023 Article IV Consultation[1] and completed the First Review under the Precautionary and Liquidity Line (PLL) Arrangement for North Macedonia. The completion of the review gives the authorities access to SDR161.35 million (equivalent to about €200 million at current exchange rates or 115 percent of quota.) The authorities intend to draw SDR 119.26 million (or 85 percent of quota) and consider the remaining amount as precautionary insurance against external shocks.

The goal of the PLL, approved in November 2022 and giving the authorities access to SDR 406.87 million (or 290 percent of quota), was to ensure financing was available at a challenging time in accessing financial markets, while supporting the authorities' objective of reducing energy subsidies (a fiscal vulnerability exposed by the energy shock) while providing better targeted support to vulnerable households that need it most and consolidating public finances.

The successful completion of the first review marks a significant step in enhancing North Macedonia's economic resilience. The authorities are progressing towards PLL objectives, encompassing the safeguarding of public finances, reduction of energy subsidies, addressing high inflation, and ensuring financial stability. Planned fiscal consolidation for 2024 aims to bring the budget deficit closer to the 3 percent of GDP ceiling under North Macedonia's

[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.

Organic Budget Law. Additionally, it seeks to build buffers for potential cost overruns for the Corridor 8/10d road project and other spending needs. Recently undertaken measures will reduce the budget's vulnerability to a surge in energy-related subsidies.

The economy is recovering post the surge in energy and food prices triggered by Russia's war in Ukraine. Economic activity in 2023 was driven by strong exports and reduced energy imports, and it is set to strengthen into 2024. The planned increase in public investment, notably the commencement of the Corridor 8/10d road project, will further support economic recovery. Although inflation remains a challenge, it has moderated substantially due to lower global energy and food prices, coupled with monetary tightening. An improved external trade balance, partly attributed to the sharp decline in global energy prices, along with resilient foreign direct investment, sustains adequate international reserves. The banking sector remains liquid, well-capitalized, profitable, with non-performing loans stable at a historically low level.

Article IV discussions focused on medium-term challenges. North Macedonia has seen a slowdown in convergence to the EU over the last decade, mainly driven by under-investment, high emigration, and low productivity growth. North Macedonia is also exposed to climate change and will be impacted by the EU-Carbon Broder Adjustment Mechanism. The country has a large potential to reduce carbon emissions through investments in renewable energy sources and decommissioning of old coal-powered powerplants.

Following the Executive Board discussion, Mr. Bo Li, Deputy Managing Director and Chair, issued the following statement:

"North Macedonia is recovering from the dual shocks of the COVID-19 pandemic and the surge in energy prices following Russia's invasion of Ukraine. The country continues to qualify under the PLL because it has sound economic fundamentals and institutional policy frameworks, and it is implementing—and has a track record of implementing—sound policies. The government met its deficit target in 2023, and it has recently adopted a strong set of measures that will materially reduce energy subsidies. The authorities are committed to containing wage increases to those agreed in the General Collective Agreement. The National Bank of the Republic of North Macedonia (NBRNM) has tightened monetary policy significantly, which has brought down inflation and helped to stabilize the foreign exchange market. In this context, reserves increased in 2023, and remain at sound levels. The financial sector is profitable, liquid, and well capitalized.

"Going forward, the authorities' policy agenda focuses on continued fiscal consolidation to rebuild buffers. In this context, parliament has approved a credible 2024 budget that targets significant fiscal consolidation while preserving space for priority spending. The authorities remain committed to strengthening tax compliance and scaling up public investment, while managing associated fiscal risks including from the Corridor 8/10d road project. Also, they plan to fully phase out untargeted energy subsidies while strengthening targeted support for vulnerable households and improving energy efficiency. The NBRNM is committed to further policy tightening should inflation risks materialize, and it continues to work towards strengthening the monetary transmission mechanism, enhancing bank-risk monitoring and supervision, and refining and operationalizing the macroprudential and resolution frameworks.

"North Macedonia faces significant medium-term challenges. Arresting emigration and boosting productivity are crucial for re-accelerating income convergence with the EU. North Macedonia is also exposed to climate change and will be impacted by the EU-Carbon Broder

Adjustment Mechanism. Addressing these challenges requires among others improving the business environment and rule of law, and accelerating the green transition.”

Republic of North Macedonia: Selected Economic Indicators, 2019–28

(Year-on-year percentage change, unless otherwise indicated)[6]

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
					Projections					
Output										
Real GDP	3.9	-4.7	3.9	2.1	2.3	3.0	3.5	3.5	3.5	3.5
Domestic demand	4.9	-5.3	5.3	5.3	1.6	4.6	2.6	3.5	3.2	4.1
Exports	8.9	-10.9	11.7	13.4	3.4	4.8	5.8	4.9	4.6	4.0
Imports	10.1	-10.9	11.9	16.1	2.2	6.3	4.2	4.5	4.0	4.6
Contributions to growth[1]										
Domestic demand	6.9	-7.2	6.7	7.8	2.0	5.9	3.5	4.5	4.2	5.3
Net exports	-2.9	2.5	-2.7	-5.7	0.3	-2.9	0.0	-1.0	-0.7	-1.8
Output gap (percent of potential GDP)	0.9	-3.3	-1.8	-1.5	-1.0	-0.6	-0.4	-0.2	0.0	0.0
Consumer prices										
Consumer prices (period average)	0.8	1.2	3.2	14.2	9.5	4.5	2.1	2.0	2.0	2.0
Consumer prices (end-of-period)	0.4	2.3	4.9	18.7	3.7	3.7	1.9	2.0	2.0	2.0
Core consumer prices (period average)	0.5	0.9	2.4	7.3	8.2	5.2	2.9	2.0	2.0	2.0
Core consumer prices (end-of-period)	-0.3	1.9	2.9	11.1	6.1	4.1	2.1	2.0	2.0	2.0
Central government operations (percent of GDP)										
Revenues[2]	29.4	28.4	30.3	30.6	31.6	31.7	31.9	31.9	31.9	31.9
Expenditures	31.4	36.4	35.7	35.1	36.3	35.1	34.9	34.8	34.7	34.6
Of which: capital expenditures	2.6	2.4	3.2	3.6	4.9	4.6	4.8	5.0	5.2	5.2
Balance[2]	-2.0	-8.0	-5.4	-4.5	-4.7	-3.4	-3.0	-2.9	-2.8	-2.7
Gross general government debt[3]	40.4	50.8	53.4	52.1	51.4	50.7	51.4	51.2	51.1	50.7
Public and publicly guaranteed debt[3, 4]	48.1	58.4	60.8	59.7	59.6	58.7	59.2	58.8	58.5	57.8
Savings and investment (percent of GDP)										
National saving	31.3	27.0	29.5	28.9	30.5	30.9	30.7	31.0	31.0	31.7
Public	0.6	-5.6	-2.1	-0.9	0.2	1.2	1.8	2.0	2.3	2.4
Private	30.7	32.6	31.6	29.7	30.2	29.7	29.0	29.0	28.7	29.3
Foreign saving	3.0	2.9	2.8	6.2	2.5	3.0	2.9	2.8	2.7	2.7
Gross investment	34.3	29.9	32.3	35.0	32.9	33.9	33.6	33.8	33.7	34.4
Credit										
Private sector credit growth	6.3	4.9	8.0	9.3	6.1	7.0	6.5	6.3	6.3	6.3
Balance of payments										
Current account balance (percent of GDP)	-3.0	-2.9	-2.8	-6.2	-2.5	-3.0	-2.9	-2.8	-2.7	-2.7
Foreign direct investment (percent of GDP)	3.2	1.4	3.3	5.1	4.0	3.7	3.7	3.7	3.7	3.7
External debt (percent of GDP)[5]	72.4	78.7	81.9	84.2	81.6	81.1	82.9	83.2	83.6	83.6
Gross official reserves (millions of euros)[5]	3,263	3,360	3,643	3,863	4,126	4,652	5,109	5,393	5,713	5,997
in percent of IMF ARA Metric	112	113	110	100	104	109	113	113	115	114
in percent of ST debt	95	102	109	81	92	92	94	97	98	99
in months of prospective imports	5.1	4.2	3.5	3.8	3.8	4.0	4.1	4.1	4.2	4.2
Memorandum items:										
Nominal GDP (billions of denars)	693	669	720	795	891	975	1028	1087	1147	1215
Nominal GDP (millions of euros)	11,262	10,852	11,690	12,898	14,457	15,829	16,684	17,634	18,620	19,710

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] For 2023, revenue forecasts at the time of PLL do not include any proceeds from the one-off Solidarity Tax, which could yield up to 1/2 percentage points of GDP.

[3] 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.

[4] Includes general government and non-financial SOEs.

[5] PLL SR 2022 column does not include NBRNM REPO net position with nonresidents (Short term debt) of €228 million. Previous WEO forecast assumes that the NBRNM closes the REPO net position with nonresidents (short-term debt) of €228 million in 2023. Current projection assumes a net REPO position of €228 million from 2022 onward.

[6] For the PLL SR columns, nominal values at time of PLL approval have been divided by the current baseline GDP projection.

INTERNATIONAL MONETARY FUND

REPUBLIC OF NORTH MACEDONIA

January 4, 2024

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION AND FIRST REVIEW UNDER THE PRECAUTIONARY AND LIQUIDITY LINE

KEY ISSUES

Recent Developments, Outlook and Risks. Staff project GDP growth of 2.3 percent in 2023, lower than at the time of PLL arrangement approval, driven by lower external demand and a slowdown in investment. Staff expect an investment recovery to be a key driver of the recovery in 2024, with projected GDP growth of 3.0 percent. Inflation is coming down, driven by monetary tightening and lower global commodity prices, and is projected to be at 4.5 percent average in 2024. The current account is benefitting from lower international energy prices, and international reserves are at an adequate level and projected to remain so. Risks are mainly related to geopolitical tensions, commodity price volatility, and unfunded promises ahead of the elections planned for the spring.

Performance and Qualification Under the PLL arrangement. Fiscal quantitative targets were met, while the net international reserves floor was temporarily breached in September. One structural benchmark on a feasibility study for the large Corridor 8/10d road project was met, while staff assessed the second structural benchmark—developing and publishing an energy action plan to lower energy subsidies—was not met. Progress was made on many soft commitments in a fragmented political environment. The NBRNM has continued to appropriately tighten monetary policy to dampen domestic inflation pressures. Staff assess that North Macedonia continues to qualify for an arrangement under the PLL.

Policies Under the PLL arrangement. The 1st review was delayed, while staff awaited additional due diligence related to the fiscal cost and risks of the large Corridor 8/10d road project. Staff decided to proceed with the review to ensure that the 2024 budget remained in line with targets agreed under the PLL arrangement, and to unlock other IFI financing, contingent on completion of the 1st review. As prior actions for the first review, the government adopted a 2024 budget in line with the PLL deficit target of 3.4 percent of GDP, building on a strong set of measures on electricity tariffs, agricultural subsidies, and partial pre-funding of Corridor 8/10d with 2023 budgetary savings. To mitigate spending pressures in the run-up to elections in 2024, a primary current spending ceiling (QPC) has been added to the program, as well as a ceiling on the public sector wage bill (IT), in addition to the existing cash balance floor (IT). New structural benchmarks are added to support transparency on Corridor 8/10d and to strengthen the monetary policy transmission.

Proposed Rephasing of the PLL arrangement. As an additional safeguard, staff propose to make 115 percent of quota (SDR 161.35 million) available at completion of the current review versus a cumulative 145 percent of quota (SDR 203.44 million) in the previous schedule (agreed at the time of PLL arrangement approval), and to make another 115 percent of quota available at the next review (now 2nd review), scheduled for May 2024, versus 85 percent of quota originally scheduled. Total access would thus remain unchanged. The authorities intend to draw 85 percent of quota (SDR 119.26 million) upon completion of the current review and treat the rest as precautionary.

Staff Recommends Completion of the 1st review. Based on the authorities having completed the prior actions for the 1st review, and a strong set of continued reform commitments, staff recommends completion of the 1st review. The policies and reforms would set North Macedonia on a successful path to exit from the PLL in November 2024.

Medium-term Challenges and Priorities. North Macedonia has seen a slowdown in convergence to the EU over the last decade, mainly driven by under-investment, high emigration, and low productivity growth. North Macedonia is also exposed to climate change and has a large potential to reduce carbon emissions through investments in renewable energy sources and decommissioning of old coal-powered powerplants.

Key Policy Recommendations:

- Continue fiscal consolidation to bring the deficit closer to the 3.0 percent deficit rule, create fiscal space, and support dampening domestic inflation pressures.
- The NBRNM should keep monetary policy tight for the time being and stand ready to tighten should inflation risks from high wage growth materialize.
- While the banking sector is well-capitalized, focus on macroprudential policies and resolution frameworks should shift to enforcement and a strengthening of the supervisory stress-testing framework.
- Implement policies that support adaptation to climate change and the green transition, address high emigration rates and low productivity growth, and continue with governance reforms.

Approved By	
Oya Celasun (EUR) and Boileau Yeyinou Loko (SPR)	Discussions took place in Skopje between October 31 – November 14, 2023. The mission met with Finance Minister Besimi, Governor Angelovska Bezhoska, and other senior officials from the Finance, Economy, Environment and Physical Planning, Agriculture, and Labor, the National Bank of the Republic of North Macedonia, the Public Revenue Office, the Parliamentary Finance and Budget Committee, the State Audit Office, the State Commission for Prevention of Corruption, the Energy Regulatory Commission, the Public Enterprise for State Roads, the Employment Agency, as well as representatives from the banking sector, industry, trade unions, the European Union, US Embassy, and international financial institutions. The staff team comprised Mr. Miniane (head), Ms. Kyobe, Messrs. Ayerst, Cabezon and Gade (all EUR), Ms. Laoprapassorn (SPR) and Mr. Sosa (Resident Representative), Ms. Kovachevska Stefanova and Mr. Sulejmani (IMF Local Economists). Messrs. Dresse and Verhelst (both OED) attended some of the meetings. Mses. Lee, Murillo (both EUR), and Davceva Mijoski (IMF Local Office) assisted the mission.

CONTENTS

CONTEXT _____ **6**
A. Article IV _____ 6
B. Precautionary and Liquidity Line (PLL) _____ 6

RECENT DEVELOPMENTS _____ **8**

OUTLOOK AND RISKS _____ **13**

REVIEW OF QUALIFICATION UNDER THE PLL _____ **15**

REVIEW OF PERFORMANCE UNDER THE PLL _____ **17**

POLICY DISCUSSION _____ **20**
A. Fiscal Policy _____ 20
B. Monetary and Financial Sector Policies _____ 24

EXTERNAL FINANCING NEEDS UNDER THE PLL _____ **27**

CAPACITY TO REPAY THE FUND, SAFEGUARDS AND EXIT FROM THE PLL _____ **29**

MEDIUM-TERM STRUCTURAL CHALLENGES AND PRIORITIES _____ **30**
A. Structural Policies _____ 30

STAFF APPRAISAL _____ **36**

FIGURES

1 Growth and Inflation Developments 8
2. Public Finance Developments in 2022 and 2023 9
3. Balance of Payments and Reserves 11
4. Monetary Developments 12
5. Banking Sector Developments 13
6. Growth and Inflation Projections 14
7. Selected Interest Rates 24
8. Convergence and Productivity 31
9. Inflation Differentials, REER and Real Wage 31
10. Emigration Over the Last Two Decades 33
11. Climate Change, Emissions, Sources 35

TABLES

1. Macroeconomic Framework, 2019–28 40
2a. Central Government Operations, 2019–28 41
2b. Central Government Operations, 2019–28 42
3a. Balance of Payments, 2019–28 43
3b. Balance of Payments, 2019–28 44
4. Monetary Survey, 2019–28 45
5. Central Bank Survey, 2019–28 46
6. Financial Soundness Indicators of the Banking System, 2013–22 47
7. Capacity to Repay Under the Adverse Scenario 48
8. Schedule and Terms Under the Precautionary and Liquidity Line Arrangement (PLL) 49
9. Quantitative Targets Under the Precautionary and Liquidity Line (PLL) 50

ANNEXES

I. Public Sector Debt Sustainability Assessment, SRDSF-MAC 51
II. External Sector Assessment 61
III. External Debt Sustainability Assessment 64
IV. Risk Assessment Matrix 66
V. Implementation of Commitments Under the PLL 69
VI. Implementation of Article IV and FSAP Recommendations 75
VII. Assessment of Qualification Criteria for a PLL 82
VIII. New General Collective Agreement for Public Sector Wages 87
IX. Developments in the Electricity Sector, Tariffs, and Subsidies 89
X. Adverse Scenario 91
XI. The Challenge of Emigration 94
XII. Fiscal Governance, Rule of Law, and Anti-Corruption Measures 97
XIII. External Economic Stress Index (EESI) 100

APPENDIX

I. Written Communication ____ 101
Attachment I. Technical Memorandum of Understanding (TMU) ____ 109

CONTEXT

A. Article IV

1. **North Macedonia is recovering from two consecutive external shocks,** the Covid 19 pandemic and the surge in energy prices in 2022 following Russia's invasion of Ukraine. As a result of these shocks, the authorities requested an arrangement under the Fund's Precautionary and Liquidity Line (PLL) during 2022 (see below). The goal of the PLL arrangement was to ensure available financing at a challenging time in terms of market access, while supporting a gradual reduction in energy subsidies (a fiscal vulnerability exposed by the energy shock) and support the consolidating of public finances.

2. **Elections are looming in the spring.** Presidential and parliamentary elections are to be held in April and May 2024, which has caused the political environment to become increasingly polarized. Separately, the government is working to secure the supermajority needed for the constitutional changes required for opening formal EU accession talks, but at present this appears to be difficult.[1]

3. **Long-standing structural issues continued to dampen potential growth in North Macedonia.** The EU accession process will be a good opportunity to tackle long-standing structural issues related to high emigration rates, low productivity growth, and governance issues, which thus far have dampened growth and convergence with the EU. These factors have since 2010 stalled convergence with the EU, following a period of faster convergence before then.

B. Precautionary and Liquidity Line (PLL)

4. **The IMF Executive Board approved North Macedonia's request for a two-year Precautionary and Liquidity Line (PLL) of SDR 406.87 million (290 percent of quota) on November 21, 2022.** As planned, the authorities purchased the 60 percent of quota (SDR 84.18 million) made available at the time of approval.

5. **The originally planned 1st review under the PLL arrangement was delayed while awaiting further due diligence on the large Corridor 8/10d road project.**[2] The feasibility study on Corridor 8/10d (structural benchmark under the 1st review) was clear that firm cost estimates for Corridor 8/10d could not be established until geotechnical studies had been performed and design plans updated. Staff therefore did not propose the completion of the 1st review of the PLL arrangement until the due diligence on the Corridor 8/10d road was more advanced, and the design of the road (and associated costs) more firmly estimated. This would have helped staff to better

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[1] After protracted discussions, the government signed a protocol with Bulgaria on Bulgarian minority identity and language issues that led Bulgaria to lift its veto, paving the way for opening EU accession talks in July 2022. The protocol was subject to a parliamentary vote and will require a change to the Constitution.

[2] Corridor 8/10d is a large road project part of the European Regional corridor 8, providing a highway connection to Albanian and Bulgarian sea ports, with a baseline cost of around 10 percent of GDP over five years.

assess whether the associated fiscal risks were compatible with commitments under the PLL arrangement. At this stage however, geotechnical studies on three of the four sections are not expected before early 2024.

6. To ensure that the budget for 2024 remained on track under the PLL arrangement, as well as to unlock other IFI financing, some of which was contingent on the IMF program, staff proposed to proceed with the 1st review ahead of adoption of the 2024 budget, including the following safeguards to support the success of the program and mitigate risks.

- In agreement with staff, the government has submitted a 2024 budget consistent with the program targets as a prior action for completing the 1st review. As part of the budget adjustment relative to 2023, the government has adopted a set of measures to lower fiscal transfers for energy subsidies (prior actions). They will also use saved funds from 2023 allocations to prepay parts of Corridor 8/10d in 2024.

- On Corridor 8/10d, the completion of geotechnical studies, updates of design plans and cost estimates, for relevant sections of the road are set as a structural benchmark for the completion of the 2nd review. In addition, the government commits to monthly publication of Corridor 8/10d monitoring reports prepared by the independent advisor, starting from December 2023 (both structural benchmarks).

- The NBRNM has agreed to develop an internal roadmap to improve the monetary framework in close consultation with Fund-provided technical assistance, including a transition plan for changes in the operational framework.

- To ensure adequate financing, while mitigating risks to Fund finances, staff propose to make 115 percent of quota (SDR 161.35 million) available to the authorities with completion of the 1st review, versus a cumulative 145 percent of quota (SDR 203.44 million) in the previous schedule.[3] Staff propose to make another 115 percent of quota available at the next review, such that total access under the PLL arrangement remains unchanged. The authorities intend to draw 85 percent of quota (SDR 119.26 million) made available under the 1st review and treat the rest as precautionary.

7. Quantitative targets under the PLL arrangement have mostly been met, while progress in other areas have been mixed. The authorities met the indicative targets for the fiscal balance. The net international reserves target for March was met, but that for September was not met, as planned external financing was shifted from Q3 to Q4 (for reasons unrelated to market access).[4] Staff assesses that the authorities met the structural benchmark on a feasibility study for the

[3] The authorities technically lost access to the PLL by not completing the 1st review as initially planned. Access to the PLL will now be reinstated with the completion of the current review (now called the 1st review).

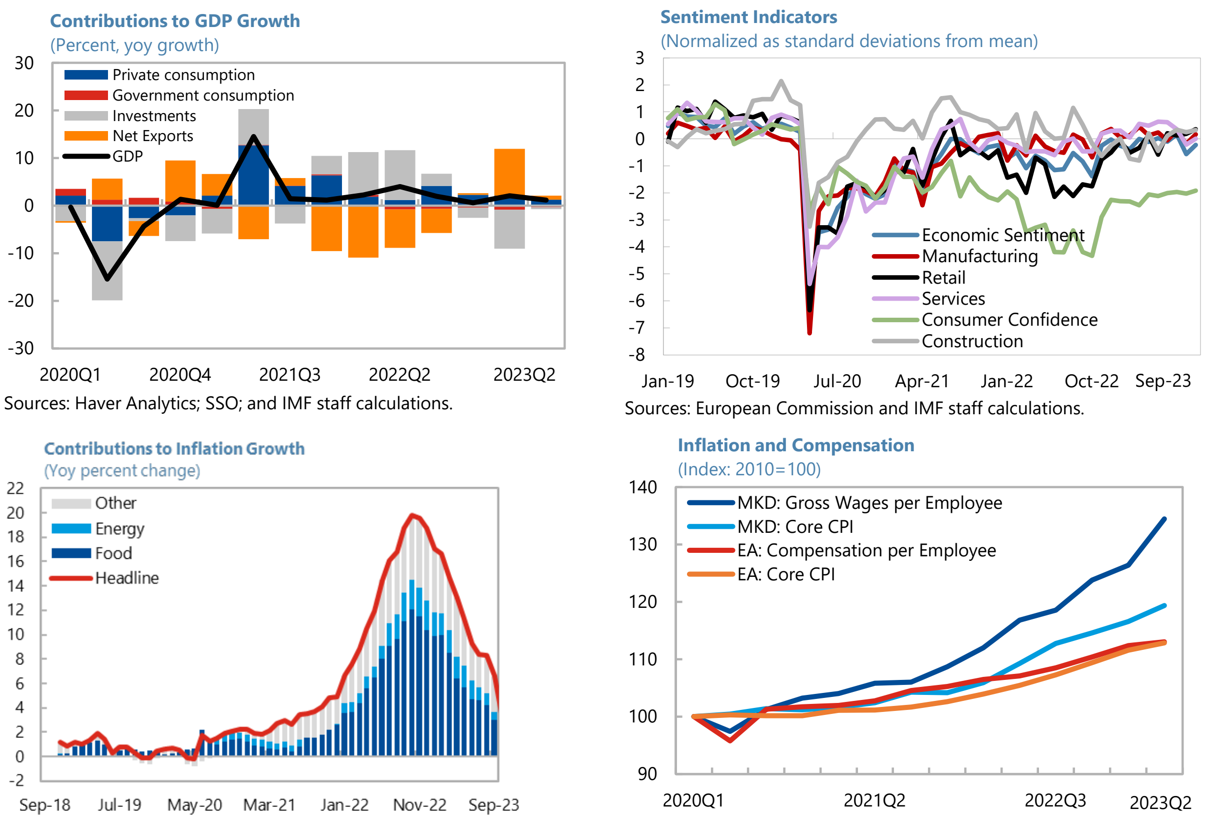
[4] As IFI financing expected by the end of 2023 is higher than projected at the time of PLL approval, the authorities have decided on less market financing, with several of the IFI financing expected to arrive late December. Should some of the disbursements move to early 2024, this will have no sustained implications for reserve adequacy.

Corridor 8/10d road project but did not meet the structural benchmark on adopting a proper energy action plan to phase-out subsidies by 2025. The latter is now proposed as a prior action.

RECENT DEVELOPMENTS

8. **Economic growth has been strong in early 2023 but sentiment indicators have been flat, and growth remains below projections at PLL approval.** Real growth slowed in 2022 to 2.1 percent, against a rate of 2.7 percent projected at the time of PLL arrangement approval, because of weaker private consumption and a larger drag from net exports. Output growth has since been recovering and was stronger than expected in the early part of 2023, rising 1.6 percent y/y in 1H-23. Growth was driven by strong exports, while private consumption, investment, and imports were weaker than expected. High frequency indicators remained relatively flat through October 2023 (see Figure 1).

Figure 1. North Macedonia: Growth and Inflation Developments



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

Sources: European Commission and IMF staff calculations.

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

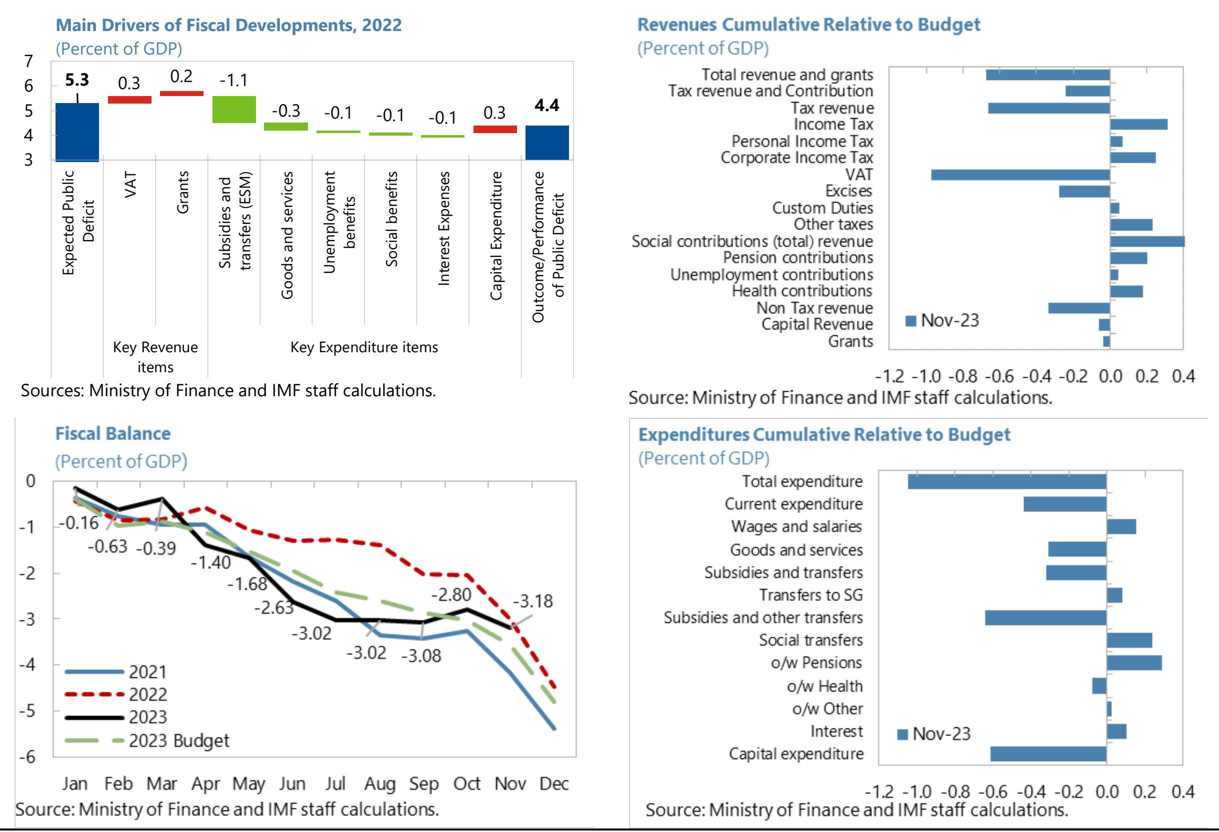
Sources: SSO; Haver Analytics; and IMF staff calculations.

9. **Inflation continues to be a challenge, despite declining to 3.1 percent y/y in November from its peak of 19.8 percent y/y in October 2022.** Food and energy prices have been the key drivers of lower inflation but remain high. While other components slowed or continued to decline, the sharp decline since September was, in part, driven by government interventions that froze the price of over 50 basic food products starting end September. The inflation differential vis-a-vis the

euro area has narrowed. Persistently high core inflation at 6.5 percent y/y in November remains a concern, amid average nominal wage growth of 14.0 percent y/y. Meanwhile, core inflation in the euro area (CPI ex. energy, food, alcohol and tobacco) was 3.6 percent y/y in November, and the inflation differential has thus halved, but it remains positive (see Figure 1).

10. Public finances overperformed in 2022 due to lower-than-projected electricity subsidies. The fiscal deficit was 4.5 percent of GDP in 2022, better than the 5.3 percent deficit projected at the time of PLL arrangement approval in November 2022, driven by lower-than-expected transfers to the state-owned electricity generator, ESM (see Figure 2). The authorities appropriately saved some of this underspending and used the rest to reduce arrears to the private sector. Parliament adopted the Organic Budget Law (OBL) in September 2022, which includes a 3/60 percent deficit/debt rule.[5]

Figure 2. North Macedonia: Public Finance Developments in 2022 and 2023



11. In 2023, the budget has overperformed through November, but with VAT revenue shortfalls, mostly mitigated by lower current and capital spending. The budget deficit was 0.4 percent of GDP lower than targeted through November, as underspending on goods and services, energy subsidies, capital expenditure, as well as the revenue from the solidarity tax, income

[5] The fiscal deficit and debt rules of the OBL are in principle binding already from 2023, but the authorities have invoked an escape clause due to the Covid pandemic.

taxes and social security contributions, more than mitigated the shortfalls in VAT revenue (see Figure 2). The VAT underperformance owes to lower energy prices and imports.

12. Parliament adopted a solidarity tax, supporting tax revenues in 2023, as a one-off revenue measure, as well as a tax reform that strengthens revenues on a permanent basis. In September 2023, Parliament adopted a one-off windfall tax on exceptional 2021 and 2022 profits. The tax did not target a specific sector and was modeled on examples of some EU countries such as Croatia. Most companies that are obliged to pay the solidarity tax have started to pay it, and the tax has thus far yielded around 2.5 bn Denars but is expected to yield around 3 bn Denars in 2023 (0.3 percent of GDP). Parliament also recently adopted a tax reform, which has benefitted from IMF TA, which streamlines preferential treatments and exemptions in corporate and personal income tax and value-added tax (see Text Table 1).

Text Table 1. North Macedonia: Key Tax Reform Measures in 2023 and Expected Yield
(Millions of denars, and percent of GDP)

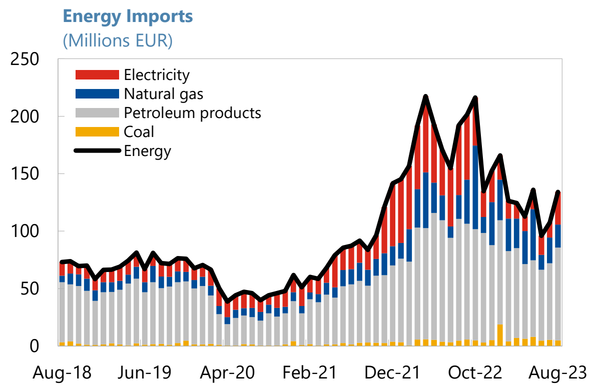
Tax Measures	Expected Annual Yield	Percent of GDP	Date of adoption
One-off Measure			
Solidarity Tax (one-off tax on large companies related to windfall profits in 2021, 2022)	3,100	0.3	Sep-23
Permanent Measures (tax reform)			
Streamlining preferential treatment in:			
• *Personal Income Tax* (capital gains; life, voluntary pension, and private health insurance premiums)	618	0.1	Dec-22
• *Corporate Income Tax* (small and micro enterprises; donations to sports bodies; life insurance premiums)	1,156	0.1	Sep-23
• *Value-Added Tax* (products for human consumption currently taxed at 5 percent)	2,340	0.3	Sep-23
Total (permanent measures)	**4,114**	**0.5**	

Sources: Ministry of Finance and IMF staff calculations.

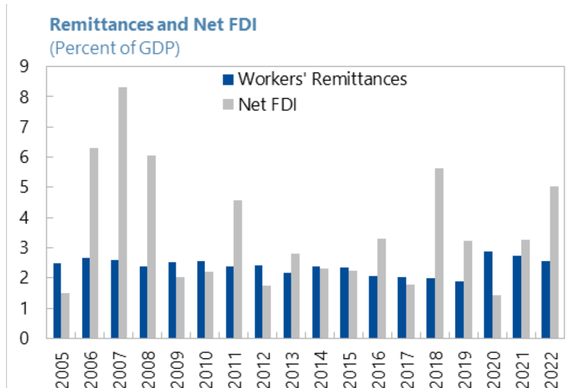
13. Parliament adopted a revised budget for 2023 in September, keeping the deficit target in line with the PLL target of 4.7 percent of GDP. The revised budget reallocates funds to cover additional spending needs on some categories, including public sector wage increases on the back of the General Collective Agreement (GCA) (see Annex IX). The 10 percent wage increase in the public sector in September, was in principle not consistent with the authorities' commitment at PLL arrangement approval to not increase public wages beyond the minimum wage adjustments. However, 2022 saw deep real wage cuts in the public sector, with public sector wages rising by 6.4 percent versus the 14.2 percent CPI inflation rate, and inflation in 2023 has been higher than projected at PLL arrangement approval in part due to more persistent food and energy inflation than anticipated.

14. Public financing has shifted more towards domestic financing during 2023. The government issued a €500 million Eurobond in March with a maturity of four years and a yield to maturity of 6.96 percent. Spreads on the government's external issuance have decreased by 120 bps to 297 bps since the time of PLL arrangement approval, with a yield around 6.3 percent by end-October. Since March, public financing has shifted more towards domestic financing and IFI financing.

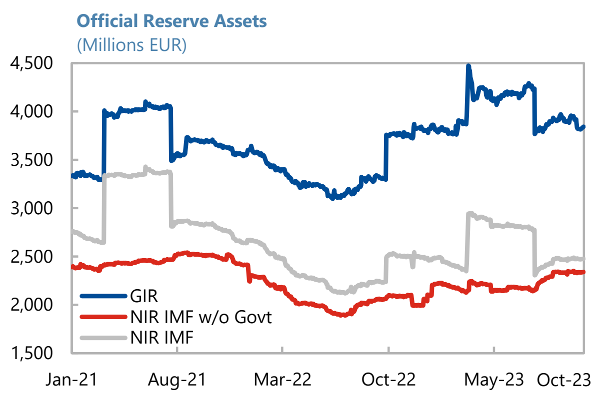
Figure 3. North Macedonia: Balance of Payments and Reserves



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



Sources: NBRNM and Haver Analytics.

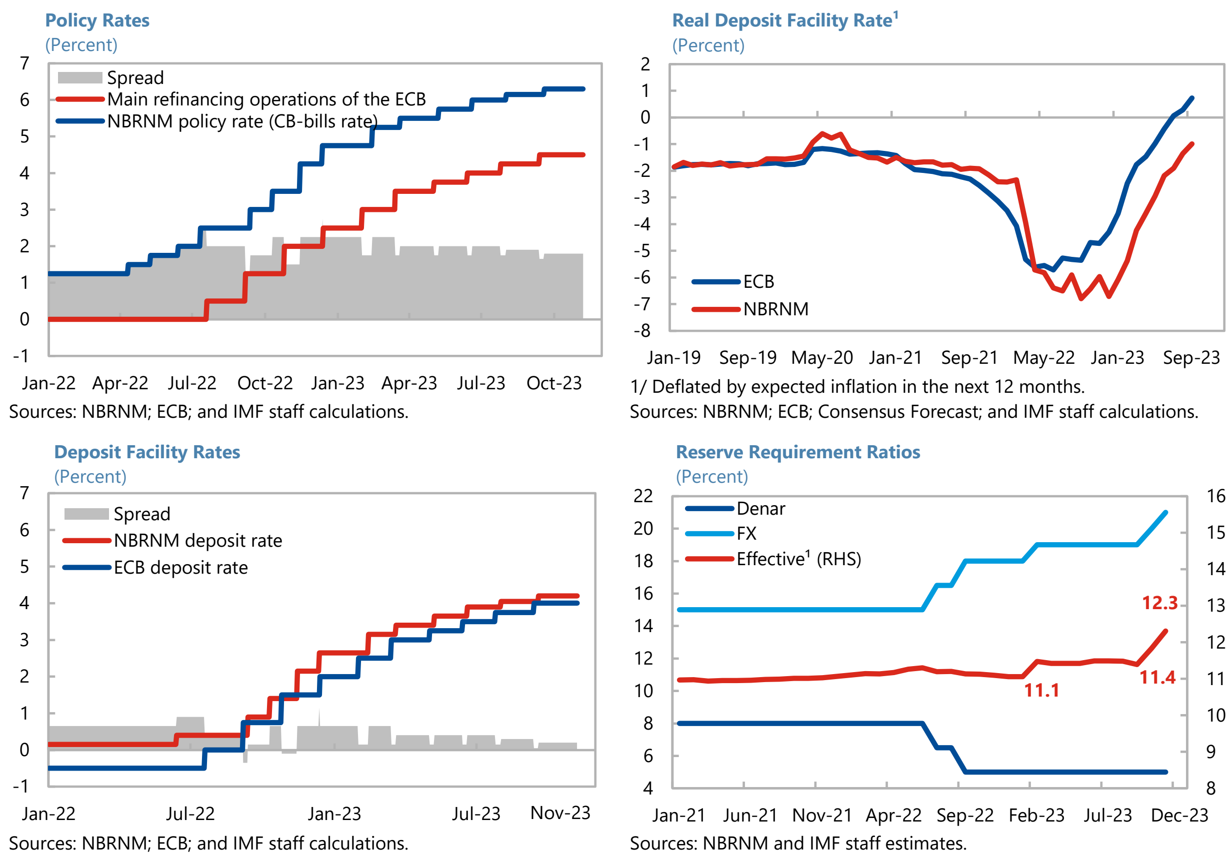


Sources: NBRNM and IMF staff calculations.

15. The current account deficit improved in 2023 following a sharp deterioration in 2022. North Macedonia is an energy importer. Due to sharply rising energy prices, the current account deteriorated sharply to 6.2 percent of GDP in 2022 from 2.8 percent in 2021. Given the peak in many commodity prices in 2H-22, a mild winter and strong remittances, the 2022 current account deficit was better than the 7.5 percent projected at the time of PLL arrangement approval. Thanks to the reversal in global energy prices, the current account deficit shrunk in 1H-23 (with a temporary surplus in 1Q-23). The financial account has recorded strong net inflows, and as a result, the NBRNM has been accumulating foreign reserves, which stood at €3.9 billion (98 percent of the ARA metric) at end-October (see Figure 3). The 2022 external position is assessed to be broadly in line with fundamentals and desirable policies (see Annex III).

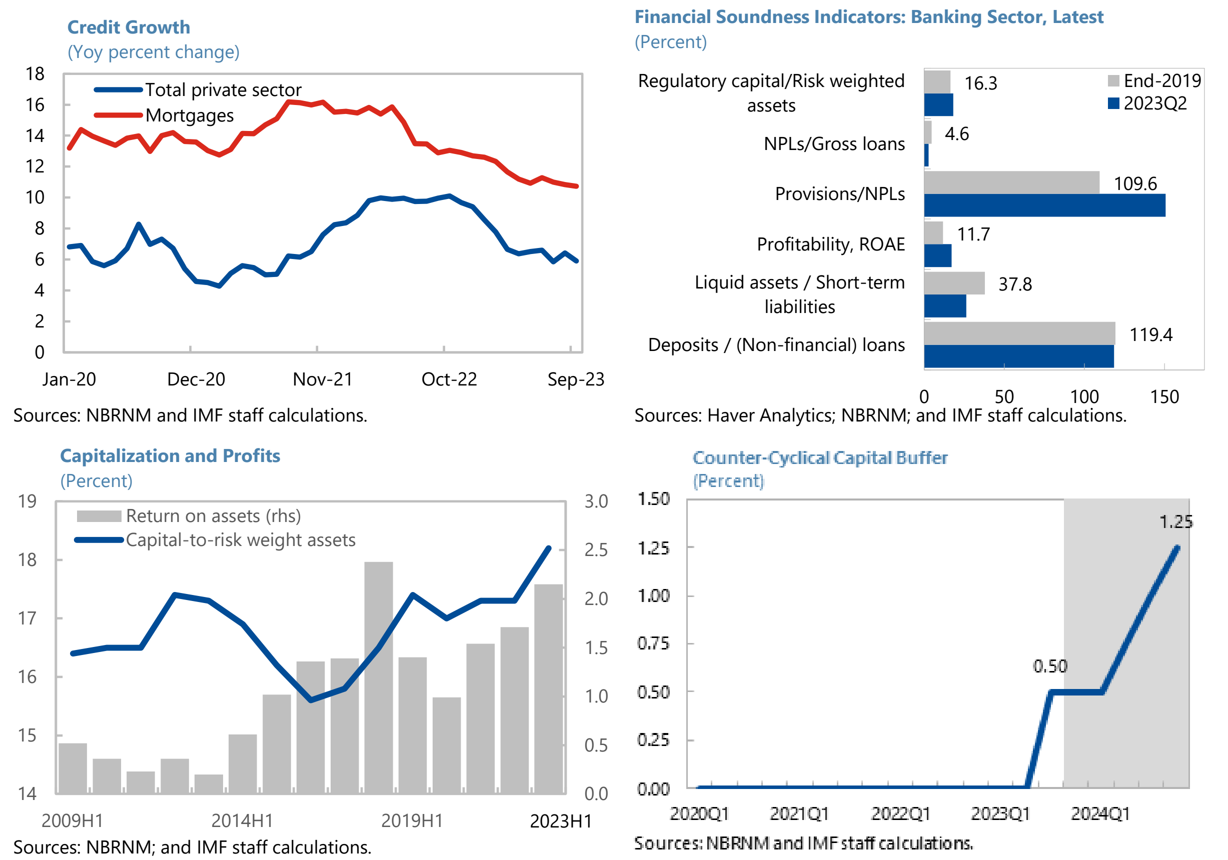
16. The NBRNM has continued tightening monetary policy through the policy rate and other instruments. The NBRNM has increased the policy rate by 505 bps in 14 rate hikes since April 2022 and the overnight central bank deposit rate, which matters given excess liquidity, by 405 bps in 11 rate hikes (see Figure 4). However, the transmission to retail rates (deposits and lending) has been partial (see Selected Issues Papers). Separately, the NBRNM has increased the reserve requirement on FX deposits by 6 p.p. to 21 percent since June 2022, implying an effective reserve requirement tightening of about 1 percentage point. This also increased the difference between reserve requirements on denar deposits and FX deposits (to 16 percentage points) to incentivize the use of domestic currency.

Figure 4. North Macedonia: Monetary Developments



17. The banking sector remains well-capitalized, while credit growth is easing. In part driven by monetary tightening, deposits and credit growth are gradually normalizing to pre-crisis rates, with deposits expanding 8.9 percent y/y and credit growing 5.8 percent y/y in September (see Figure 5). Credit growth also slowed as corporates repaid operational loans, taken at the height of the energy crisis. Banks' return on assets rose to 2.1 percent in 2Q-23 from 1.7 percent in 2Q-22 and the CAR increased to 18.2 percent in 2Q-23. NPLs have remained stable at a historically low level of 2.9 percent. With solid bank profitability, the NBRNM has increased the countercyclical capital buffer from 0.5 to 1.25 percent, effective by 4Q-24. Separately, and to mitigate the risk from high mortgage' growth, the NBRNM introduced LTV (85 percent) and DSTI limits (55 percent denars loan/50 percent FX loans). Not surprisingly, mortgage credit and real estate prices have cooled off in response to these changes (as well as the decline in construction cost inflation). Macroprudential policy was strengthened with the adoption of a Macroprudential Strategy in April 2023. A new bank resolution law was adopted by parliament in October.

Figure 5. North Macedonia: Banking Sector Developments

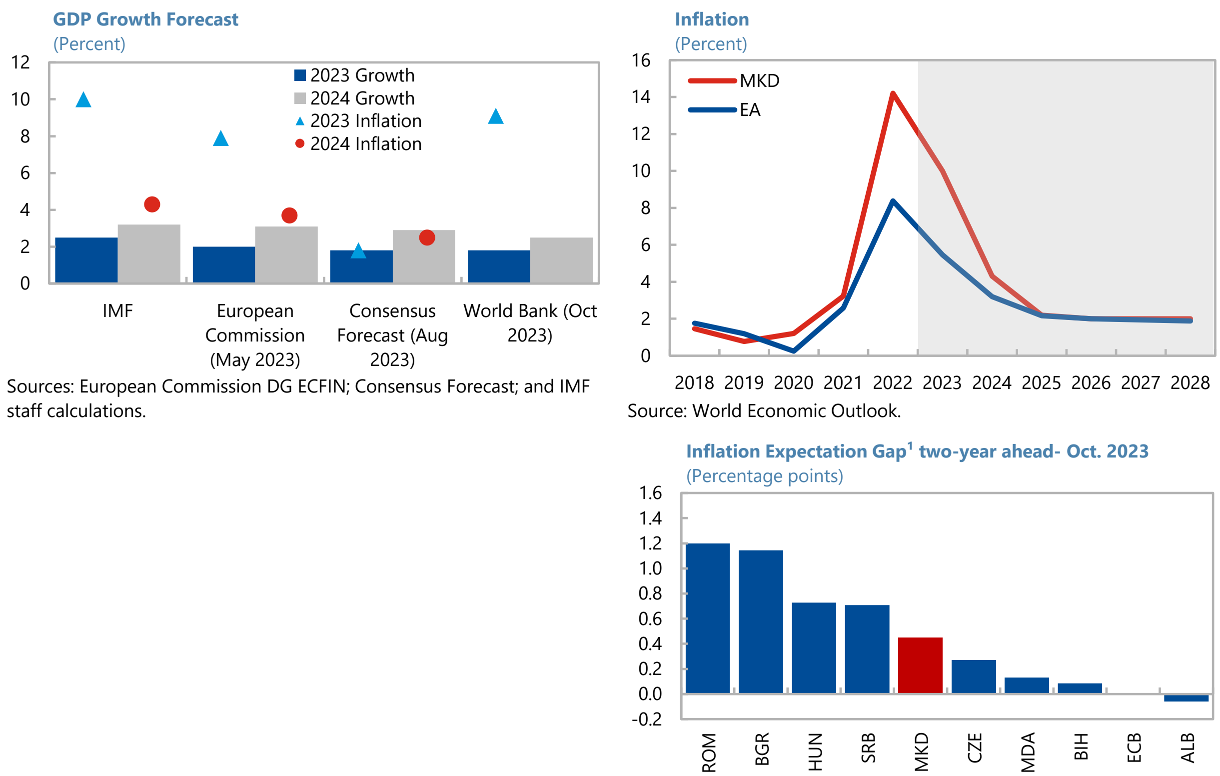


OUTLOOK AND RISKS

18. The growth outlook is broadly similar to what was expected at PLL arrangement approval, supported by the scale-up in public investments. As a result of higher inflation negatively impacting real incomes, continued monetary tightening, and weaker foreign demand, real GDP growth is expected to be 2.3 percent in 2023, lower than the 2.9 percent projected at time of PLL arrangement approval. Growth in the second half of 2023 and in 2024 will be supported by the planned scale-up of public investment, notably as construction on the Corridor 8/10d project begins in earnest. This should bolster 2024 growth, currently projected at 3.0 percent.

19. Underlying inflation pressures are expected to remain persistent for some time, with headline inflation gradually easing towards the implicit target. Headline inflation is projected to continue easing on the back of lower global energy and food prices as well as substantial base effects but will still be around 9.5 percent and 4.5 percent on average in 2023 and 2024 respectively (vs 7.1 and 2.5 percent projected at PLL arrangement approval). 2023 inflation is expected to be around 0.5 percentage points lower-than-otherwise due to recently frozen food prices, announced until the end of January 2024, and be higher by a similar magnitude in 2024 due to base effects and a rebound in food prices. Meanwhile, core inflation is expected to remain more persistent than headline at 8.2 percent and 5.2 percent this year and next, respectively, due to high nominal wage growth. Inflation expectations, however, remain well-anchored (see Figure 6).

Figure 6. North Macedonia: Growth and Inflation Projections



1/ Inflation expectation minus inflation target or medium term inflation forecast.
Sources: Concensus Forecast; IMF WEO; and IMF staff estimates.

20. The public debt outlook remains sustainable with high probability over the medium-term. The adopted Organic Budget Law with the 3 percent deficit rule applying from 2025, as well as the appointment of a fiscal council in 2023, are expected to bolster fiscal discipline, when the council becomes fully operational in 2024. Staff projects the public deficit to narrow to 2.7 percent of GDP in the medium-term, complying with the deficit rule. Public debt is projected to be on a downward path, in the baseline, remaining close to 50 percent of GDP over the projection period with total public debt (including SOEs) remaining below 60 percent of GDP over the projection horizon (see Table 1 & Annex I).

21. The current account is projected to continue improving, financed by robust FDI. The current account is expected to narrow to 2.5 percent of GDP in 2023 and remain broadly stable in 2024, driven by moderated import growth given projected energy prices and lower import demand following the stockpiling of inventories in 2022, as well as continued strong remittances, and financed by robust FDI inflows. These being said, with banks in good health, bank subsidiaries have been repaying loans extended by the parents during the energy crisis at a fast clip, leading to stronger capital outflows than staff was projecting. All in all, gross reserves are projected to reach €4,126 million by end-2023 (104 percent of the ARA metric), and €4,652 million (108.5 percent of the ARA metric) by end 2024. This is stronger than the reserves projection at the time of PLL arrangement approval. The External Debt Sustainability Assessment indicates that external debt is sustainable (see Annex III).

22. Risks remain on the downside with Russia's war in Ukraine, regional conflicts, global fragmentation, and volatile commodity prices. Increased global uncertainty stemming from the potential intensification of the war in Ukraine and regional conflicts could lead to higher and volatile commodity prices, adding to inflation, and weighing on growth and fiscal space (see Annex IV). A higher-than projected slowdown in Europe risks weighing on growth in North Macedonia through reduced exports, FDI and remittances. Domestic risks are mainly related to political uncertainty in the run-up to the elections, which could lead to a deterioration in investor confidence, as well as high inflation becoming entrenched in expectations.

Authorities' Views

23. The authorities broadly agreed with staff's assessment of growth, inflation, and risks. The authorities have revised growth down, relative to PLL arrangement approval, due to weaker-than-expected domestic demand and a worse international outlook. Investment is expected to drive an increase in 2024 growth, which they see at or above 3 percent. They see inflation as falling to around 2 percent by end-2024 as international prices normalize while core is expected to remain elevated, although lower than in 2023 and lower than in staff's projections. They see risks to the outlook are mainly global factors fueling further increases in commodity prices.

24. The authorities agree with staff's assessment that the 2022 external position was broadly in line with fundamentals. The authorities view the real exchange rate to be in line with fundamentals and given the lack of misalignment, consider the de facto pegged exchange rate to be stable. While projecting end-2023 reserves to be in line with staff's baseline projection, the authorities expect the current account deficit to be lower than projected by staff on the basis of lower import of goods, as world import prices stabilize and as companies de-accumulate inventories that were stockpiled in 2022, and strong performance in services trade.

REVIEW OF QUALIFICATION UNDER THE PLL

25. Since Board approval of the PLL, North Macedonia has continued to meet the qualification criteria for an arrangement under the PLL. North Macedonia is assessed to perform strongly on four out of five of the main policy areas: External position and market access, monetary policy, financial sector soundness and supervision, and data adequacy. Meanwhile, North Macedonia does not substantially underperform in the fiscal area (see Text Table 2 for a summary assessment of changes, and Annex VII for a full assessment of the qualification criteria under the PLL). Having met most quantitative targets, one structural benchmark, and the prior actions completed for the 1st review (see below for more details on the prior actions), policies are broadly on track within the program context to achieve the program objectives: safeguarding public finances, reducing energy subsidies and improving energy efficiency while protecting vulnerable households, tackling high inflation, and preserving financial stability.

Text Table 2. North Macedonia: Summary of Qualification Assessments

	2022 PLL Request 1/	2023 PLL 1st Review
1. Sustainable external position (EBA assessment at least "moderately weaker").	Broadly in line	Broadly in line
2. Capital account dominated by private flows (share of private flows in total capital flows>50 percent, on average in the past three years).	73 percent	71 percent
3. Track record of steady sovereign access to sovereign markets at favorable terms (public sector bonds issued or loans disbursed in international markets in at least 3 of the last 5 years; cumulative amount during the last 5 years at least 50 percent of the Fund quota).	3 issues over the last 5 years in the amount of more than 1,000 percent of quota	3 issues over the last 5 years in the amount of more than 1,000 percent of quota
4. Comfortable reserve position (reserves >100 percent of ARA metric on average over three years, and not below 80 percent in any of these years).	105 percent between 2020–22	108 percent between 2020–22
5. Sound public finances (debt sustainable with high probability).	Debt is sustainable with high probability	Debt is sustainable with high probability
6. Low and stable inflation (inflation in single digits in the last 5 years preceding qualification).	1.6 percent	4.2 percent 2/
7. Sound financial system (the average capital adequacy ratio for the banking sector>regulatory thresholds; no significant solvency risks or recapitalization needs).	Tier 1 capital ratio stood at 15.9 percent; NPL 3.1 percent; no significant solvency risks or recapitalization needs.	Tier 1 capital ratio stood at 16.6 percent at end-2022; NPL 2.9 percent; no significant solvency risks or recapitalization needs.
8. Effective financial sector supervision (no substantial concerns regarding the supervisory framework).	No substantial concerns in supervisory framework.	No substantial concern in supervisory framework.
9. Data transparency and integrity (an SDDS subscriber or has made satisfactory progress toward meeting the SDDS requirements).	SDDS Plus Adherent	SDDS Plus Adherent.

1/ Reported indicators are those available at the time of the request and review, respectively.
2/ Inflation in 2022 was 14.2%, mainly driven by global commodity prices, energy, and food, and is projected to return to single digit in 2023.

26. The authorities have a track record of implementing sound policies and have managed to adopt some key reform measures in a challenging political environment. Economic fundamentals and the institutional framework continue to be generally sound in line with the assessment at the time of PLL arrangement approval, aided by the Organic Budget Law, the appointment of a Fiscal Council, and a more rules-based framework for public sector wages, from 2025. The MONEYVAL report confirmed that the country has a sound AML/CFT framework and identified some deficiencies that the authorities are committed to addressing. North Macedonia has a sustainable public and external position, market access, financial sector soundness and supervision absent of solvency issues, as well as data adequacy. The authorities' decision to include clauses in the large road contract for Corridor 8/10d, such as flexibility on the final design to minimize costs and keep spending consistent with the fiscal framework, reinforces this view. Inflation developments are broadly in line with global and regional developments considering the large share of food products in the consumption basket, and within a context of a sound monetary policy and exchange rate framework. Institutional reforms, e.g., fiscal council, the framework for public sector wages, and financial sector legislation, since the PLL arrangement approval have generally been favorable.

27. Parliament adopted controversial changes to the criminal code in September. North Macedonia fares relatively well on rule-of-law, regulatory quality and government effectiveness, but below average on control for corruption. This being said, the authorities adopted changes to the criminal code in September. Staff's assessment is that the amendments to the criminal code raise concerns about the country's commitment to anti–corruption initiatives and the rule of law, but at this stage they do not significantly affect PLL qualification in relation to institutional strength and the ability to respond to shocks in particular (see Annex VII and Annex XII).

REVIEW OF PERFORMANCE UNDER THE PLL

28. The March and September fiscal targets under the PLL were met, while the stock of public payment arrears has been reduced since November 2022. The end-March government cash balance floor of -17,560 million Denars was met with a substantial margin. The September cash balance floor of -29.538 million Denars was also met. The cash balance floor is proposed to be adjusted downward by €8 million (0.5 billion Denars), reflecting the EU grant disbursed with a first tranche of €72 million in 1Q-23, and the remaining €8 million in 1Q-24, against the expectation of the full €80 million being disbursed in 1Q-23 at the time of PLL arrangement approval. Also, there was a reduction in arrears to the private sector of -1.97 billion Denars (0.2 percent of GDP) since PLL approval in November 2022, at which time the stock of payment arrears to the private sector was 15.3 billion Denars (1.7 percent of GDP). The largest reduction was for SOEs, as well as a reduction in VAT refund arrears. There has been no accumulation of new external debt payment arrears (see Text Table 3 and Table 9).

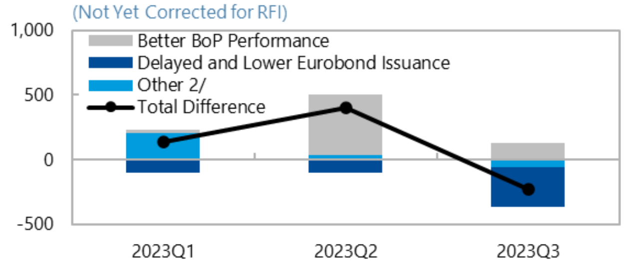
Text Table 3. North Macedonia: Fiscal Indicative Targets and Continuous Performance Criteria
(End of period, million denars, unless otherwise indicated)

	March 2023	Outcome	Status	Sept. 2023	Outcome	Status
Indicative Targets						
Floor on the central government cash balance (PLL approval)	-17,560			-29,538		
Adjusted floor on the central government cash balance (Proposed modification)	-18,052	-3,603	Met	-30,030	-27,643	Met
Non-accumulation of new domestic arrears since PLL approval, since end-November 2022	0	-1,709	Met	0	-1,969	Met
Continuous Performance Criteria						
Non-accumulation of new external debt payment arrears	0	0	Met	0	0	Met

Source: IMF staff estimates and projections.
Note: Public domestic arrears to the private sector are measured cumulative from end-November 2022.

29. The March net international reserves (NIR) floor was met,[6] while the government's decision to delay and replace some of market financing with IFI financing meant that the September floor was not met. Reserve developments in 2023 have been favorable, with the end-March NIR reaching €2.86 billion, well above the adjusted indicative target of €2.73 million. The September floor was not met as projected (see Text Table 4), mainly due to the government's decision to shift FX financing from 3Q-23 to 4Q-23 and 1Q-24 as it assesses various options (including IFI financing), and not due to unfavorable BoP or market access developments–in fact, staff's reserves forecast for end-2023 is higher than at the time of PLL approval. End-2023 GIR is expected to reach 104 percent of ARA, significantly overperforming the projected 100 percent of ARA at PLL approval.

NIR: Difference from Targets at PLL Request 1/
(Not Yet Corrected for RFI)



1/ PLL request assumed 600 million EUR market financing in Q1 and 200 million EUR market financing in Q3. After the request this has been revised to 500 million EUR Eurobond issuance in Q1 and 100 million EUR market financing in Q4.
2/ "Other" difference includes mistakes in seasonality applied to the projection at PLL approval.
Source: IMF staff calculations

[6] NIR projections and NIR floors set at the time of PLL approval did not account for the outstanding RFI credit. Outstanding RFI credit has been subtracted from NIR floors set at the time of PLL approval and subsequent NIR calculations to be consistent with the NIR definition in the Technical Memorandum of Understanding (TMU).

Text Table 4. North Macedonia: Indicative Targets on Net International Reserves 2023Q1–2023Q3
(Million euros)

	2023Q1	Status	2023Q2	2023Q3	Status
Gross International Reserves (GIR)	**4,148**		**4,194**	**3,890**	
% of ARA	104		105	98	
Outstanding IMF Credit	296		296	273	
Of which: PLL	*111*		*111*	*111*	
Of which: RFI 2/	*185*		*185*	*162*	
Other Reserve-Related Liabilities	991		1,131	1,157	
Net International Reserves (NIR)	**2,860**	**Met**	**2,766**	**2,461**	**Not Met**
NIR at time of PLL Approval 1/	2,919		2,557	2,862	
Adjustor: EU Grant	-8		-8	-8	
Other modification: RFI 2/	-185		-185	-162	
Adjusted NIR at PLL Approval 1/	**2,726**		**2,364**	**2,692**	
Difference	**134**		**403**	**-232**	

Source: IMF staff calculations.
1/ 2023Q1 and 2023Q3 are set as ITs.
2/ NIR targets and projections at the time of PLL approval did not account for the outstanding RFI credit. Outstanding RFI credit is subtracted from the NIR floors and subsequent NIR calculations in order to be consistent with the NIR definition in the TMU.

30. **The authorities have met one structural benchmark on a comprehensive feasibility study on the Corridor 8/10d road project, while the structural benchmark on an energy action plan to reduce energy subsidies was not met due to lack of concrete measures. Hence, staff proposed concrete measures on energy subsidies as prior actions for the 1st review, and these measures have now been adopted (see below).** The authorities had to complete two structural benchmarks for the first review under the PLL (see Text Table 5). There were no structural benchmarks attached to the 2nd review at the time of PLL arrangement approval.

Text Table 5. North Macedonia: Structural Benchmarks for the 1st Review

Structural Benchmark	Deadline	Status
Corridor 8/10d Road Project	End-January 2023	Met
Comprehensive and independent feasibility study of Corridor 8/10d road project, shared with IMF staff		
Energy Action Plan	End-February 2023	Not met
Adoption and publication of a government action plan to gradually eliminate the need for government subsidies for electricity services and further improve energy efficiency.		

- **The authorities shared the feasibility study on Corridor 8/10d with Fund staff by end-January, and they are assessed to have met the structural benchmark.** A feasibility study for Corridor 8/10d was shared with Fund staff by end-January. The Feasibility Study (FS) provided was comprehensive and independent, and candidly acknowledged knowledge gaps in project design, given that the feasibility study had to be delivered before the geotechnical studies and other due diligence could be realistically completed. Given these knowledge gaps, the feasibility study acknowledged uncertainty regarding the likely project cost. The authorities used the Feasibility Study and its findings when negotiating and signing a contract for the construction of Corridor 8/10d in March 2023. Important safeguards in the contract include provisions that the Constructor and Engineer cannot make changes (except well-specified emergency changes) without approval from the government. The government also has the prerogative to opt for least-cost design if it is technically feasible.

- **The government adopted an energy action plan by end-February to gradually eliminate energy subsidies, but staff found it short of meeting the structural benchmark.** Staff assessed that the various iterations of the plan lacked sufficient concrete measures and thus advised that the plan not be adopted and published. Instead, staff therefore proposed concrete measures on energy subsidies as prior actions for the 1st review: (i) lowering the mandatory share of the demand of the regulated market to be supplied by the state-owned electricity generator (ESM), (ii) increasing the price charged by the ESM for providing electricity to the regulated market, and (iii) raising the price charged by ESM for covering electricity distribution losses. These measures have now been adopted.

31. The authorities are making progress on many of the "soft" commitments in their written communication at PLL arrangement approval, despite a challenging political environment. The authorities have fulfilled 23 out of 32 "soft" commitments in the Written Communication (see Annex V) for individual details on each commitment.

POLICY DISCUSSION

A. Fiscal Policy

32. Staff expect the authorities to overperform on the 2023 budget outcome. Staff expect the authorities to overperform the 4.7 percent deficit target on the 2023 budget outcome by 0.2–0.3 percent of GDP. They have committed to use any savings on the 2023 budget for a €30 million pre-funding of the Corridor 8/10d road project, other capital expenditure projects, or reduction of arrears, but not for an expansion of current spending.

33. The government has adopted a 2024 budget consistent with program objectives (prior action), with adoption in Parliament expected not later than December 31. Next year's budget will benefit from the full-year effect of the recently adopted tax reform. Nevertheless, based on policies as of October, staff's projection of the 2024 deficit would have been 4.2 percent of GDP. The authorities have made a commendable effort in finding additional consolidation measures of

0.8 percent of GDP to support the 3.4 percent deficit target for 2024, which is the target agreed at the time of PLL arrangement approval. There were three key reasons for seeking a lower deficit in 2024: (i) moving towards the Organic Budget Law's 3 percent deficit target; (ii) rebuilding buffers for future crises or cost overruns from the large road project; (iii) helping monetary policy to reduce inflation further. The main additional consolidation measures in 2024 are from energy measures, leading to lower subsidization of electricity prices (0.5 percent of GDP), reform of agricultural subsidies (0.1 percent of GDP), as well as pre-funding for the Corridor 8/10d road project with 2023 savings (0.2 percent of GDP) (see Text Table 6, and further details below). The public investment budget in 2024 is large by historical standards, but there is no room to compress it further as buffers are needed for potential cost overruns on Corridor 8/10d, as well as the scale-up in public investments needed to close infrastructure gaps to the EU and support the green transition.

Text Table 6. North Macedonia: Key Drivers of Projected Budget Adjustment in the 2024 Budget*

(Percent of GDP)

Expected Public Deficit in 2024 based on policies as of October	**4.2**
New adopted measures since October	
Energy Measures	
Lower ESM electricity provision to the regulated market	-0.3
Price/Tariff changes	-0.2
Reform of Agricultural Subsidies	-0.1
Pre-funding Corridor 8/10d with saved funds from the 2023 Budget	-0.2
Expected Public Deficit in 2024 with adopted measures	**3.4**
Public deficit agreed under the PLL (nominal, deflated at current GDP)	**3.4**

* Estimates on the consolidation measure are provided by the Energy Regulatory Commission, the Agricultural Ministry, and the Ministry of Finance. Verified by estimates of Fund staff.

34. **The authorities have adopted a set of energy measures to lower electricity subsidies and support the green transition, including through incentivizing energy efficiency.** Staff assess that the state-owned electricity generator, ESM, is selling electricity to the regulated market at some 40 percent below its cost-recovery, and that the ESM would continue to make financial losses through the full projection period. If energy prices were to rise again, resulting subsidies would continue to be a fiscal vulnerability for the government, as it would need to recapitalize the ESM (see Annex IX). The authorities therefore adopted a set of energy measures as a prior action for completion of the 1st Review.

- Lowering the mandatory provision of electricity by the ESM to the regulated market from currently 100 percent of the demand to 95 percent of demand, to be implemented from January 1st, 2024, and to 85 percent to be implemented from 1st July 2024 (Prior Action). This measure essentially abrogates the current crisis measure mandating the ESM to supply 100 percent of the demands of the regulated market at a fixed price set in six-month intervals. This prior action will allow the ESM to, first, lower the need to purchase expensive electricity imports and, second, to sell excess electricity in the open market at more advantageous prices, or to reduce non-competitive production, as it is gradually exposed to competition as contemplated in the 2018

Energy Law. The measure will also strengthen price signals in the regulated market, as the remaining part of the electricity demand in the regulated market will need to be supplied on market terms (see also Annex IX and SIP for further details). The measure is expected to yield savings of 0.3 percent of GDP.

- Increasing the price charged by the ESM to the universal supplier from 53 €/MWh to 57 €/MWh starting January 1st, 2024, and the price charged by ESM for covering distribution losses in the electricity distribution system from 100 €/MWh to 105 €/MWh. The first measure allows to bring the price charged by the ESM for delivering electricity to the regulated market more in line with the cost-recovery price thus providing savings. The second measure reduces financial losses from covering electricity losses in the distribution system. The package of measures will also result in higher average tariffs, incentivizing lower electricity consumption among households and small companies, as well as incentivizing reducing distribution losses, although the latter would be best accommodated with additional reform measures to lower commercial distribution losses. The measure is expected to yield savings of 0.2 percent of GDP.

The proposed set of measures adopted as prior actions are equivalent to reducing the transfers to the ESM in 2024 by about two thirds based on current and projected prices. For the medium-term, staff assumes that the authorities continue to meaningfully increase tariffs to bring those closer to the cost recovery price, and hence eliminate the remaining third.

35. **The authorities have adopted a new methodology for agricultural subsidies from an input-based system to an output-based system.** The methodology for agricultural subsidies is shifting from a fixed, guaranteed subsidy, to a blend of a lower guaranteed amount and an output-based subsidy, with effect in 2024. The previously fixed guaranteed subsidy per hectare (for crops) will shift into two equal parts; one part with a lower fixed amount per hectare, and one part, which will be based on verified output. There will be enhanced inspections and documentation needs to ensure compliance. A similar reform is introduced for cattle production. The measures are expected to also incentivize greater agricultural production output and will provide savings on agricultural subsidies of 0.1 percent of GDP.

36. The authorities need to carefully plan for additional potential costs on the large Corridor 8/10d road project. Following extensive discussions with the authorities, their financial transaction advisor, IRD Engineering, and the construction consortium, BECHTEL/ENKA, fiscal risks are mainly concentrated in the mountainous section II and to a lesser degree section III, which is a UNESCO protected area. Sections I and IV are flat and present fewer challenges. However, the geotechnical studies which are key to determine whether changes to original design are needed (and hence whether costs are higher) are not likely to be completed before early 2024. Staff propose to set the completion of geotechnical studies on sections I, II, and IV, updated designs informed by the geotechnical studies, and an updated bill of quantities (costs), agreed between the parties, as structural benchmarks for the next (second) review (Deadline April 15, 2024).[7] If cost estimates

[7] Section III is not part of the structural benchmark by April 15, as Section III is not scheduled to start until 2025.

resulting from the new designs and bills-of-quantities become significantly higher or do not appear manageable, the authorities are committed to adjusting the timeline of the project implementation in order to fit it into a sustainable medium-term fiscal framework, and/or implement a part of the project with concessional involvement and financing, consistent with the agreed program targets and the fiscal rules of the organic budget law. While the geotechnical studies and an updated design will help firm-up the fiscal costs, fiscal risks from cost overruns will remain a risk throughout the construction phase.

37. Beyond reducing the deficit, several structural fiscal reforms are needed. The authorities have committed to continue staffing the Public Investment Management Department in the Ministry of Finance to its full capacity, together with the strengthening of methodologies for the identification and costing of projects, which will lead to more efficient public investment. They have also committed to better management of fiscal risks from public investment, including through Fund provided TA. The authorities have also committed to submit the new PPP law to Parliament during 2024. Separately, increasing tax compliance is crucial for improving the fiscal position and ensuring a competitive playing field in the economy, and the authorities have committed to continue the ongoing reform efforts inside the Public Revenue Office in 2024, including by strengthening the centralized compliance risk management (CRM), as well as implementing a more efficient risk-based approach to the VAT refund framework. Finally, staff expects the Fiscal Council to become fully operational in 2024, and improve fiscal governance, in line with the provisions and intent of the OBL.

38. To support the 2024 budget, the government will need to avoid unfunded promises on public sector wages and pensions ahead of the elections. To ensure that, as per commitments in the new general collective agreement, public wages should not increase in 2024 beyond a well-defined inflation adjustor, and to limit risks of spending slippages on other entitlements ahead of the elections (later to be financed from reallocations from capital expenditure), staff propose a Quantitative Performance Criteria (QPC) on current primary spending and an indicative target (IT) on central government wages and allowances,[8] both consistent with the 2024 budget approved by government (see Table 9). It will be important to adhere to the newly agreed GCA framework to maintain public sector wage discipline in the medium-term.

39. On the financing side, the government is projected to cover the total 2024 gross financing needs of about €1.7 billion euros, of which about €547 million from the deficit, with roughly 2/3 domestic debt issuance and 1/3 external borrowing. The government is expected to enter 2024 with solid FX deposits. There are no major amortizations such as Eurobonds in 2024. IFI financing, in the form of EU-MFA (€50 million) and EBRD financing (€50 million), is expected, on top of the IFI financing from the World Bank, KfW and OPEC in 2023. Remaining access under the PLL arrangement is expected to remain precautionary in 2024, following the planned drawdown of 85 percent of quota (SDR 119.25 million). The European Commission has also recently announced a new Growth Plan for the Western Balkans, which includes a €6 billion Reform and Growth Facility for

[8] Because current spending is the broader aggregate and that it already captures developments on public sector wages, the QPC is set on that and the IT on wages and salaries.

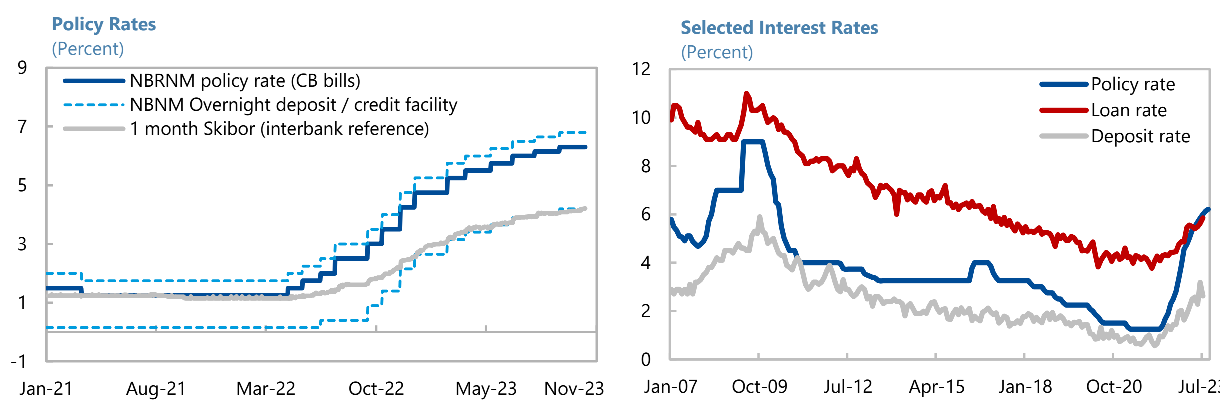
the Western Balkans for the period 2024-2027 in the form of grants and loans. This could potentially provide additional funding to North Macedonia, though it is too early to speculate on the amounts.

40. Staff propose to adjust the fiscal cash balance floor for March 2024 to better reflect energy intensive months in 2024, EBRD financing for ESM electricity purchases, and the EU grant. The March 2024 cash balance floor would be adjusted upwards by the €8 million (493 million Denars) EU grant assumed disbursed in 1Q-24, from previously in 2023. In addition, the 2024 cash balance floor provided at time of PLL arrangement approval did not reflect greater seasonal spending of subsidies in the energy intensive months, which would be corrected in the adjusted floor. The revised cash balance floor with a downward adjustment of 1,185 million Denars, Text Table 3, is fully consistent with the 3.4 percent deficit target.

B. Monetary and Financial Sector Policies

41. Inflation is coming down but risks to inflation remain high, monetary policy should therefore remain tight, and the NBRNM should stand ready to tighten further if risks to inflation materialize. As discussed above, the increase in the policy rate to 6.30 percent, together with other measures (reserve requirements, macro-prudential measures) have combined with lower global commodity prices to slow down credit growth and bring down inflation. Inflation expectations are broadly anchored, and the FX market is very stable. Nevertheless, given high nominal wage growth, there are risks that inflation will reaccelerate and become entrenched at a higher level. In this context, the NBRNM should keep policy tight, and it should stand ready to tighten further if inflation reaccelerates on a sequential basis.

Figure 7. North Macedonia: Selected Interest Rates



Sources: NBRNM; ECB; and IMF staff calculations.

Sources: NBRNM and IMF staff calculations.

42. The interest rate pass-through from the policy rate to retail interest rates has thus far been modest (see Figure 7 and SIP). Given the decline in inflation, the stabilization of inflation expectations, and the stability of the FX market in the midst of an energy crisis last year, staff believe that, on the whole, the monetary framework is robust, with a clear mandate and instruments to deliver it. Nevertheless, to strengthen transmission, staff see a need to continue upgrading the monetary operations framework, in particular by narrowing the interest corridor—by raising the floor—reducing the maturity of CB-bills, and improving the CB-bills auction system. The NBRNM has committed to develop an internal roadmap to improve the monetary operations framework as a structural benchmark for the 2nd review (deadline: end-March 2024), though the exact nature of the measures, and their sequencing, will need to be carefully calibrated including in close discussions with MCM TA experts. Separately, the indicative target for end-March 2024 NIR is proposed to be kept at €2,759 million, the same as the target set at PLL arrangement approval (see Table 9).

43. The NBRNM should continue enhancing bank-risk monitoring and aligning supervision regulation with the European standards. Given the global monetary tightening, the NBRNM has intensified its risk monitoring. Banks' valuation losses have been modest as banks' securities portfolios are narrow, but the NBRNM has appropriately been focused on indirect credit risk, including performing sensitivity analysis on the impact of interest rate shocks on NPLs and capital. The NBRNM is making progress in further developing bottom-up stress tests with Fund-provided TA. To strengthen supervision, the NBRNM is transposing EBA standards to the domestic banking system, and in this sense credit risk management and banks' disclosure regulations have been upgraded. Despite the strong position of banks, it is key to continue closely monitoring the mortgage market, systemic banks, and NBFIs, as well as the borrowers' credit worthiness.

44. Following the upgrade of the macroprudential and resolution frameworks, efforts should now turn to enforcement and operationalization. To prevent the build-up of risks in credit, particularly in real estate, the NBRNM commendably introduced borrower-based macro-prudential measures—DSTI and LTV limits—developed and calibrated in close consultation with the Fund.[9] Going forward, the focus should be on enforcement and on monitoring their impact and effectiveness. Separately, and given banks' robust profitability, staff support the ongoing strengthening of capital requirements. While liquidity remains at sound levels, banks' resilience can be strengthened by adopting differentiated liquidity requirements (LCRs) for FX and denars.[10] With the approval of the new bank resolution law in October,[11] the priority is to operationalize the bank-resolution framework by amending by-laws and building capacity on this area. These efforts should be complemented by upgrading the deposit insurance law to improve the operations and governance of the fund. A draft law on deposit insurance is expected to be submitted to Parliament by 2024. Finally, the authorities are strengthening the non-bank financial intermediation (NBFI) supervision. A new law on financial corporations (FCs) that tightens requirements for FCs' operations—was approved in October 2023, and the Securities and Exchange Commission is working to upgrade the law on financial instruments and transparency and prospective issuers.

45. The NBRNM is strengthening its governance and independence. It is key to preserve the operational independence of the NBRNM. Amendments to the NBRNM law were submitted to parliament but have yet to be adopted. They aim to ensure i) the autonomy to set employment

[9] LTVs sets a cap of 85 percent of LTV and DSTIs set maximum DSTI of 55 percent for denars loan and 50 percent for FX loans.

[10] A differentiated LCR for FX and denar will prevent the situation where banks meet the minimum 100 percent LCR, but FX-LCRs are lower than the 100 percent, as banks compensate with higher denar-LCRs.

[11] This law transposes the EU BRRD IV into the domestic bank resolution regulation.

conditions of staff, ii) establish a formal macroprudential mandate, and iii) an improved NBRNM's governance framework. The 2023 Safeguards Assessment recommended additional amendments to strengthen the profit retention, formalizing the audit committee and improving the reporting line of internal audit. Therefore, staff recommend that the National Bank Law be withdrawn from parliament, that the additional amendments from the 2023 Safeguards Assessment be added, and that the law be re-submitted to parliament without delay. Separately, it is key to amend other relevant legislation (Draft Law on Administrative Servants, Draft Law on Public Sector Employees, and Draft Law on the Salary System of the Public Sector) to preserve the central bank's autonomy to set its employment conditions.

46. The authorities should push ahead with ongoing efforts to address the main AML/CFT deficiencies identified in the recent Mutual Evaluation Report (MER). The authorities have prepared draft amendments to the AML/CFT law. They have also started the process of updating the national risk assessment and the action plan aimed at addressing all Recommended Actions in the MER. One of the priorities in this respect should be to review the regime for sanctioning non-compliant obligated entities to grant the supervisory authorities with appropriate discretion in imposing pecuniary sanctions commensurate with the severity of the breaches identified.

Authorities' Views

47. The authorities agreed on the need to continue fiscal consolidation. The authorities agreed that fiscal consolidation is important to bring the deficit closer to the deficit limit of the Organic Budget Law, to build buffers to meet future unexpected needs, and to support efforts to lower inflation. They are confident that costs for Corridor 8/10d will be contained within the existing price estimate for the road, and that the Public Enterprise for State Roads (PESR) will have sufficient own revenues to cover the expropriation costs without transfers from the budget. They point to already significant electricity tariff increases since 2020 but agree that the current setup for the regulated market is a fiscal vulnerability. They agree in principle that revenues could play a stronger role in fiscal consolidation, including through further broadening the tax base, reforms of tax rates, but also point to current political limits on the ability to adopt tax policy changes.

48. The NBRNM considered that the current monetary policy stance is appropriate, and that it remains ready to act if inflation risks materialize. Beyond issues on the appropriate stance where there is agreement with staff, the NBRNM views its success in reducing inflation, anchoring inflation expectations, and stabilizing the FX market, as vindication that its monetary policy framework is robust and equipped with the right instruments. In addition, the NBRNM views the pass-through from policy rates to market rates as only one channel of transmission, albeit an important one. Moreover, their estimates point to higher pass-through than assessed by staff, with full pass-through in the medium-term. They acknowledge however that there is some room to improve monetary policy transmission by enhancing monetary operations but noted that enhancements to the monetary operations framework are complex, and require proper calibration, adequate timing, and clear communications (in particular, to avoid compromising disinflation efforts by introducing changes that could muddy policy signals).

49. The authorities fully share Fund staff's views on the resilience of the banking system; however, they will continue to closely monitor risks. The authorities considered that further tightening of capital requirements is key to build resilience given high uncertainty. They agree on the need to continue closely monitoring risks and enhancing stress testing capacity. They emphasized the importance of operationalizing the bank-resolution framework and will make it a priority. The NBRNM emphasize the need to approve the amendments to the Draft NBRNM law and related laws.

EXTERNAL FINANCING NEEDS UNDER THE PLL

50. The 1st review under the PLL would cover the financing needs for 2024 assisted by multiple IFI financing. In the baseline, staff estimate a total external financing gap of €406 million in 2023, which is to be covered by exceptional IFI financing, consisting of €72 million from an EU grant, €50 million from the EU-MFA, U$100 million-equivalent from the World Bank, €50 million from OPEC, €90 from KfW, and €50 million from the EBRD. In 2024, in the baseline, the financing gap of €255 million is covered by a €147 million drawing under the PLL arrangement, and other exceptional IFI financing, i.e., the residual EU grant, EU-MFA and EBRD financing, and there is no residual financing gap. This would result in total reserves being €4,126 million (104 percent of ARA) by end 2023 and €4,652 million (109 percent of ARA) by end 2024. This is higher than what was projected at PLL approval. In the adverse scenario (see Annex X) staff expect the financing gap and coverage in 2023 to remain unchanged, but the financing gap in 2024 to increase to €506 million, to be covered by drawing the full amounts available under the PLL of €398 million, co-financed by the EU-MFA of €50 million and the EBRD of €50. In this scenario, total reserves would drop to €4383 million (103 percent of ARA) by end 2024. Both in the baseline and the adverse scenario, the program is fully financed and there is no remaining financing gap for the remainder of the program.

Text Table 7. North Macedonia: Proposed Rephasing

Availability Date	Condition	Credit Available: Millions of SDRs (cumulative)	Credit Available: Percent of Quota (cumulative)
November 21, 2022	Approval of PLL Arrangement	84.18	60
May 21, 2023	Originally Scheduled Review	203.44	145
November 21, 2023	Completion of First Review	245.53	175
May 21, 2024	Completion of Second Review	406.87	290
Total		**406.87**	**290**

Source: IMF staff.

51. Staff propose to rephase the original schedule of purchases agreed with the authorities and endorsed by the Board at approval of the PLL arrangement. Because this review is being completed more than six months after the original schedule, the authorities have technically lost access to the PLL. Staff recommends that access be restored based on continued qualification and the strength of the revised program under the PLL arrangement. As agreed at time of PLL arrangement approval, 85 percent of quota (SDR 119.26 million) would be made available upon completion of the 1st review (planned for May), while another 60 percent of quota (SDR 84.18 million) would be made available upon completion of the 2nd review (planned for November), c.f. Table 8. Staff is now proposing to complete the first review but make 115 percent of quota (SDR 161.35) available subject to Board approval (see Text Table 7). The authorities have requested that the amount equivalent to30 percent of quota (SDR 42.09 million) made available in the first (i.e., current) review be treated as precautionary. The original schedule contemplated making 85 percent of quota (SDR 119.25 million) available in the third review (planned for May 2024). Staff now propose to make 115 percent of quota (SDR 161.34 million) available at the next review (now called second review) subject to Board approval. Total cumulative access under the program would not be affected, the rephasing simply shifts some of the disbursement backwards in light of the fact that risks attached to the large road project remain.

Text Table 8. North Macedonia: Proposed New Prior Actions (PA) and Structural Benchmarks (SB) Under the PLL

No.	Measure	Deadline
Prior Actions		
1	The government adopts a 2024 budget consistent with the PLL program target of a deficit of 3.4 percent of GDP.	Met
2	The government adopts a decision to raise the price for electricity charged by the ESM to the universal supplier from 53 €/MWh to 57 €/MWh starting January 1st, 2024, and the price charged by ESM for covering distribution losses from 100 €/MWh to 105 €/MWh.	Met
3	The government adopts a decision to lower the mandatory provision of electricity by the ESM to the regulated market from currently 100 percent of the demand to 95 percent of demand, to be implemented from January 1st, 2024, and to 85 percent to be implemented from 1st, July 2024. This is to be regarded as a ceiling.	Met
Structural Benchmarks		
4	Monthly publication of Corridor 8/10d monitoring reports, edited only for what is stated as confidential in the contract, starting from December 2023.	Met
5	Geotechnical studies on sections I, II, and IV, of the road project, are completed, and an updated design for these sections informed by the studies is agreed by the parties, as is the updated bill of quantities (costs).	April 15, 2024
6	Developing an internal roadmap to improve the monetary operations framework in close consultation with Fund-provided technical assistance, including a transition plan for changes in the operational framework.	March 31, 2024

Source: Fund staff.

CAPACITY TO REPAY THE FUND, SAFEGUARDS AND EXIT FROM THE PLL

52. North Macedonia's capacity to repay the Fund is assessed as adequate. North Macedonia has 135 percent of quota outstanding, after drawing on the Rapid Financing Instrument in April 2020, and the first PLL drawdown in November 2022. Were the full amount available under the PLL arrangement to be drawn, North Macedonia's exposure to the Fund would peak at 315 percent of quota, or SDR 442 million in 2024 (see Table 7). This would represent 11.3 percent of gross international reserves under the adverse scenario, or 3.4 percent of GDP. Nominal debt service to the Fund would peak in 2027, being equivalent to 3.8 percent of reserves and 1.8 percent of exports of goods and services. The authorities have an excellent track record of servicing their obligations, including from the Fund, and as discussed above, regularly access international markets in normal times.

53. Risks to program implementation are mitigated primarily by prior actions. Overall, the strength of the authorities' policies under the arrangement mitigates the risks to the Fund. Risks to program implementation are mitigated by the use of prior actions, especially on the adoption of the 2024 budget, and a strong set of energy measures, lowering electricity subsidies, as well as the overall strength and breadth of the commitments in the authorities' written communication. Risks related to actions and developments in 2024 are as outlined in the risk outlook, (see above). The first round of the presidential elections will be on April 24, followed by the presidential runoff and the parliamentary elections on May 8. A technical government, unable to take new policy or spending decisions, will be in place from January 28. As general elections have been announced to be held on May 8, staff will seek political assurances from the key political stakeholders ahead of the 2nd review which is also scheduled for May.

54. The National Bank of the Republic of North Macedonia (NBRNM) continues to have a strong safeguards framework in place. A safeguards assessment was concluded in March 2023. The assessment found that the NBRNM internal and external audit mechanisms and financial reporting practices remain strong. Risk management and cyber security were strengthened with IMF technical assistance and the implementation of the related recommendations is underway. The amendments to the NBRNM law (¶45) were initially submitted to parliament in January but have not been approved. The 2023 Safeguards Assessment made further recommendations that this will be addressed in a consolidated set of law-amendments (also including the amendments submitted in January) soon to be submitted to parliament.

55. With the authorities remaining committed to the program modalities, this will allow for a smooth exit from the arrangement in 2024, if external conditions allow. The team estimate the fiscal deficit to narrow by the end of the arrangement, contributing to a gradual decline in public debt over the medium term. The level of gross international reserves would increase to 110 percent of the ARA metric at end-2024, in the baseline, and further above that through the projection horizon. North Macedonia would be less vulnerable to energy price surges. A successful exit from the PLL arrangement depends not only on the authorities' policies, but also on a reduction of external risks.

MEDIUM-TERM STRUCTURAL CHALLENGES AND PRIORITIES

North Macedonia was converging towards EU income levels until the GFC, but convergence has stalled since then. PPP income per capita was 27 percent of the EU average in 2000, 37 percent in 2010, and only marginally higher at 38 percent in 2019. The main reason for the slowdown in convergence is weak productivity growth and a decline in capital relative to output since the GFC. Reigniting convergence will require a multi-pronged approach towards arresting emigration, boosting investment and productivity by improving the business environment, rule of law, infrastructure, and education.

North Macedonia is exposed to climate change and natural hazards that pose substantial risks to public safety and public infrastructure, mainly from flooding and forest fires. North Macedonia has committed to an ambitious climate change mitigation and adaption agenda, reducing GHG emissions by more than 50 percent by 2030 compared to 1990. At the same time, North Macedonia has an aging fossil-fuel based energy generating infrastructure and potentially a large scope for improving energy efficiency. A scale-up of private and public investments, along with decommission of old and polluting coal-based power plants is needed to meet emissions targets and support the green transition. Finally, North Macedonia will be impacted by the EU-Carbon Border Adjustment Mechanism (EU-CBAM) from 2026, and the authorities should consider a gradual introduction of carbon taxation to prepare for the EU-CBAM, as also envisioned in existing legislation.

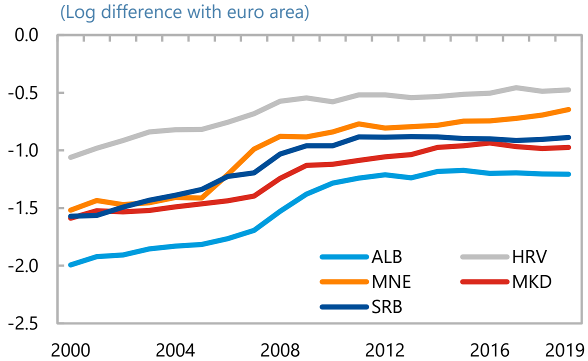
A. Structural Policies

Productivity—Boosting the Allocative Efficiency

56. Allocative efficiency is a key reason beyond poor productivity growth in North Macedonia. After a period of convergence prior to the global financial crisis, output-per-capita convergence slowed in North Macedonia, as in other Western Balkan countries. Unlike other Western Balkan countries where convergence dynamics followed productivity, productivity growth in North Macedonia has been relatively steady but low since the early 2000, c.f., Figure 8. Staff analysis using firm-level data highlights that more productive and growing firms in Macedonia do not attract as much additional employees and capital as in advanced economies, limiting the contributions of these firms to aggregate productivity. Following this metric of allocative efficiency, North Macedonia's efficiency is but a fraction of that in advanced economies. Staff's estimates suggest that modest improvements to allocative efficiency and the business environment can substantially improve aggregate productivity and encourage other favorable outcomes, such as increased labor market participation and firm dynamism, compared with policies targeted at increasing labor participation or the aggregate capital stock. Efforts to improve allocative efficiency should focus on increasing financial inclusion, especially of small and young firms, and improving matches between firms and the labor market, in particular through efforts to reskill and retrain groups that have traditionally suffered from persistent unemployment and underemployment (e.g., low-skill young workers) (see SIP).

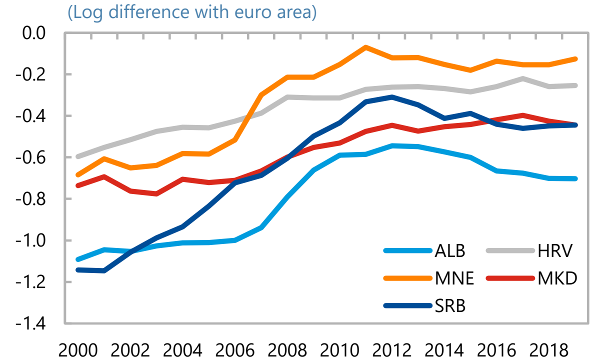
Figure 8. North Macedonia: Convergence and Productivity

Convergence in Output-per-Capita
(Log difference with euro area)



Sources: Penn World Tables 10.0 and IMF staff calculations.

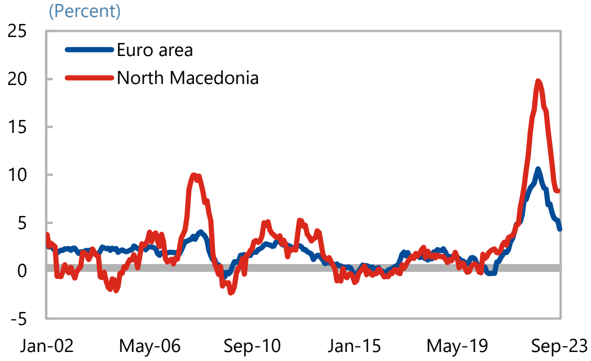
Convergence in Total Factor Productivity
(Log difference with euro area)



Sources: Penn World Tables 10.0 and IMF staff calculations.

Figure 9. North Macedonia: Inflation Differentials, REER and Real Wage

Annual Inflation
(Percent)

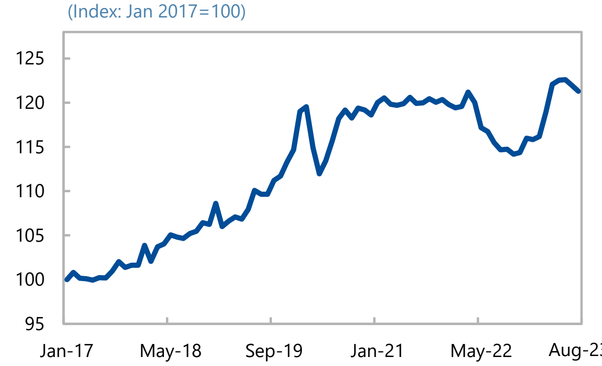


Sources: Eurostat; SSO; and IMF staff calculations.

REER
(Index: 2015=100)

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

Real Wage
(Index: Jan 2017=100)



Sources: SSO and IMF staff calculations.

57. Risks to medium-term competitiveness need monitoring. The recent rise in nominal wage growth, amid modest productivity growth, has the potential to lead to a loss of competitiveness in the medium-term. Staff does not view this as an immediate threat, as the appreciation of the Real Effective Exchange Rate (REER) is a recent phenomenon, inflation differentials are now closing, and real wages have increased recently but only to catch up losses during COVID, c.f. Figure 9. Moreover, the current account and REER are assessed to be broadly in line with fundamentals and desirable policies as of 2022 (see Annex II). Similarly, robust FDI inflows suggest foreign confidence in the competitiveness of the North Macedonia economy. Nevertheless, it will be important to avoid sustained price and wage differentials with the euro area and other important trade partners going forward.

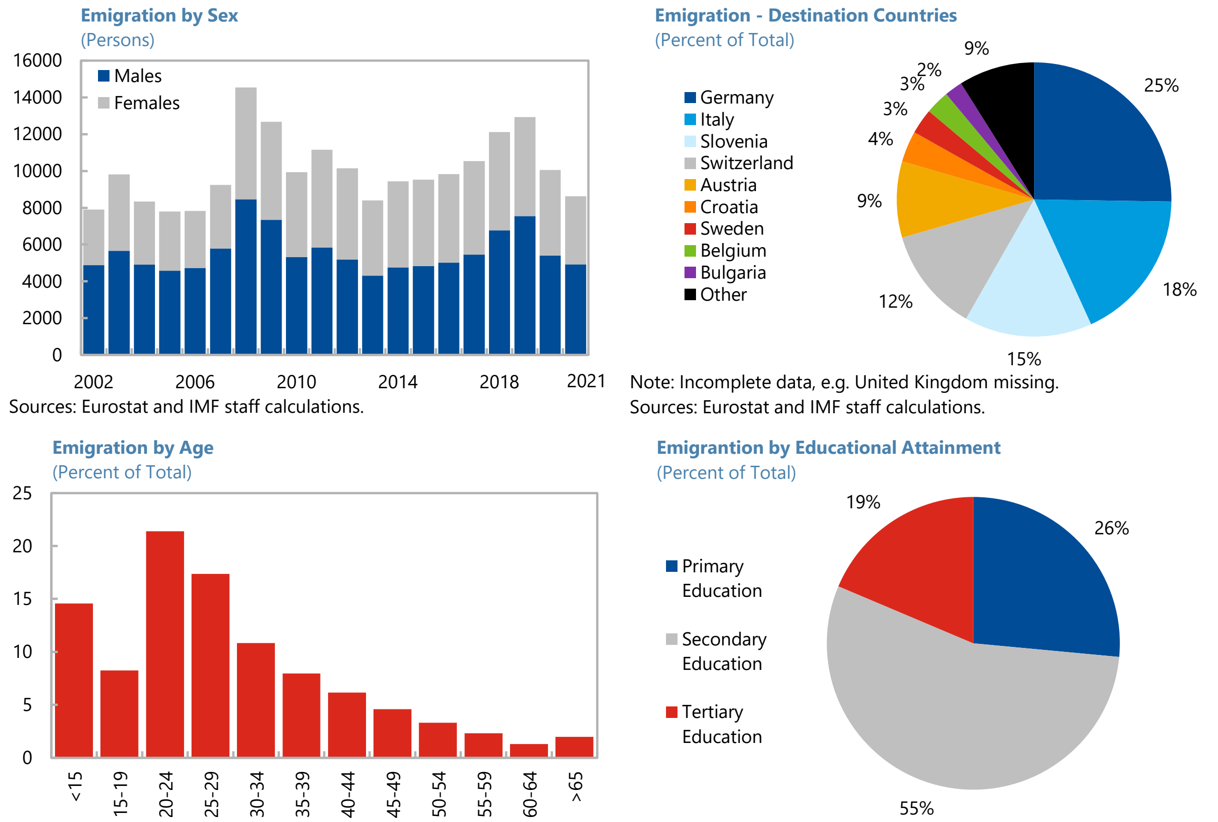
Emigration—A Long-Term Challenge Dampening Growth

58. Emigration has been a challenge for North Macedonia over the last two decades; creating the conditions to arrest emigration is a key priority to improve medium-term prospects. Like many other Western Balkan countries, North Macedonia has experienced high emigration over the last two decades. The 2021 Census showed a non-resident population of 260,606, out of a total population (resident and non-resident) of 2.1 million. Due to self-registration, the Census may even have underestimated the actual number of non-residents. The demographics of the emigrating population indicate that emigration is especially pronounced among the youngest of the working age population, i.e., people in the age range 20–30 years of age. Moreover, emigrants have higher than average education levels (see Figure 10). Whether emigration is a 'youth drain' or a 'brain drain' or both, it leads to a loss of labor, knowledge, and entrepreneurial spirit and has a disproportionate effect on output.

59. There are other channels through which emigration has a disproportional effect on GDP, leading to a loss of GDP per capita. Emigrants tend to be not only younger and more educated but also more entrepreneurial. Using municipal data for emigration, staff's novel estimates suggest that a 1 percentage point rise in the emigration in North Macedonia leads to a loss in the number of companies by about 3 percent.[12] The long-run effects of emigration on the number of firms are less negative than the short-run impacts, suggesting some adaption, but they are still large and significant. Emigration also impacts capital formation, and more in the industrial sector, through a skilled labor shortage channel. The effect of a 1 percent increase in emigration on the level of GDP is 1–3 percent, leading to a drop in GDP per capita (see Annex XI).

[12] Li and Gade, "Emigration, Business Dynamics, and Firm Heterogeneity in North Macedonia", IMF Working Paper No. WP/2023/268.

Figure 10. North Macedonia: Emigration Over the Last Two Decades



Sources: Eurostat and IMF staff calculations.

Note: Incomplete data, e.g. United Kingdom missing.
Sources: Eurostat and IMF staff calculations.

Sources: Eurostat and IMF staff calculations.

Sources: SSO and IMF staff calculations.

60. Strengthening governance and the business environment and reducing informality should be a key priority. North Macedonia continues to perform well across a variety of indicators in the Worldwide Governance Indicators relative to other emerging markets and Western Balkans countries (see Annex XII).[13] There is further scope to strengthen the rule of law and control of corruption, including improving enforcement and strengthening resources available to key anti-corruption agencies, as well as addressing weaknesses in the anti-corruption framework brought about by the recent amendments in Criminal Code. Strengthening governance overall could yield positive benefits both in terms of attracting foreign capital, raising productivity and lower emigration. The EU accession process will be very important for strengthening the rule of law and control of corruption, bringing both up to EU standards, but the authorities will need to show a strong commitment to enforcement going ahead (see Annex XII).

61. Policies to reduce emigration enhance productivity, and bolster competitiveness complement each other. Policy efforts to increase productivity should focus on: (i) fighting informality through removing tax benefits of informality, such as through increasing progressivity of business and labor taxation or creating tax benefits of formality (e.g., tax write offs); (ii) reducing corruption and regulatory delays faced by firms through reform efforts, such as those associated

[13] The WGI are perceptions-based indicators and warrant a cautious interpretation.

with the accession process towards EU membership; and (iii) promoting financial development, especially of small firms, through developing a capital market strategy and exploring ways to decrease intermediary and trading fees. Continued reforms in tax compliance, such as ongoing efforts within the Public Revenue Office, are welcomed and policy should ensure that tax benefits (for employers and employees) to remaining in the informal economy are minimized. In addition, policies that could reduce emigration such as better matching of education outcomes with labor market needs, to avoid high youth unemployment, could benefit both lower emigration and higher productivity. For emigration, the pull factor of the relative income differential to Western Europe is not under the control of the authorities. However, higher convergence should over time eliminate these differences.

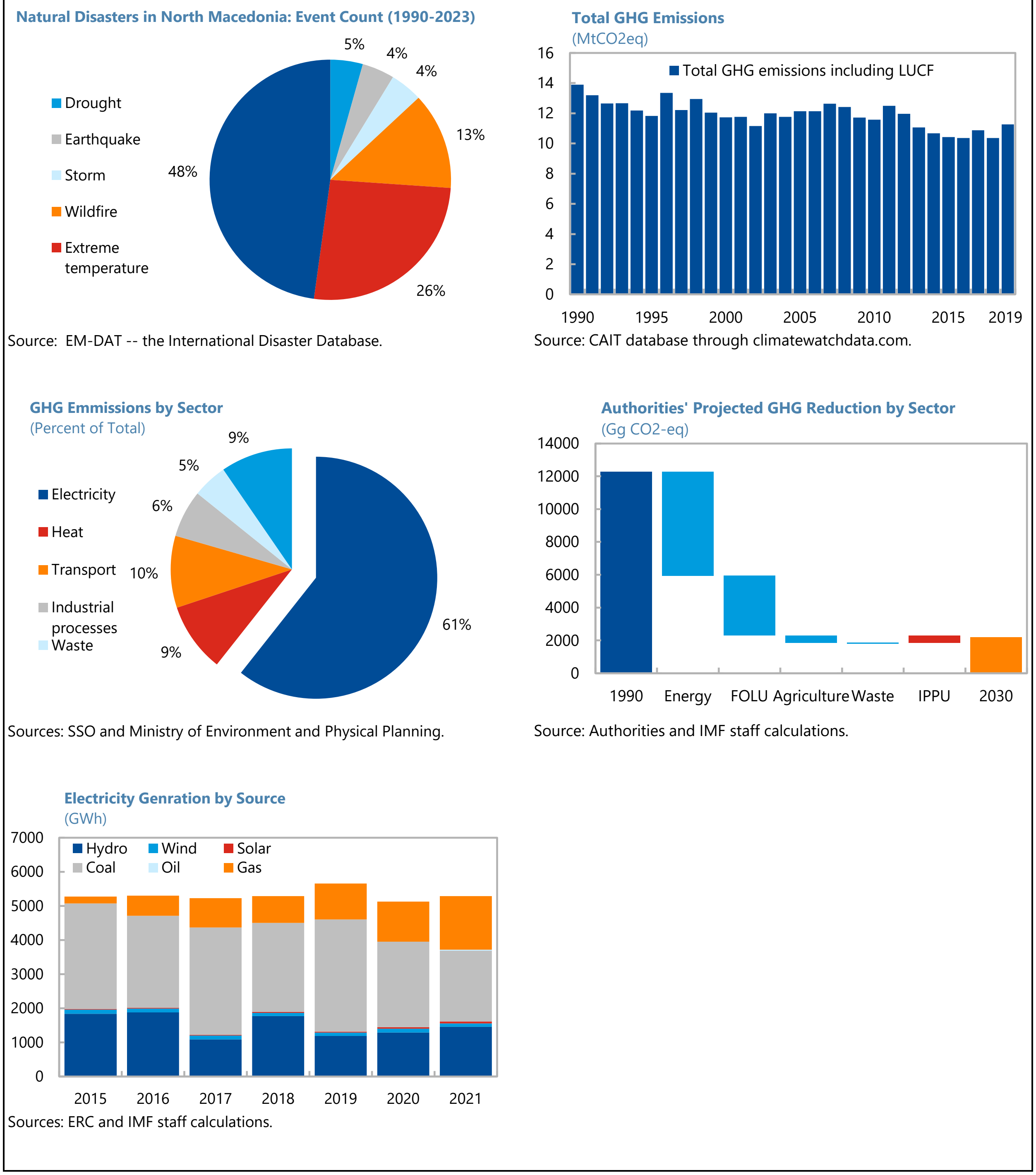
Climate Change – Challenges and Policies

62. North Macedonia is exposed to climate change and natural hazards that pose substantial risks to public safety and public infrastructure. Floods and fires have been the main sources of natural hazards, which are forecasted to become more frequent and extreme as climate change alters temperatures and climate patterns. The country is highly exposed to river floods and urban flood hazards. Between 1990 and 2023, flooding events were most numerous and caused the largest damages. Potentially damaging and life-threatening floods are likely to occur at least once in the next 10 years. Climate change and natural hazards are expected to pose greater risks to North Macedonia in the future (see Figure 11).

63. North Macedonia has an aging fossil-fuel based energy infrastructure mix, but an ambitious climate agenda. North Macedonia has an aging fossil-fuel based energy generating infrastructure. GHG emissions from electricity production is around 60 percent of total GHG emissions and around 90 percent of that is from using coal as an energy source. Under the European Green Deal, North Macedonia committed to work towards the 2050 climate neutrality target. Public investments and policies play a key role in mitigation and adaptation of climate change. In addition, North Macedonia will be impacted by the EU CBAM when fully implemented in 2030 (see SIP).

64. The investment needs to achieve the government's GHG emission reduction targets are large, and the authorities have an ambitious investment agenda. The authorities have outlined their decarbonization and adaptation plans, including investment needs, in the National Strategy for Energy Development 2020–2040, which reflects the most comprehensive document on climate change related measures in North Macedonia. The authorities estimate that the cumulative capital investment needs (public and private) are between €18.5 billion and €34.1 billion through 2050 (30 years), depending on the level of ambition in reducing GHG emissions and strengthen climate resilience. This is equivalent to 4.3–8.0 percent of 2023 GDP annually, and 130–241 percent of GDP cumulative. To cover such large investment needs, would require a strong Public Investment Management (PIM) framework, that also incorporates climate considerations, as well as catalyzing private capital would have to be an essential element.

Figure 11. North Macedonia: Climate Change, Emissions, Sources



Source: EM-DAT -- the International Disaster Database.

Source: CAIT database through climatewatchdata.com.

Sources: SSO and Ministry of Environment and Physical Planning.

Source: Authorities and IMF staff calculations.

Sources: ERC and IMF staff calculations.

65. Policies to adapt to and mitigate climate change should scale-up green investments, strengthen PIM, also introducing climate considerations, and setting the right incentives transition of the electricity sector, as well as consider a carbon tax. To prepare for climate change, and support the green transition through GHG emissions reduction, let alone meeting the national emissions targets, will require a large scale-up of public and private investments. Meeting the targets would require a decommissioning of the old and polluting coal-fire powerplants, as also specified as conditions in the authorities' loan agreement with the EBRD, as well as it requires investments in renewable energy, and setting the right incentives, including through further tariff reforms and consideration of a carbon tax as also specified in national legislation.

Authorities' Views

66. The authorities broadly agreed with staff's assessment of slower convergence, lower productivity growth, and challenges related to emigration and governance, as well as the need to scale-up public investments to adapt to climate change and support the green transition. The authorities agreed with the assessment that convergence to the EU had slowed, as in other Western Balkan countries, and that part of the reason was due to lack of public and private investments, low productivity growth, and that a large share of the young and well-educated working age population had emigrated over the last two decades. They agreed on the need to scale-up public and private investments to mitigate the impact of climate change, and to support the green transition, and agreed that this requires a transition from coal-powered power sources to renewable power sources. They agreed on the need to strengthen governance and combat corruption, as well as to improve the business environment, and see the process towards EU accession as an important catalyst for these reforms.

STAFF APPRAISAL

67. Economic activity is projected to accelerate into 2024, helped by the scale-up in public investments. After strong economic growth in the first half of 2023, the economy cooled off in the second half on the back of lower domestic demand. IMF staff project the economy to expand by 2.3 percent this year and by 3 percent next year. The acceleration will be led by domestic demand, supported by the scale-up in public investments, notably the Corridor 8/10d road project. The improvement in the trade balance together with resilient foreign direct investment should continue to support supporting international reserves, which remain at adequate levels. The 2022 external position is assessed to be broadly in line with fundamentals and desirable policies.

68. Inflation is coming down thanks to monetary policy tightening and the normalization of global energy and food prices. Headline inflation is projected to continue easing on the back of monetary policy tightening and lower global energy and food prices but will still be around 9.5 percent and 4.5 percent on average in 2023 and 2024 respectively. Meanwhile, core inflation is expected to remain more persistent at 8.2 percent and 5.2 percent due to still high nominal wage growth. While recently introduced price caps will have a short-term effect, they're effect is rarely lasting, and they can be distortionary.

69. Risks to the outlook are tilted to the downside, due to regional conflicts, geoeconomic fragmentation, and domestic political developments. Risks to the outlook include global geoeconomic fragmentation, the intensification of regional conflicts, and potential volatility in global commodity prices, while political fragmentation and spending pressures ahead of the election are key domestic risks.

70. The 2024 budget appropriately targets a lower deficit, in line with the commitments under the PLL arrangement. The government adopted a budget consistent with a fiscal deficit of 3.4 percent of GDP in 2024. Fiscal consolidation is needed to facilitate the transition towards the 3 percent of GDP deficit ceiling required by the Organic Budget Law. In addition, it is important to build fiscal buffers to help face increased global uncertainty and any crisis that could stem from it, or in case the large Corridor 8/10d road project ends up costing more than projected. In this context, the 2024 budget keeps current spending contained on the back of an important reduction in energy subsidies and aided by program targets on current spending and wages and salaries. Prudence on the side of current spending will allow for a generous capital spending envelope. This will ensure that spending on the large road project is accommodated while allowing for the build-up of further buffers. Stakeholders have a key role to play in advancing prudent policies and keeping spending at sustainable levels ahead of the elections. In this context, wage increases next year and in the medium-term should not exceed what has already been agreed in the general collective agreement.

71. The recently adopted energy measures are strong and should materially reduce energy subsidies. By increasing the price paid to the state-owned energy producer, by decreasing the share said producer is mandated to provide to the regulated market, and by increasing charges for distribution losses, the measures should decrease the losses of the electricity producer and hence reduce budget transfers. It will be important that the government continues expanding its program for energy-related targeted transfers to vulnerable households, as it lowers broad-based subsidies.

72. Reform efforts on public investment management and tax compliance should be accelerated. Continued staffing of the Public Investment Management to its full capacity, together with the strengthening of methodologies for the identification and costing of projects, will lead to more efficient public investment. Separately, increasing tax compliance is crucial for improving the fiscal position and ensuring a competitive playing field in the economy. In this context, the reform efforts inside the Public Revenue Office should be accelerated further. The appointment of the Fiscal Council, expected to become fully operational in 2024, will improve fiscal governance.

73. The NBRNM has appropriately tightened monetary policy, but it should remain ready to tighten further given inflation risks. Monetary tightening has translated into a slowdown in credit growth and a deceleration in both headline and core inflation and helped stabilize the foreign exchange market. This, and the fact that inflation expectations have not de-anchored shows the monetary framework is effective in delivering the mandate. However, high nominal wage growth, if sustained, creates risks that inflation will reaccelerate. Given these latent risks, monetary policy needs to remain tight for the time being, and the NBRNM should stand ready to tighten further should these risks materialize. It is important to expeditiously approve amendments to the central bank law.

74. The NBRNM should continue work towards strengthening the monetary transmission mechanism. To strengthen the monetary transmission, staff see a need to continue upgrading the monetary operations framework, in particular by narrowing the interest corridor by raising the floor, reducing the maturity of CB-bills, and improving the CB-bills auction system. The NBRNM has committed to develop an internal roadmap to improve the monetary operations framework as a structural benchmark for the 2nd review, though the exact nature of the measures, and their sequencing, will need to be carefully calibrated including in close discussions with MCM TA experts.

75. The NBRNM should continue enhancing bank-risk monitoring and aligning supervision regulation with the EBA standards. Banks are liquid, well capitalized and profitable. The NBRNM is making progress in further developing bottom-up stress tests. To strengthen supervision, NBRNM is transposing EBA standards to the domestic banking system. It is key to continue monitoring closely the mortgage market, systemic banks, and NBFIs, and borrowers' credit worthiness more generally. Also, the authorities should push ahead the ongoing efforts to address the main AML/CFT deficiencies identified in the recent MONEYVAL Mutual Evaluation Report.

76. Focus on of the macroprudential and resolution frameworks should shift to enforcement. Staff welcomes the phase-in of macroprudential tools to mitigate risks and build up financial buffers, which are helping to safeguard financial stability by reducing pressures in the real estate market. In this context of high bank profitability, staff supports efforts to further tighten capital requirements. Recent upgrades to the regulations on credit risk management and on banks' disclosure, as well as the new bank-resolution law, are good steps forward. Upgrading the bank deposit insurance law should remain a priority.

77. Arresting emigration and boosting productivity are important to strengthen income convergence with the EU. North Macedonia's income per capita was 27 percent of the EU level in 2000, 37 percent in 2010, and still slightly below 40 percent now. Accelerating structural reforms to lift living standards is therefore a priority. Reforms will be crucial in laying the foundations for strong, sustained growth, and will support the country on its path to EU accession. Reigniting convergence will require a multi-pronged approach towards reducing the flow of emigration, boosting investment and productivity, and accelerating the green transition. This can be achieved by:

- *Improving the business environment and rule of law*. It will be important to reduce informality, not least through a more effective Public Revenue Office and lower bureaucratic delays, and to combat corruption. Recent amendments to the criminal code are a step in the wrong direction, and in particular the decriminalization of abuse of public office in the area of public procurement.

- P*reserving room in the budget to support public infrastructure and education.* A key reason for the slowdown in potential growth in North Macedonia lies in relatively weak investment levels. Therefore, recent increases in the size of the budget for capital expenditures are welcome and should be preserved going forward. Improving public investment management will also help better prioritize public investment projects.

- *Accelerating the green transition and adapting to climate change*. Scaling-up green investments is needed because the decommissioning of old and polluting power plants before the end of the decade cannot be avoided if North Macedonia is to meet its emission targets. Setting the right incentives for the transition towards energy efficiency and preparing for the phasing in of the

EU's Carbon Border Adjustment Mechanism are also important objectives, including through consideration of a carbon tax, further strengthening of price incentives, and ensuring that price signals work in the regulated market for electricity and heating. Adding emission and resilience objectives in public investment will help with climate mitigation and adaptation. Ongoing greening of the financial sector will help with the climate transition.

78. Staff recommends the completion of the 1st review under the PLL arrangement. Macroeconomic performance and progress on the reform agenda under the PLL arrangement have been sound, and North Macedonia continues to meet the qualification criteria under the PLL arrangement. Staff supports the modification of quantitative targets, the proposed new quantitative targets, and the proposed new structural benchmarks for the second review. This will allow for a smooth exit from the PLL arrangement in 2024, if external conditions allow.

79. North Macedonia has sustainable debt with high probability in the medium-term and adequate capacity to repay the Fund. Staff projects public debt to remain below 60 percent of GDP during the projection period and gradually decline over the medium term. The PLL arrangement remains unchanged at SDR 406.87 million (290 percent of quota) representing 3.5 percent of 2023 GDP. If the proposed PLL arrangement were to be fully drawn, North Macedonia's capacity to repay the Fund would remain adequate supported by steady program implementation and continued market access. The authorities' excellent track record of servicing their debt obligations, further limit the risk to the Fund.

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

Table 1. North Macedonia: Macroeconomic Framework, 2019–28

(Year-on-year percentage change, unless otherwise indicated)[6]

	2019	2020	2021	2022		2023		2024		2025		2026		2027		2028
				Projections												
					PLL SR		PLL SR		PLL SR		PLL SR		PLL SR		PLL SR	
Output																
Real GDP	3.9	-4.7	3.9	2.1	2.7	2.3	2.9	3.0	3.9	3.5	3.8	3.5	3.8	3.5	3.8	3.5
Domestic demand	4.9	-5.3	5.3	5.3	4.8	1.6	3.4	4.6	4.5	2.6	4.7	3.5	4.6	3.2	4.3	4.1
Exports	8.9	-10.9	11.7	13.4	6.5	3.4	6.1	4.8	7.8	5.8	8.0	4.9	6.3	4.6	6.2	4.0
Imports	10.1	-10.9	11.9	16.1	8.7	2.2	6.4	6.3	7.3	4.2	7.0	4.5	6.2	4.0	6.1	4.6
Contributions to growth 1/																
Domestic demand	6.9	-7.2	6.7	7.8	6.5	2.0	5.0	5.9	5.6	3.5	5.2	4.5	5.6	4.2	5.6	5.3
Net exports	-2.9	2.5	-2.7	-5.7	-3.8	0.3	-2.0	-2.9	-1.8	0.0	-1.3	-1.0	-1.8	-0.7	-1.8	-1.8
Output gap (percent of potential GDP)	0.9	-3.3	-1.8	-1.5	-1.8	-1.0	-1.1	-0.6	-0.8	-0.4	-0.4	-0.2	-0.2	0.0	0.1	0.0
Consumer prices																
Consumer prices (period average)	0.8	1.2	3.2	14.2	12.9	9.5	7.1	4.5	2.5	2.1	2.1	2.0	2.2	2.0	2.0	2.0
Consumer prices (end-of-period)	0.4	2.3	4.9	18.7	14.2	3.7	4.2	3.7	1.9	1.9	2.1	2.0	2.2	2.0	1.9	2.0
Core consumer prices (period average)	0.5	0.9	2.4	7.3	6.9	8.2	4.7	5.2	2.9	2.9	2.5	2.0	2.3	2.0	2.0	2.0
Core consumer prices (end-of-period)	-0.3	1.9	2.9	11.1	8.8	6.1	2.9	4.1	2.8	2.1	2.3	2.0	2.2	2.0	2.1	2.0
Central government operations (percent of GDP)																
Revenues 2/	29.4	28.4	30.3	30.6	31.0	31.6	31.5	31.7	30.9	31.9	31.4	31.9	31.9	31.9	32.2	31.9
Expenditures	31.4	36.4	35.7	35.1	36.4	36.3	36.3	35.1	34.3	34.9	34.7	34.8	35.0	34.7	35.1	34.6
Of which: capital expenditures	2.6	2.4	3.2	3.6	3.3	4.9	4.3	4.6	4.4	4.8	4.8	5.0	5.1	5.2	5.4	5.2
Balance 2/	-2.0	-8.0	-5.4	-4.5	-5.5	-4.7	-4.8	-3.4	-3.4	-3.0	-3.3	-2.9	-3.1	-2.8	-2.9	-2.7
Gross general government debt 3/	40.4	50.8	53.4	52.1	52.7	51.4	52.8	50.7	52.5	51.4	53.7	51.2	53.3	51.1	53.3	50.7
Public and publicly guaranteed debt 3/ 4/	48.1	58.4	60.8	59.7	60.3	59.6	60.7	58.7	59.9	59.2	60.9	58.8	60.3	58.5	60.1	57.8
Savings and investment (percent of GDP)																
National saving	31.3	27.0	29.5	28.9	30.6	30.5	33.2	30.9	33.7	30.7	34.5	31.0	35.4	31.0	36.4	31.7
Public	0.6	-5.6	-2.1	-0.9	-2.2	0.2	-0.5	1.2	1.0	1.8	1.5	2.0	2.1	2.3	2.4	2.4
Private	30.7	32.6	31.6	29.7	32.8	30.2	33.6	29.7	32.7	29.0	33.0	29.0	33.3	28.7	33.9	29.3
Foreign saving	3.0	2.9	2.8	6.2	7.7	2.5	4.3	3.0	3.7	2.9	3.6	2.8	3.6	2.7	3.7	2.7
Gross investment	34.3	29.9	32.3	35.0	38.3	32.9	37.5	33.9	37.4	33.6	38.1	33.8	39.0	33.7	40.1	34.4
Credit																
Private sector credit growth	6.3	4.9	8.0	9.3	10.7	6.1	8.2	7.0	7.2	6.5	6.5	6.3	6.3	6.3	6.1	6.3
Balance of payments																
Current account balance (percent of GDP)	-3.0	-2.9	-2.8	-6.2	-7.7	-2.5	-4.3	-3.0	-3.7	-2.9	-3.6	-2.8	-3.6	-2.7	-3.7	-2.7
Foreign direct investment (percent of GDP)	3.2	1.4	3.3	5.1	3.8	4.0	3.8	3.7	3.8	3.7	3.8	3.7	3.8	3.7	3.9	3.7
External debt (percent of GDP) 5/	72.4	78.7	81.9	84.2	81.4	81.6	80.5	81.1	80.1	82.9	82.5	83.2	83.1	83.6	83.9	83.6
Gross official reserves (millions of euros) 5/	3,263	3,360	3,643	3,863	3,377	4,126	3,887	4,652	4,442	5,109	5,015	5,393	5,342	5,713	5,703	5,997
in percent of IMF ARA Metric	112	113	110	100	93	104	100	109	106	113	110	113	113	115	113	114
in percent of ST debt	95	102	109	81	83	92	102	92	99	94	101	97	118	98	112	99
in months of prospective imports	5.1	4.2	3.5	3.8	3.4	3.8	3.7	4.0	3.9	4.1	4.1	4.1	4.1	4.2	4.1	4.2
Memorandum items:																
Nominal GDP (billions of denars)	693	669	720	795	795	891	891	975	975	1028	1028	1087	1087	1147	1147	1215
Nominal GDP (millions of euros)	11,262	10,852	11,690	12,898	12,898	14,457	14,457	15,829	15,829	16,684	16,684	17,634	17,634	18,620	18,620	19,710

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/ For 2023, revenue forecasts at the time of PLL do not include any proceeds from the one-off Solidarity Tax, which could yield up to 1/2 percentage points of GDP

3/ 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.

4/ Includes general government and non-financial SOEs.

5/ PLL SR 2022 column does not include NBRNM REPO net position with nonresidents (Short term debt) of €228 million. Previous WEO forecast assumes that the NBRNM closes the REPO net position with nonresidents (short-term debt) of €228 million in 2023. Current projection assumes a net REPO position of €228 million from 2022 onward.

6/ For the PLL SR columns, nominal values at time of PLL approval have been divided by the current baseline GDP projection.

Table 2a. North Macedonia: Central Government Operations, 2019–28

(Billions of Denars)[6]

	2019	2020	2021	2022	2022	2023	2023	2023	2024	2024	2025	2025	2026	2026	2027	2027	2028
									Projections								
					PLL SR	Proj.	Rev. Budget	PLL SR		PLL SR		PLL SR		PLL SR		PLL SR	
Total Revenues	203.9	189.8	218.5	243.2	246.0	281.8	282.1	280.9	309.1	301.4	327.8	323.1	346.7	346.8	365.8	369.4	386.9
Tax Revenues and Contributions	178.9	173.5	196.3	220.2	222.5	253.8	253.6	248.4	278.9	271.7	293.8	291.5	311.6	313.1	328.9	333.6	348.1
PIT	18.7	18.6	20.6	23.9	23.5	27.5	27.6	26.1	31.0	28.5	32.9	30.6	35.3	32.9	37.1	34.7	39.2
CIT 1/	11.6	10.5	10.9	15.8	15.5	19.7	17.4	15.1	19.0	18.3	20.0	20.7	21.1	23.9	22.3	25.9	23.6
VAT (net)	52.1	46.9	58.2	64.8	67.1	71.1	72.5	77.3	80.7	84.9	85.1	91.0	90.5	97.7	95.6	104.4	101.2
Excises	26.1	22.5	25.5	25.5	25.5	28.9	27.7	30.7	31.7	33.1	33.4	35.3	35.3	37.5	37.3	39.9	39.4
Custom Duties	6.0	6.7	8.5	10.0	10.0	11.5	11.3	10.9	12.6	11.7	13.2	12.5	14.0	13.3	14.8	14.1	15.6
Other Taxes	2.3	1.7	2.0	2.7	2.7	2.8	6.0	3.0	3.1	3.2	3.3	3.5	3.5	3.7	3.7	3.9	3.9
Social Contributions	62.2	66.6	70.6	77.6	78.0	92.2	91.0	85.3	100.9	91.9	105.9	97.9	111.9	104.1	118.2	110.7	125.1
Pensions	41.9	45.0	47.8	52.5	52.8	63.0	63.1	58.2	69.1	62.7	72.4	66.8	76.5	71.1	80.8	75.5	85.5
Unemployment	2.6	2.8	2.9	3.2	3.2	3.6	3.3	3.5	3.9	3.7	4.1	4.0	4.3	4.2	4.6	4.5	4.8
Health	17.6	18.8	19.9	21.9	22.0	25.6	24.6	23.6	28.0	25.4	29.4	27.1	31.1	28.8	32.8	30.6	34.7
Non-Tax Revenues	18.8	11.4	14.4	17.4	16.5	17.6	17.7	19.7	20.2	21.2	21.3	22.6	22.6	24.0	23.8	25.5	25.2
Capital Revenues	2.4	1.8	1.9	2.3	2.2	2.2	2.8	2.5	2.4	2.6	2.6	2.8	2.7	3.0	2.9	3.2	3.0
Grants	3.9	3.1	5.9	3.4	4.9	8.2	8.0	10.4	7.5	5.9	7.3	6.3	6.9	6.6	7.3	7.1	7.7
Unidentified Revenue Measures 2/									*0.0*		*2.9*		*0.0*		*0.0*		*0.0*
Expenditures	217.5	243.6	257.3	278.7	289.4	323.2	324.8	323.3	342.3	335.1	358.8	356.8	378.6	380.3	398.5	403.0	420.0
Current Expenditures	199.7	227.5	233.9	250.1	263.4	279.9	280.9	285.0	297.5	291.8	312.8	307.6	327.8	324.4	342.6	341.5	360.7
Wages and salaries	27.8	29.8	31.0	32.2	32.1	37.4	37.5	34.7	41.1	36.3	44.0	37.7	45.1	39.3	46.5	40.8	48.6
Goods and services	16.3	15.4	20.1	20.6	23.0	23.4	23.7	23.5	24.8	22.0	24.7	21.9	25.5	21.3	26.3	21.2	27.1
Transfers	147.6	174.3	173.7	188.2	198.0	206.0	206.5	213.8	215.0	215.7	224.8	227.1	235.2	239.1	245.3	252.1	255.2
Pension fund expenditures	65.2	69.0	72.0	78.6	78.4	90.4	90.1	89.0	97.9	95.7	103.4	101.1	108.2	106.7	113.3	112.6	118.7
Health	30.8	34.7	35.1	38.3	38.2	42.8	42.9	42.1	46.3	45.4	48.3	47.9	51.1	50.9	53.9	54.1	57.1
Other	51.5	70.6	66.6	71.4	81.4	72.8	73.5	82.8	70.8	74.6	73.1	78.1	75.9	81.5	78.0	85.5	79.5
Of which transfers to the ESM				*12.5*	*18.1*	*5.9*	*5.9*	*13.9*	*1.7*	*0.0*	*1.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Interest	8.1	8.0	9.1	9.1	10.2	13.2	13.2	13.0	16.5	17.8	19.2	21.0	22.0	24.7	24.6	27.3	29.8
Capital Expenditures	17.8	16.1	23.4	28.6	26.0	43.3	43.9	38.3	44.8	43.3	49.3	49.2	54.1	55.9	59.1	61.5	62.6
Of which Corridor 8/10d 3/				*0.0*	*0.0*	*15.1*	*15.1*	*15.4*	*18.3*	*15.4*	*22.2*	*15.0*	*21.8*	*18.0*	*23.3*	*12.9*	*0.0*
Unidentified Expenditure Measures 2/									*0.0*		*3.3*		*0.0*		*0.0*		*0.0*
Overall fiscal balance 1/	-13.6	-53.9	-38.8	-35.5	-43.4	-41.5	-42.8	-42.3	-33.2	-33.6	-31.0	-33.7	-32.0	-33.5	-32.7	-33.6	-33.1
Primary fiscal balance 1/	-5.5	-45.8	-29.7	-26.3	-33.2	-28.2	-29.5	-29.3	-16.7	-15.8	-11.7	-12.7	-10.0	-8.8	-8.1	-6.3	-3.4
Financing	13.6	53.9	38.8	35.5	43.4	41.6	42.8	42.3	33.2	33.6	31.0	33.7	32.0	33.5	32.8	33.6	33.2
Domestic, net	9.9	14.2	13.6	16.9	20.5	20.1	13.4	11.3	17.9	16.3	16.0	18.6	30.9	34.7	33.1	36.6	38.9
Central Bank deposits	1.2	-6.9	-3.5	5.3	9.2	-2.6	-4.6	-9.2	-3.3	-7.7	-3.1	-6.2	4.0	6.2	3.0	1.5	4.4
Other net domestic financing	8.7	21.1	17.0	11.6	11.3	22.8	18.0	20.6	21.2	24.0	19.0	24.7	26.9	28.6	30.2	35.1	34.5
Privatization receipts	0.7	1.0	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign, net	3.0	38.7	24.7	18.6	22.9	21.4	29.3	31.0	15.4	17.3	15.1	15.1	1.2	-1.2	-0.4	-3.0	-5.7
Memo items:																	
Gross general government debt (percent of GDP) 4/	40.4	50.8	53.4	52.1	52.7	51.4		52.8	50.7	52.5	51.4	53.7	51.2	53.3	51.1	53.3	50.7
Nominal GDP (billions of denars)	693	669	720	795	795	891		891	975	975	1028	1028	1087	1087	1147	1147	1215
Stock of Central Bank deposits (billions of denars eop)	32	41	43	36	34	48		43	42	51	45	57	39	51	34	49	32
Public and publicly guaranteed debt (percent of GDP) 4/ 5/	48.1	58.4	60.8	59.7	60.3	59.6		60.7	58.7	59.9	59.2	60.9	58.8	60.3	58.5	60.1	57.8

Sources: MoF and IMF staff estimates.

1/ For 2023, revenue forecasts at the time of PLL approval do not include any proceeds from the one-off Solidarity Tax, which could yield up to 1/2 percentage points of GDP

2/ Unidentified revenue and expenditure measures reflect the additional adjustement needed, in addition to current policies, that will be needed to bring the deficit to 3.0 percent of GDP in 2025.

3/ Compared to the time of PLL approval, staff is using the agreed contract price, but also including expropriation costs, documentation and supervision costs, as well as a larger nominal factor.

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

4/ 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.

5/ Includes general government and non-financial SOEs.

6/ For the PLL SR columns, nominal values at time of PLL approval have been divided by the current baseline GDP projection.

Table 2b. North Macedonia: Central Government Operations, 2019–28

(Percent of GDP)[6]

	2019	2020	2021	2022		2023			2024		2025		2026		2027		2028
											Projections						
					PLL SR	Proj.	Rev. Budget	PLL SR		PLL SR		PLL SR		PLL SR		PLL SR	
Total Revenues	29.4	28.4	30.3	30.6	31.0	31.6	31.7	31.6	31.7	30.9	31.9	31.4	31.9	31.9	31.9	32.2	31.9
Tax Revenues and Contributions	25.8	25.9	27.2	27.7	28.0	28.5	28.5	28.0	28.6	27.9	28.6	28.3	28.7	28.8	28.7	29.1	28.7
PIT	2.7	2.8	2.9	3.0	3.0	3.1	3.1	2.9	3.2	2.9	3.2	3.0	3.2	3.0	3.2	3.0	3.2
CIT 1/	1.7	1.6	1.5	2.0	2.0	2.2	2.0	1.7	1.9	1.9	1.9	2.0	1.9	2.2	1.9	2.3	1.9
VAT (net)	7.5	7.0	8.1	8.1	8.4	8.0	8.1	8.7	8.3	8.7	8.3	8.9	8.3	9.0	8.3	9.1	8.3
Excises	3.8	3.4	3.5	3.2	3.2	3.2	3.1	3.5	3.2	3.4	3.2	3.4	3.2	3.5	3.2	3.5	3.2
Custom Duties	0.9	1.0	1.2	1.3	1.3	1.3	1.3	1.2	1.3	1.2	1.3	1.2	1.3	1.2	1.3	1.2	1.3
Other Taxes	0.3	0.3	0.3	0.3	0.3	0.3	0.7	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Social Contributions	9.0	9.9	9.8	9.8	9.8	10.3	10.2	9.6	10.3	9.4	10.3	9.5	10.3	9.6	10.3	9.6	10.3
Pensions	6.1	6.7	6.6	6.6	6.6	7.1	7.1	6.6	7.1	6.4	7.0	6.5	7.0	6.5	7.0	6.6	7.0
Unemployment	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Health	2.5	2.8	2.8	2.8	2.8	2.9	2.8	2.7	2.9	2.6	2.9	2.6	2.9	2.7	2.9	2.7	2.9
Non-Tax Revenues	2.7	1.7	2.0	2.2	2.1	2.0	2.0	2.2	2.1	2.2	2.1	2.2	2.1	2.2	2.1	2.2	2.1
Capital Revenues	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Grants	0.6	0.5	0.8	0.4	0.6	0.9	0.9	1.2	0.8	0.6	0.7	0.6	0.6	0.6	0.6	0.6	0.6
Unidentified Revenue Measures 2/											*0.3*						
Expenditures	31.4	36.4	35.7	35.1	36.4	36.3	36.5	36.4	35.1	34.4	34.9	34.7	34.8	35.0	34.7	35.1	34.6
Current Expenditures	28.8	34.0	32.5	31.5	33.1	31.4	31.5	32.1	30.5	29.9	30.4	29.9	30.2	29.9	29.9	29.8	29.7
Wages and salaries	4.0	4.4	4.3	4.0	4.0	4.2	4.2	3.9	4.2	3.7	4.3	3.7	4.2	3.6	4.1	3.6	4.0
Goods and services	2.3	2.3	2.8	2.6	2.9	2.6	2.7	2.6	2.5	2.3	2.4	2.1	2.3	2.0	2.3	1.8	2.2
Transfers	21.3	26.0	24.1	23.7	24.9	23.1	23.2	24.1	22.0	22.1	21.9	22.1	21.6	22.0	21.4	22.0	21.0
Pension fund expenditures	9.4	10.3	10.0	9.9	9.9	10.1	10.1	10.0	10.0	9.8	10.1	9.8	10.0	9.8	9.9	9.8	9.8
Health	4.4	5.2	4.9	4.8	4.8	4.8	4.8	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7
Other	7.4	10.5	9.2	9.0	10.2	8.2	8.2	9.3	7.3	7.7	7.1	7.6	7.0	7.5	6.8	7.4	6.5
Of which transfers to the ESM				*1.6*	*2.3*	*0.7*	*0.7*	*1.6*	*0.2*	*0.0*	*0.1*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Interest	1.2	1.2	1.3	1.1	1.3	1.5	1.5	1.5	1.7	1.8	1.9	2.0	2.0	2.3	2.1	2.4	2.4
Capital Expenditures	2.6	2.4	3.2	3.6	3.3	4.9	4.9	4.3	4.6	4.4	4.8	4.8	5.0	5.1	5.2	5.4	5.2
Of which Corridor 8/10d 3/				*0.0*	*0.0*	*1.7*	*1.7*	*1.7*	*1.9*	*1.6*	*2.2*	*1.5*	*2.0*	*1.7*	*2.0*	*1.1*	*0.0*
Unidentified Expenditure Measures 2/											*0.3*						
Overall fiscal balance 1/	-2.0	-8.0	-5.4	-4.5	-5.5	-4.7	-4.8	-4.8	-3.4	-3.4	-3.0	-3.3	-2.9	-3.1	-2.8	-2.9	-2.7
Primary fiscal balance 1/	-0.8	-6.8	-4.1	-3.3	-4.2	-3.2	-3.3	-3.3	-1.7	-1.6	-1.1	-1.2	-0.9	-0.8	-0.7	-0.6	-0.3
Financing	2.0	8.0	5.4	4.5	5.5	4.7	4.8	4.8	3.4	3.5	3.0	3.3	2.9	3.1	2.9	2.9	2.7
Domestic, net	1.4	2.1	1.9	2.1	2.6	2.3	1.5	1.3	1.8	1.7	1.6	1.8	2.8	3.2	2.9	3.2	3.2
Central Bank deposits	0.2	-1.0	-0.5	0.7	1.2	-0.3	-0.5	-1.0	-0.3	-0.8	-0.3	-0.6	0.4	0.6	0.3	0.1	0.4
Other domestic financing	1.3	3.2	2.4	1.5	1.4	2.6	2.0	2.3	2.2	2.5	1.9	2.4	2.5	2.6	2.6	3.1	2.8
Privatization receipts	0.1	0.1	0.1	0.0	0.0	0.0	-1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign, net	0.4	5.8	3.4	2.3	2.9	2.4	3.3	3.5	1.6	1.8	1.5	1.5	0.1	-0.1	0.0	-0.3	-0.5
Memo items:																	
Gross general government debt (percent of GDP) 4/	40.4	50.8	53.4	52.1	52.7	51.4		52.8	50.7	52.5	51.4	53.7	51.2	53.3	51.1	53.3	50.7
Nominal GDP (billions of denars)	693	669	720	795	795	891		891	975	975	1028	1028	1087	1087	1147	1147	1215
Stock of Central Bank deposits (billions of denars eop)	32	41	43	36	34	48		43	42	51	45	57	39	51	34	49	32
Public and publicly guaranteed debt (percent of GDP) 4/ 5/	48.1	58.4	60.8	59.7	60.3	59.6		60.7	58.7	59.9	59.2	60.9	58.8	60.3	58.5	60.1	57.8

Sources: MoF and IMF staff estimates.

1/ For 2023, revenue forecasts at time of PLL approval do not include any proceeds from the one-off Solidarity Tax, which could yield up to 1/2 percentage points of GDP

2/ Unidentified revenue and expenditure measures reflect the additional adjustement needed, in addition to current policies, that will be needed to bring the deficit to 3.0 percent of GDP in 2025.

3/ Compared to the time of PLL approval, staff is using the agreed contract price, but also including expropriation costs, documentation and supervision costs, as well as a larger nominal factor.

4/ 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.

5/ Includes general government and non-financial SOEs.

6/ For the PLL SR columns, nominal values at time of PLL approval have been divided by the current baseline GDP projection.

Table 3a. North Macedonia: Balance of Payments, 2019–28

(Millions of euros, unless otherwise indicated)[2]

	2019	2020	2021	2022		2023		2024		2025		2026		2027		2028
						Projections										
					PLL SR		PLL SR		PLL SR		PLL SR		PLL SR		PLL SR	
Current account	-335	-318	-329	-797	-996	-361	-622	-468	-584	-481	-597	-489	-638	-502	-686	-537
Trade balance	-1,949	-1,804	-2,337	-3,481	-3,277	-3,061	-3,178	-3,268	-3,230	-3,305	-3,336	-3,431	-3,529	-3,544	-3,708	-3,744
Exports	5,347	4,820	6,041	7,320	6,856	7,564	7,085	8,078	7,803	8,653	8,534	9,170	9,132	9,669	9,798	10,182
Imports	7,296	6,623	8,378	10,801	10,133	10,624	10,263	11,346	11,033	11,958	11,870	12,601	12,661	13,212	13,506	13,926
Services (net)	336	424	498	752	554	619	617	787	682	831	751	879	824	928	873	982
Primary Income (net)	-520	-411	-519	-568	-612	-677	-686	-781	-769	-814	-834	-860	-888	-908	-943	-961
Secondary Income (transfers, net)	1,798	1,473	2,029	2,500	2,339	2,758	2,625	2,795	2,733	2,806	2,822	2,923	2,955	3,022	3,092	3,186
Of which																
Official	43	110	139	59	117	185	214	109	130	91	112	89	110	87	106	80
Private	1,755	1,363	1,891	2,441	2,221	2,574	2,411	2,686	2,604	2,715	2,710	2,835	2,845	2,935	2,987	3,106
Capital account (net)	8	11	7	0	11	10	13	10	13	10	14	9	15	8	13	9
Net lending (+) / Net borrowing (-)	-327	-307	-322	-797	-985	-351	-609	-458	-571	-471	-582	-480	-622	-494	-672	-527
Financial account	-627	-428	-405	-1,023	-719	-614	-1,119	-984	-1,125	-929	-1,156	-763	-949	-815	-1,033	-811
Direct investment (net)	-363	-155	-388	-654	-493	-578	-553	-586	-596	-617	-634	-652	-675	-689	-717	-729
Portfolio investment (net)	151	-284	-116	-52	-260	-112	-331	-249	-261	-132	-146	70	53	72	51	160
Of which: Eurobonds amortizations	0	178	500	0	0	450	450	0	0	500	500	700	700	600	0	700
Of which: Eurobonds disbursements	0	700	700	250	300	600	800	300	300	700	700	700	700	600	0	600
Other investment	-415	11	98	-317	35	76	-236	-149	-268	-180	-376	-181	-327	-198	-367	-241
Trade credits (net)	-263	-208	-88	-322	-137	-92	-130	-194	-193	-146	-206	-158	-219	-172	-233	-180
MLT loans (net)	-209	-276	-123	-159	-173	-353	-313	-198	-188	-292	-301	-314	-283	-341	-305	-408
Public sector	-62	-116	-49	-89	-72	-198	-153	51	19	-45	-45	-19	20	6	49	-8
Disbursements	177	378	150	154	173	343	298	255	186	216	216	217	217	195	195	195
of which: IMF credit	0	166	0	110	110	0	155	147	0	0	0	0	0	0	0	0
Amortization	-99	-259	-98	-101	-101	-145	-145	-306	-206	-171	-171	-198	-237	-201	-244	-187
of which: Repayment to the IMF	0	0	0	0	0	-43	-43	-87	-87	-43	-43	-55	-94	-92	-133	-74
ST loans (net) 1/	-16	7	-126	-213	-61	-15	-3	-11	-13	-15	-16	-15	-16	-13	-14	-14
Currency and deposits (net)	73	489	433	383	405	536	210	254	126	274	147	306	191	328	184	361
Other (net)	0	-1	2	-6	0	0	0	0	0	0	0	0	0	0	0	0
Errors and omissions	76	-7	58	41	0	0	0	0	0	0	0	0	0	0	0	0
Overall Balance	376	114	141	267	-266	263	510	525	554	457	574	284	327	321	361	283
Memorandum items:																
ST debt at residual maturity (year-end) 1/	3,447	3,295	3,330	4,767	4,086	4,472	3,816	5,041	4,487	5,438	4,984	5,542	4,545	5,814	5,089	6,036
Gross foreign exchange reserves 1/	3,263	3,360	3,643	3,863	3,377	4,126	3,887	4,652	4,442	5,109	5,015	5,393	5,342	5,713	5,703	5,997
Percent of IMF ARA Metric	120.3	115.6	122.7	100.4	93.1	104.0	99.5	108.5	105.5	112.6	109.6	112.8	113.4	114.5	113.2	114.0
Months of prospective imports of G&S	5.1	4.2	3.5	3.8	3.4	3.8	3.7	4.0	3.9	4.1	4.1	4.1	4.1	4.2	4.1	4.2
Percent of short-term debt (residual maturity)	94.7	102.0	109.4	81.0	82.6	92.3	101.9	92.3	99.0	93.9	100.6	97.3	117.5	98.3	112.1	99.4
External debt (percent of GDP) 1/	72.4	78.7	81.9	84.2	78.7	81.6	77.9	81.1	78.7	82.9	80.2	83.2	80.4	83.6	80.6	83.6
External debt service	2,468	3,023	2,689	2,558	2,621	4,043	3,393	3,761	3,136	4,342	3,821	4,749	4,329	4,864	3,900	5,147
Percent of exports of G&S	35	48	35	27	30	41	36	36	31	38	34	40	36	39	31	39
Percent of exports of G&S and transfers	28	40	28	21	24	32	29	28	24	31	28	32	29	31	25	31

Sources: NBRNM and IMF staff estimates.

1/ PLL SR 2022 column does not include NBRNM REPO net position with nonresidents (Short term debt) of €228 million. Previous WEO forecast assumes that the NBRNM closes the REPO net position with nonresidents (short-term debt) of €228 million in 2023. Current projection assumes a net REPO position of €228 million from 2022 onward.

2/ For the PLL SR columns, nominal values at time of PLL approval have been divided by the current baseline GDP projection.

Table 3b. North Macedonia: Balance of Payments, 2019–28
(Percent of GDP, unless otherwise indicated)[2]

	2019	2020	2021	2022		2023		2024		2025		2026		2027		2028
						Projections										
					PLL SR		PLL SR		PLL SR		PLL SR		PLL SR		PLL SR	
Current account	-3.0	-2.9	-2.8	-6.2	-7.7	-2.5	-4.3	-3.0	-3.7	-2.9	-3.6	-2.8	-3.6	-2.7	-3.7	-2.7
Trade balance	-17.3	-16.6	-20.0	-27.0	-25.4	-21.2	-22.0	-20.6	-20.4	-19.8	-20.0	-19.5	-20.0	-19.0	-19.9	-19.0
Exports	47.5	44.4	51.7	56.8	53.2	52.3	49.0	51.0	49.3	51.9	51.2	52.0	51.8	51.9	52.6	51.7
Imports	64.8	61.0	71.7	83.7	78.6	73.5	71.0	71.7	69.7	71.7	71.1	71.5	71.8	71.0	72.5	70.7
Services (net)	3.0	3.9	4.3	5.8	4.3	4.3	4.3	5.0	4.3	5.0	4.5	5.0	4.7	5.0	4.7	5.0
Primary Income (net)	-4.6	-3.8	-4.4	-4.4	-4.7	-4.7	-4.7	-4.9	-4.9	-4.9	-5.0	-4.9	-5.0	-4.9	-5.1	-4.9
Secondary Income (transfers, net)	16.0	13.6	17.4	19.4	18.1	19.1	18.2	17.7	17.3	16.8	16.9	16.6	16.8	16.2	16.6	16.2
Of which																
Official	0.4	1.0	1.2	0.5	0.9	1.3	1.5	0.7	0.8	0.5	0.7	0.5	0.6	0.5	0.6	0.4
Private	15.6	12.6	16.2	18.9	17.2	17.8	16.7	17.0	16.4	16.3	16.2	16.1	16.1	15.8	16.0	15.8
Capital account (net)	0.1	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.1	0.0
Net lending (+) / Net borrowing (-)	-2.9	-2.8	-2.8	-6.2	-7.6	-2.4	-4.2	-2.9	-3.6	-2.8	-3.5	-2.7	-3.5	-2.7	-3.6	-2.7
Financial account	-5.6	-3.9	-3.5	-7.9	-5.6	-4.2	-7.7	-6.2	-7.1	-5.6	-6.9	-4.3	-5.4	-4.4	-5.5	-4.1
Direct investment (net)	-3.2	-1.4	-3.3	-5.1	-3.8	-4.0	-3.8	-3.7	-3.8	-3.7	-3.8	-3.7	-3.8	-3.7	-3.9	-3.7
Portfolio investment (net)	1.3	-2.6	-1.0	-0.4	-2.0	-0.8	-2.3	-1.6	-1.6	-0.8	-0.9	0.4	0.3	0.4	0.3	0.8
Of which: Eurobonds amortizations	0.0	1.6	4.3	0.0	0.0	3.1	3.0	0.0	0.0	3.0	2.9	4.0	3.8	3.2	0.0	3.6
Of which: Eurobonds disbursements	0.0	6.5	6.0	1.9	2.3	4.2	5.5	1.9	1.9	4.2	4.2	4.0	4.0	3.2	0.0	3.0
Other investment	-3.7	0.1	0.8	-2.5	0.3	0.5	-1.6	-0.9	-1.7	-1.1	-2.3	-1.0	-1.9	-1.1	-2.0	-1.2
Trade credits (net)	-2.3	-1.9	-0.7	-2.5	-1.1	-0.6	-0.9	-1.2	-1.2	-0.9	-1.2	-0.9	-1.2	-0.9	-1.2	-0.9
MLT loans (net)	-1.9	-2.5	-1.1	-1.2	-1.3	-2.4	-2.2	-1.3	-1.2	-1.8	-1.8	-1.8	-1.6	-1.8	-1.6	-2.1
Public sector	-0.6	-1.1	-0.4	-0.7	-0.6	-1.4	-1.1	0.3	0.1	-0.3	-0.3	-0.1	0.1	0.0	0.3	0.0
Disbursements	1.6	3.5	1.3	1.2	1.3	2.4	2.1	1.6	1.2	1.3	1.3	1.2	1.2	1.0	1.0	1.0
of which: IMF credit	0.0	1.5	0.0	0.9	0.9	0.0	1.1	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-0.9	-2.4	-0.8	-0.8	-0.8	-1.0	-1.0	-1.9	-1.3	-1.0	-1.0	-1.1	-1.3	-1.1	-1.3	-1.0
of which: Repayment to the IMF	0.0	0.0	0.0	0.0	0.0	-0.3	-0.3	-0.5	-0.5	-0.3	-0.3	-0.3	-0.5	-0.5	-0.7	-0.4
Banks	-0.4	-0.5	-0.6	0.2	-0.6	-0.2	-0.6	-0.2	-0.3	-0.3	-0.3	-0.3	-0.4	-0.3	-0.4	-0.4
Other sectors	-0.9	-1.0	-0.1	-0.7	-0.2	-0.9	-0.5	-1.4	-1.0	-1.2	-1.2	-1.4	-1.3	-1.5	-1.5	-1.7
ST loans (net) 1/	-0.1	0.1	-1.1	-1.7	-0.5	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Currency and deposits (net)	0.7	4.5	3.7	3.0	3.1	3.7	1.5	1.6	0.8	1.6	0.9	1.7	1.1	1.8	1.0	1.8
Other (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	0.7	-0.1	0.5	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance	3.3	1.1	1.2	2.1	-2.1	1.8	3.5	3.3	3.5	2.7	3.4	1.6	1.9	1.7	1.9	1.4
						(Percentage change, year-on-year)										
Exports of G&S (Value)	7.9	-10.1	24.3	23.8	14.1	2.6	5.3	7.1	9.7	6.7	8.9	5.9	7.1	5.5	7.1	5.4
Volume	8.9	-10.9	11.7	13.4	6.5	3.4	6.1	4.8	7.8	5.8	8.0	4.9	6.3	4.6	6.2	4.0
Price	-0.9	0.9	11.3	9.2	7.1	-0.8	-0.8	2.2	1.8	0.8	0.8	1.0	0.8	0.8	0.8	1.4
Imports of G&S (Value)	9.7	-11.0	25.9	28.5	20.2	-0.3	2.6	6.0	7.5	5.4	7.4	5.4	6.6	4.9	6.6	5.5
Volume	10.1	-10.9	11.9	16.1	8.7	2.2	6.4	6.3	7.3	4.2	7.0	4.5	6.2	4.0	6.1	4.6
Price	-0.4	-0.1	12.5	10.7	10.5	-2.5	-3.5	-0.2	0.2	1.2	0.4	0.9	0.4	0.9	0.5	0.8
Memorandum Items:																
ST debt at residual maturity (year-end) 1/	30.6	30.4	28.5	37.0	31.7	30.9	26.4	31.8	28.3	32.6	29.9	31.4	25.8	31.2	27.3	30.6
Gross foreign exchange reserves 1/	29.0	31.0	31.2	30.0	26.2	28.5	26.9	29.4	28.1	30.6	30.1	30.6	30.3	30.7	30.6	30.4
Percent of IMF ARA Metric	120.3	115.6	122.7	100.4	93.1	104.0	99.5	108.5	105.5	112.6	109.6	112.8	113.4	114.5	113.2	114.0
Months of prospective imports of G&S	5.1	4.2	3.5	3.8	3.4	3.8	3.7	4.0	3.9	4.1	4.1	4.1	4.1	4.2	4.1	4.2
Percent of short-term debt (residual maturity)	94.7	102.0	109.4	81.0	82.6	92.3	101.9	92.3	99.0	93.9	100.6	97.3	117.5	98.3	112.1	99.4
External debt (percent of GDP) 1/	72.4	78.7	81.9	84.2	78.7	81.6	77.9	81.1	78.7	82.9	80.2	83.2	80.4	83.6	80.6	83.6
External debt service	21.9	27.9	23.0	19.8	20.3	28.0	23.5	23.8	19.8	26.0	22.9	26.9	24.5	26.1	20.9	26.1
Percent of exports of G&S	35	48	35	27	30	41	36	36	31	38	34	40	36	39	31	39
Percent of exports of G&S and transfers	28	40	28	21	24	32	29	28	24	31	28	32	29	31	25	31

Sources: NBRNM; and IMF staff estimates.

1/ PLL SR 2022 column does not include NBRNM REPO net position with nonresidents (Short term debt) of €228 million. Previous WEO forecast assumes that the NBRNM closes the REPO net position with nonresidents (short-term debt) of €228 million in 2023. Current projection assumes a net REPO position of €228 million from 2022 onward.

2/ For the PLL SR columns, nominal values at time of PLL approval have been divided by the current baseline GDP projection.

Table 4. North Macedonia: Monetary Survey, 2019–28

(Billions of Denars, unless otherwise indicated)

	2019	2020	2021	2022	2022	2023	2023	2024	2024	2025	2025	2026	2026	2027	2027	2028
						Projections										
					PLL SR		PLL SR		PLL SR		PLL SR		PLL SR		PLL SR	
NFA 1/	192.4	195.2	195.9	188.5	180.7	232.9	211.3	253.2	245.6	278.2	281.2	290.1	301.1	304.0	323.4	320.5
Central Bank 1/	195.7	202.6	203.1	203.9	186.7	232.5	218.2	255.8	252.3	283.9	287.7	299.1	307.8	316.5	330.0	336.2
Commercial Banks 1/	-3.3	-7.4	-7.2	-15.4	-6.0	0.4	-6.8	-2.5	-6.7	-5.7	-6.5	-9.0	-6.7	-12.5	-6.6	-15.7
NDA	211.6	241.1	278.8	311.3	317.4	302.9	323.9	320.6	327.8	332.4	331.4	358.4	350.5	384.4	368.9	410.4
Credit to Government (net)	17.0	35.4	47.1	53.6	62.6	50.3	63.8	64.3	68.4	68.1	74.8	84.1	95.4	100.0	114.6	114.2
From Banks (net)	42.7	70.1	74.9	74.3	81.1	82.6	91.6	90.4	103.8	97.4	116.4	107.2	130.8	118.1	148.5	130.5
of which: Credit	44.2	71.7	76.8	76.1	82.7	84.4	93.2	92.2	105.5	99.2	118.0	109.0	132.5	119.9	150.2	132.3
From Central Bank (net)	-25.7	-34.7	-27.8	-20.7	-18.5	-32.3	-27.8	-26.1	-35.5	-29.2	-41.6	-23.1	-35.5	-18.2	-33.9	-16.3
of which: Deposits	-31.8	-40.5	-43.0	-36.1	-33.8	-47.8	-43.0	-41.6	-50.7	-44.7	-56.9	-38.5	-50.7	-33.6	-49.2	-31.8
Credit to Private Sector (gross)	343.4	360.1	388.9	424.9	430.4	451.0	465.7	482.7	499.1	514.0	531.4	546.6	565.0	581.1	599.1	617.6
From Banks	342.5	359.2	388.1	424.0	429.6	450.1	464.9	481.8	498.3	513.1	530.6	545.7	564.1	580.2	598.3	616.7
Denars	200.7	210.5	230.7	245.2	255.4	260.2	276.3	278.6	296.2	296.7	315.4	315.5	335.4	335.5	355.7	356.6
FX	141.9	148.7	157.4	178.8	174.2	189.8	188.5	203.2	202.1	216.4	215.2	230.1	228.8	244.7	242.6	260.1
From Central Bank	0.8	0.9	0.8	0.9	0.8	0.9	0.8	0.9	0.8	0.9	0.8	0.9	0.8	0.9	0.8	0.9
Other Items (net)	-148.7	-154.4	-157.2	-167.2	-165.6	-188.4	-190.6	-211.3	-219.6	-229.7	-249.8	-247.3	-279.8	-269.1	-314.8	-291.4
Broad Money (M3)	404.0	436.2	474.8	499.8	498.1	535.8	535.2	573.9	573.5	610.6	612.6	648.5	651.6	688.4	692.3	730.9
Currency in Circulation	36.1	43.7	44.5	47.5	50.5	50.9	56.6	54.8	61.0	57.2	65.0	59.8	69.1	62.5	73.4	65.4
Total Deposits	367.9	392.5	430.3	452.3	447.6	484.9	478.6	519.1	512.4	553.5	547.6	588.7	582.5	626.0	618.9	665.5
Denars	225.5	235.5	245.5	255.5	245.7	276.5	271.0	303.9	297.6	332.5	324.6	353.7	345.3	376.1	366.9	399.9
FX	142.5	157.1	184.8	196.8	201.9	208.4	207.6	215.1	214.9	220.9	222.9	235.0	237.2	249.9	252.0	265.7
(Percentage change, year-on-year)																
Private Sector Credit	6.3	4.9	8.0	9.3	10.7	6.1	8.2	7.0	7.2	6.5	6.5	6.3	6.3	6.3	6.1	6.3
Broad Money	8.2	8.0	8.8	5.3	4.9	7.2	7.4	7.1	7.2	6.4	6.8	6.2	6.4	6.2	6.2	6.2
Private Sector Deposits	7.8	6.7	9.6	5.1	4.0	7.2	6.9	7.1	7.1	6.6	6.9	6.4	6.4	6.3	6.2	6.3
(Contribution to annual growth in broad money)																
NFA	3.1	0.7	0.2	-1.6	-3.2	8.9	6.1	3.8	6.4	4.4	6.2	1.9	3.3	2.2	3.4	2.4
NDA	5.1	7.3	8.7	6.8	8.1	-1.7	1.3	3.3	0.7	2.1	0.6	4.3	3.1	4.0	2.8	3.8
(Percent of GDP)																
Private Sector Credit	49.6	53.8	54.0	53.5	52.4	50.6	50.6	49.5	50.3	50.0	50.3	50.3	50.3	50.6	50.2	50.8
Broad Money	58.3	65.2	65.9	62.9	60.6	60.1	58.1	58.8	57.8	59.4	58.0	59.7	58.0	60.0	58.0	60.2
Private Sector Deposits	53.1	58.6	59.7	56.9	54.5	54.4	52.0	53.2	51.7	53.8	51.8	54.2	51.8	54.6	51.8	54.8
Memorandum items:																
Money Multiplier	3.1	3.1	3.3	3.2	3.6	3.1	3.5	2.9	3.3	2.8	3.1	2.8	3.0	2.8	2.9	2.7
Reserve Requirement Ratio (percent of deposits)																
Denars	8.0	8.0	8.0	8.0	8.0	5.0	8.0	5.0	8.0	5.0	8.0	5.0	8.0	5.0	8.0	5.0
FX Indexed	50.0	50.0	50.0	50.0	50.0	100.0	50.0	100.0	50.0	100.0	50.0	100.0	50.0	100.0	50.0	100.0
FX	15.0	15.0	15.0	18.0	15.0	21.0	15.0	21.0	15.0	21.0	15.0	21.0	15.0	21.0	15.0	21.0
Velocity	1.7	1.5	1.5	1.6	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Nominal GDP growth	6.9	1.3	7.6	10.3	13.6	12.1	12.0	9.5	7.8	5.4	6.5	5.7	6.4	5.6	6.2	5.8

Sources: NBRNM and IMF staff estimates.

1/ PLL SR column excludes NBRNM REPO open position with nonresidents (Short term debt).

Table 5. North Macedonia: Central Bank Survey, 2019–28

(Billions of Denars, unless otherwise indicated)[2]

	2019	2020	2021	2022		2023		2024		2025		2026		2027		2028
						Projections										
					PLL SR		PLL SR		PLL SR		PLL SR		PLL SR		PLL SR	
Net foreign assets 1/	195.7	202.6	203.1	203.9	186.7	232.5	218.2	255.8	252.3	283.9	287.7	299.1	307.8	316.5	330.0	336.2
Assets 1/	200.7	207.4	226.7	246.6	210.3	271.8	241.8	295.1	275.9	323.2	311.3	338.4	331.4	355.8	353.6	375.5
Liabilities 1/	-5.0	-4.8	-23.6	-42.7	-23.6	-39.3	-23.6	-39.3	-23.6	-39.3	-23.6	-39.3	-23.6	-39.3	-23.6	-39.3
Net domestic assets	-65.7	-62.7	-58.8	-48.0	-47.6	-59.0	-63.5	-59.4	-77.9	-68.8	-90.7	-68.8	-91.1	-67.4	-90.9	-68.7
Central Government (net)	-25.7	-34.7	-27.8	-20.7	-18.5	-32.3	-27.8	-26.1	-35.5	-29.2	-41.6	-23.1	-35.5	-18.2	-33.9	-16.3
of which:																
Deposits at Central Bank	-31.8	-40.5	-43.0	-36.1	-33.8	-47.8	-43.0	-41.6	-50.7	-44.7	-56.9	-38.5	-50.7	-33.6	-49.2	-31.8
Denar	-18.2	-18.0	-21.0	-19.7	-16.8	-25.0	-21.0	-22.2	-24.4	-23.6	-27.2	-20.8	-24.4	-18.6	-23.7	-17.8
FX	-13.6	-22.5	-22.1	-16.4	-17.0	-22.8	-22.1	-19.4	-26.3	-21.1	-29.7	-17.7	-26.3	-15.0	-25.5	-14.0
Banks (net)	-27.3	-14.1	-17.3	-15.8	-13.5	-13.9	-18.4	-19.2	-23.6	-24.7	-29.1	-30.1	-34.3	-32.8	-34.4	-34.9
Other items (net)	-12.7	-13.9	-13.7	-11.4	-15.5	-12.8	-17.4	-14.0	-18.8	-14.8	-20.0	-15.6	-21.3	-16.5	-22.6	-17.5
Monetary base	129.9	139.9	144.4	155.9	139.1	170.7	154.6	196.4	174.4	215.1	197.0	230.3	216.7	249.1	239.1	267.5
Currency in circulation	43.3	50.0	51.4	53.9	57.5	58.1	63.5	63.6	67.9	67.1	71.9	70.9	76.0	74.8	80.4	79.2
Liabilities to banks	78.1	81.5	85.1	93.7	73.4	102.2	82.9	123.9	98.4	138.9	116.9	149.9	132.5	165.1	150.6	179.0
Required reserves	48.5	36.2	49.0	44.9	50.1	53.4	53.5	57.1	57.3	60.9	61.3	64.8	65.2	68.9	69.2	73.3
Excess reserves	29.6	45.3	36.1	48.8	23.3	48.9	29.4	66.8	41.1	78.0	55.6	85.1	67.4	96.2	81.4	105.8
Liabilities to other sectors	8.5	8.4	7.9	8.3	8.3	10.3	8.2	8.8	8.1	9.2	8.2	9.4	8.1	9.1	8.1	9.3
	(Contribution to annual growth in monetary base)															
Net foreign assets	22.7	5.3	0.4	0.5	-11.4	18.4	9.2	13.6	11.6	14.3	16.2	7.1	11.1	7.6	13.5	7.9
Net domestic assets	-0.8	2.3	2.8	7.4	7.7	-7.0	-10.0	-0.2	-11.1	-4.8	-16.0	0.0	-10.4	0.6	-9.6	-0.5
	(Percentage change, year-on-year)															
Monetary base	21.9	7.6	3.2	8.0	-3.6	9.5	-0.8	15.1	2.2	9.5	0.3	7.0	0.7	8.2	3.9	7.4
Memorandum items:	(Percent of GDP) 2/															
Central Bank bills	3.6	1.5	1.4	1.2	1.2	1.1	1.6	1.5	2.0	1.9	2.4	2.3	2.7	2.4	2.5	2.5
Central government deposits at Central Bank	4.6	6.1	6.0	4.5	4.1	5.4	4.7	4.3	5.1	4.3	5.4	3.5	4.5	2.9	4.1	2.6

Sources: NBRNM and IMF staff estimates.

1/ PLL SR column excludes NBRNM REPO open position with nonresidents (Short term debt).

2/ For the PLL SR columns, nominal values at time of PLL approval have been divided by the current baseline GDP projection.

Table 6. North Macedonia: Financial Soundness Indicators of the Banking System, 2013–22

(Percent)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Capital adequacy										
Regulatory capital/risk weighted assets	16.8	15.7	15.5	15.2	15.7	16.5	16.3	16.7	17.3	17.7
Tier I capital/risk weighted assets	14.4	13.7	13.9	13.9	14.2	15.0	14.8	15.3	15.8	16.6
Equity and reserves to Assets	11.3	10.8	10.8	10.6	10.8	10.8	11.0	11.6	11.6	12.3
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	46.3	46.9
Households (loans to households/total loans)	37.7	38.7	40.0	42.9	44.8	46.4	48.4	49.7	49.4	48.3
Lending with foreign currency component to private sector	52.7	49.4	46.5	44.9	42.5	41.4	42.3	42.3	41.2	43.2
Foreign currency lending/total credit to private sector	23.8	22.4	20.5	18.0	16.5	15.5	14.8	14.6	14.7	17.7
Foreign currency indexed lending/total credit to private sector	28.9	27.0	25.9	27.0	26.1	25.9	27.5	27.7	26.5	25.5
NPLs 1/										
NPLs/gross loans	10.9	10.8	10.3	6.3	6.1	5.0	4.6	3.3	3.1	2.8
NPLs net of provision/own funds	-1.8	-3.0	-5.3	-5.5	-3.7	-5.2	-2.4	-6.9	-5.4	-6.8
Provisions to NPLs	80.1	81.9	86.7	80.9	77.2	76.3	67.7	73.2	66.3	69.4
Large exposures/own funds	188.5	233.1	212.4	185.4	176.3	218.2	256.2	281.5	256.3	243.6
Connected lending										
Banking system exposure to subsidiaries and shareholders/own	4.2	4.3	3.4	8.4	3.8	3.8	4.0	3.9	3.3	4.5
Banking system equity investments/own funds	1.7	2.6	2.6	2.0	1.9	1.2	1.3	0.8	1.0	0.8
Earning and profitability										
ROAA 2/	0.6	0.8	1.1	1.5	1.5	1.7	1.3	1.3	1.5	1.5
ROAE 2/	5.7	7.4	10.4	13.6	13.5	16.0	11.7	11.3	12.9	12.2
Interest margin/gross income 3/	62.2	63.5	62.8	62.7	60.6	57.9	58.3	56.8	52.9	55.2
Noninterest expenses/gross income 4/	62.8	58.1	54.7	53.2	52.5	50.5	55.0	53.0	53.1	54.0
Personnel expenses/noninterest expenses	35.0	35.5	35.8	35.2	34.8	37.4	36.6	36.7	34.3	33.3
Interest Rates										
Local currency spreads	3.9	4.3	4.6	4.3	4.1	3.9	3.7	3.7	3.6	3.5
Foreign currency spreads	5.2	5.3	4.8	4.5	4.3	3.9	3.7	3.6	3.6	3.6
Interbank market interest rate	2.2	1.5	1.2	1.0	1.1	1.1	1.1	1.1	1.1	2.5
Liquidity										
Highly liquid assets/total assets 5/	27.3	25.5	24.3	25.7	23.2	22.6	24.0	21.5	21.4	19.3
Highly liquid assets/total short-term liabilities 6/	47.6	45.5	42.4	44.5	40.1	39.2	41.3	35.7	34.4	30.6
Liquid assets/total assets	31.2	29.8	28.2	28.9	27.1	26.7	26.9	23.3	23.0	21.3
Liquid assets/total short-term liabilities	54.5	53.2	49.2	50.1	46.9	46.4	46.2	38.6	37.0	33.8
Customer deposits/total (noninterbank) loans	112.7	113.4	110.3	114.9	114.0	116.0	119.4	121.9	122.2	116.9
Foreign currency deposits/total deposits	44.9	42.3	42.1	43.0	42.7	42.3	40.7	41.8	44.8	46.3
Including foreign exchange-indexed 7/	45.5	42.8	42.4	43.1	43.1	42.5	40.8	41.9	45.0	46.4
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	2.1	6.7

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.

Table 7. North Macedonia: Capacity to Repay Under the Adverse Scenario

(Under obligated repurchase schedule)

	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
	Projections 1/									
Fund Repurchases and Charges										
In millions of SDRs	0.0	100.9	68.2	73.4	170.2	178.2	70.0	8.4	8.4	8.4
In millions of Euro	0.0	123.5	83.6	90.5	211.0	222.5	87.5	10.4	10.4	10.4
In percent of Gross International Reserves	0.0	2.7	1.6	1.7	3.7	3.7	1.6	0.2	0.2	0.2
In percent of Exports of Goods and Services	0.0	1.2	0.7	0.8	1.7	1.7	0.6	0.1	0.1	0.1
In Percent of GDP	0.0	0.8	0.5	0.5	1.1	1.1	0.4	0.0	0.0	0.0
In Percent of Government Revenue	0.0	2.5	1.6	1.6	3.5	3.5	1.3	0.1	0.1	0.1
In Percent of External Debt Service, Public	0.0	2.7	1.7	1.9	4.4	4.7	1.8	0.2	0.2	0.2
In percent of Quota	0.0	71.9	48.6	52.3	121.3	127.0	49.9	6.0	6.0	6.0
Fund Credit Outstanding (end of period)										
In millions of SDRs	189.4	442.0	406.9	364.8	221.9	60.5	0.0	0.0	0.0	0.0
In millions of Euro	232.1	540.7	498.8	449.7	275.1	75.6	0.0	0.0	0.0	0.0
In percent of Gross International Reserves	5.6	11.6	9.8	8.3	4.8	1.3	0.0	0.0	0.0	0.0
In percent of Exports of Goods and Services	2.3	5.1	4.4	3.8	2.2	0.6	0.0	0.0	0.0	0.0
In Percent of GDP	1.6	3.4	3.0	2.6	1.5	0.4	0.0	0.0	0.0	0.0
In Percent of Government Revenue	5.1	10.8	9.4	8.0	4.6	1.2	0.0	0.0	0.0	0.0
In Percent of External Public Debt	5.4	11.9	10.4	9.3	5.7	1.6	0.0	0.0	0.0	0.0
In Percent of Quota	135.0	315.0	290.0	260.0	158.1	43.1	0.0	0.0	0.0	0.0
Memorandum Items (in millions euro)										
Gross International Reserves	4,126	4,652	5,109	5,393	5,713	5,997	5,641	5,979	6,338	6,718
Exports of Goods and Services	9,887	10,590	11,300	11,968	12,624	13,310	14,416	15,280	16,197	17,169
Nominal GDP	14,457	15,829	16,684	17,634	18,620	19,710	20,892	22,146	23,474	24,883
Government Revenue	4,582	5,027	5,331	5,637	5,948	6,292	6,660	7,059	7,482	7,931
External Public Debt	4,298	4,547	4,792	4,811	4,805	4,713	4,787	5,919	6,274	6,651
External Debt Services, Public	951	619	928	898	820	763	854	1,056	1,119	1,186
Quota (in millions of SDRs)	140.3	140.3	140.3	140.3	140.3	140.3	140.3	140.3	140.3	140.3

Source: NBRNM, SSO, IMF Finance department, and IMF staff estimates.

1/ Projections assume the following purchases:

PLL: a first purchase of 60 percent of quota on November 18, 2022, a second purchase of 115 percent of quota at the first review on January 19, 2024, and a third purchase of 115 percent of quota on May 21, 2024.

Table 8. North Macedonia: Schedule and Terms Under the Precautionary and Liquidity Line Arrangement (PLL)

PLL Approval

Availability Date	Condition	Credit Available	
		Millions of SDRs (cumulative)	Percent of Quota (cumulative)
November 21, 2022	Approval of PLL Arrangement	84.18	60
May 19, 2023	Completion of First Review	203.44	145
November 22, 2023	Completion of Second Review	287.62	205
May 22, 2024	Completion of Third Review	406.87	290
Total		**406.87**	**290**

Source: IMF staff.

Rephased

Availability Date	Condition	Credit Available	
		Millions of SDRs (cumulative)	Percent of Quota (cumulative)
November 21, 2022	Approval of PLL Arrangement	84.18	60
May 21, 2023	Originally Scheduled Review	203.44	145
November 21, 2023	Completion of First Review	245.53	175
May 21, 2024	Completion of Second Review	406.87	290
Total		**406.87**	**290**

Source: IMF staff.

Table 9. North Macedonia: Quantitative Targets Under the Precautionary and Liquidity Line (PLL)

(Millions of euros, unless otherwise indicated)

	2023								2024	
	end-March				end-September				end-March	
	Prog. QT	Adj. Prog.	Actual	Status	Prog. QT	Adj. Prog.	Actual	Status	Prog. QT	Proposed Rev. QT
	CR 22/354				CR 22/354				CR 22/354	
I. Quantitative Performance Criteria										
1. Ceiling for current primary expenditure										69,746
II. Indicative Targets										
2. Floor on central government cash balance	-17,560	-18,052	-3,603	Met	-29,538	-30,030	-27,643	Met	-10,881	-12,066
3. Non-accumulation of domestic payment arrears	0		-1,709	Met	0		-1,969	Met	0	0
4. Ceiling for wages and salaries										9,951
5. Floor on net international reserves (million euros)	2,919	2,726	2,860	Met	2,862	2,692	2,461	Not met	2,759	2,759
III. Continuouts Performance Criteria										
6. Non-accumulation of new external debt payment arrears	0		0	Met	0		0	Met	0	0

Annex I. Public Sector Debt Sustainability Assessment, SRDSF-MAC

Public debt in North Macedonia is projected to be on a declining path through the projection period reaching around 50 percent of GDP for general government debt in 2028, and 47.8 percent in an extended projection through 2032. The primary driver of lower debt is the projected gradual reduction in the primary deficit to 0.3 percent by 2028 as well as supportive medium-term growth prospects. Medium-term risk of debt distress is assessed to be moderate. Debt is assessed to be sustainable with a high probability in the medium-term, while there are risks related to aging and potential natural disasters in the long-term.

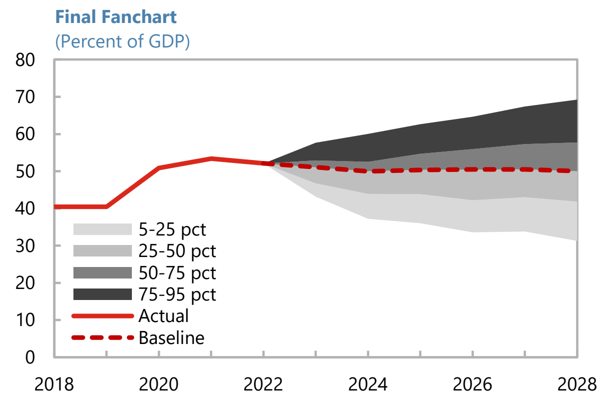
A. Background

1. A traditional large share of external financing may shift more towards domestic financing. North Macedonia has traditionally relied on foreign IFI financing as well as external private financing since the issuance of Eurobonds in 2005. The share of foreign currency debt is approximately 2/3, while the share of domestic debt is around 1/3, c.f. Figure 2. About 12 percent of total debt (issued as domestic debt) is issued with a foreign currency clause. North Macedonia has long-standing de-facto pegged exchange rate vis-à-vis the euro. About 10 percent of outstanding debt is short-term T-bills, while the rest have been issued at increasingly longer maturities in recent years. The average residual maturity of domestic issuance is 10.5 years, while external issuance, primarily Eurobonds and IFI financing, has a shorter maturity of around 4–7 years. North Macedonia has market access and issued a €500 million Eurobond in March.

2. Domestic debt is held by banks and pension funds, and external debt by banks and institutional investors, as well as multilateral. Domestic debt is held primarily by domestic banks who hold around 80 percent of the total, while pension funds hold around 20 percent. Ownership by households is indirect, although North Macedonia recently issued a 'savings bond' targeted directly to households. Private external issuance through Eurobonds or direct loans are held mainly by foreign banks and institutional investors. IFI financing is held by IFIs by definition. Through the projection period, North Macedonia is expected to gradually rely increasingly on domestic issuance, as domestic markets develop, including through direct foreign participation in the local currency-denominated market inter alia via inclusion on the Bloomberg platform.

B. Baseline

3. Debt is expected to be on a declining path below 50 percent through the projection period. As a result of a gradually declining primary deficit and medium-term growth prospects supported by the EU accession process and a ramp up of capital spending, public debt is projected to be on a modestly declining trend, c.f. Table 2. Indicators suggest adequate realism around the baseline projections, c.f. Figure 3. The decline in the primary deficit rests on fiscal adjustment agreed under the PLL as well as the recently introduced Organic Budget Law which sets a deficit limit of 3 percent; the adjustment comes on the back of the Covid pandemic and the energy crisis, which also implies that the adjustment in the near-term is above average. Staff's growth projections over the projection period include a significant scale-up of public investments, including from the large Corridor 8/10d road project, and income convergence to the European Union, and are therefore higher than the historical average. Taken together with the planned consolidation efforts, supported by the PLL, and given a typically low fiscal multiplier for North Macedonia, this underpins the lower debt/GDP trajectory going forward.

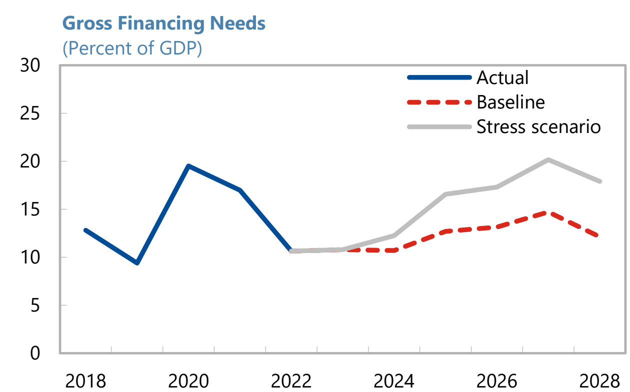


Source: IMF staff calculations.

C. Risk Assessment

4. Risks to debt are mainly related to spending pressures in the run-up to the 2024 elections. Risks of expenditure slippages may increase in the run-up to elections in 2024 which, if they materialize, can impact the fiscal balance and the debt level negatively, but will not be large enough to pose a material change from a sustainability perspective. The risk is further mitigated by legislation that does not allow spending, beyond budget-authorized spending, after elections have been called. As discussed in the main text of the policy note, cost-overruns on the Corridor 8/10d road project can be accommodated to a reasonable extent within the baseline projection, with anything additional being a moderate risk in the medium-term. Long-term risks are mainly related to unfavorable demographics indicate that the dependency ratio will increase over the next two decades, implying a greater need for spending related to health and pensions, c.f. below.

5. Gross financing needs are high and should be managed carefully. The gross financing needs (GFN) are hovering between 10 and 14 percent of GDP through the projection period, not an immediate threat but one that needs to be monitored and managed, especially potential debt rollovers in 2030 and 2032. A stress scenario, modelled through a shock to banking sector assets, signals a moderate level of risk related to GFN. The GFN are typically large around large Eurobond amortizations in the projection period. However, the debt management department of the Ministry of Finance have been skilled in matching amortizations and issuance, as well as placing new issuance with a maturity where there is existing amortization space.



Sources: IMF staff calculations.

6. Debt is assessed to be sustainable in the medium-term with high probability. The projected debt path is expected to stabilize and GFNs will remain at manageable levels, conditional on the implementation of fiscal adjustment measures that are assessed as feasible. The mechanical signal from the long-term module signals debt is sustainable with high probability. Confidence bands around the baseline projection (based on historical volatility) suggest that public debt will remain below 57.8 percent by 2028 with 75 percent probability and below 70 percent by 2028 with 95 percent probability. The historical data include large events such as the COVID pandemic. It is important to continue to build fiscal buffers to be able to counteract a future large crisis, such as another pandemic or a potential natural disaster, should such risks materialize.

7. Continued reform efforts are needed to underpin debt sustainability in the long-term, mainly due to unfavorable demographics. Long-term debt risks are assessed to be moderate. There are no large amortization triggers in the long-term baseline projections. However, unfavorable demographics indicate that the dependency ratio will increase over the next two decades, implying a greater need for spending related to health and pensions in the absence of pension and labor market reforms. These dynamics may be amplified by emigration. Continued pension reform efforts, including through the ongoing World Bank technical assistance, in addition to labor market reforms increasing the labor supply and lower structural unemployment, are needed to mitigate the effects of unfavorable demographics and thus underpin long-term debt sustainability[1]. Also, the need for additional public investments to adapt to climate change, as well as climate change related events, is a risk that can lead to a higher debt ratio, but not a risk to long-term debt sustainability (see Figure 5).

[1] Staff will assess pension sustainability in a subsequent Article IV consultation, using the SRDSF long-term pension module, pending the outcome of World Bank recommendations on pension reforms and their adoption.

Table 1. North Macedonia: Risk of Sovereign Stress

Horizon	Mechanical Signal	Final Assessment	Comments
Overall	…	Moderate	The overall risk of sovereign stres is moderate, reflecting a relatively low level of vulnerability in the near-term and moderate levelss of vulnerability in the medium-, and long-term horizons.
Near Term 1/			Not applicable
Medium Term	Moderate	Moderate	Medium-term risks are assessed as moderate against a mechanical moderate signal on the basis of a moderate debt level, moderate-to-high GFN needs, and moderate indication from natural disaster stress-test.
Fanchart	Moderate	…	
GFN	Moderate	…	
Stress test	…	…	
Long Term	…	Moderate	Long-term risks are moderate as aging-related expenditures on health and social security feed into debt dynamics.
Sustainability Assessment 2/	…	Sustainable	The projected debt path is expected to stabilize and GFNs will remain at manageable levels, conditional on the implementation of fiscal adjustment measures that are assessed as feasible. Therefore debt is assessed as sustainable.
Debt Stabilization in the Baseline			Yes

DSA Summary Assessment

Commentary: North Macedonia is at a moderate medium-term overall risk of sovereign stress, but debt is sustainable with high probability. Most indicators have started to normalize as the recovery from the COVID-19 shock has proceeded and global commodity prices have receded, folowing the sharp-rise on the back of Russia's invasion of Ukraine. Reforms continue to be needed to lower energy subsidies, reducing the vulnerability of public finances to energy price shocks. Debt is projected on a gradually declining path. Medium-term liquidity risks as analyzed by the GFN Financeability Module are moderate. Over the longer run, reforms to tackle risks arising from population aging pension spending are needed.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Figure 1. North Macedonia: Debt Coverage and Disclosures

						Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					n.a.	
2. Subsectors included in the chosen coverage in (1) above:						

Coverage groups		Subsectors captured in the baseline	Inclusion	Comments
CPS / NFPS / GG: expected / CG	1	Budgetary central government	Yes	
CPS / NFPS / GG: expected / CG	2	Extra budgetary funds (EBFs)	No	
CPS / NFPS / GG: expected / CG	3	Social security funds (SSFs)	Yes	
CPS / NFPS / GG: expected	4	State governments	Yes	
CPS / NFPS / GG: expected	5	Local governments	Yes	
CPS / NFPS	6	Public nonfinancial corporations	No	PNFCs exists on a small scale.
CPS	7	Central bank	No	
CPS	8	Other public financial corporations	Yes	

3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/

4. Accounting principles:	Basis of recording		Valuation of debt stock		
	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/

5. Debt consolidation across sectors:	Consolidated	Non-consolidated

Color code: chosen coverage | Missing from recommended coverage | Not applicable

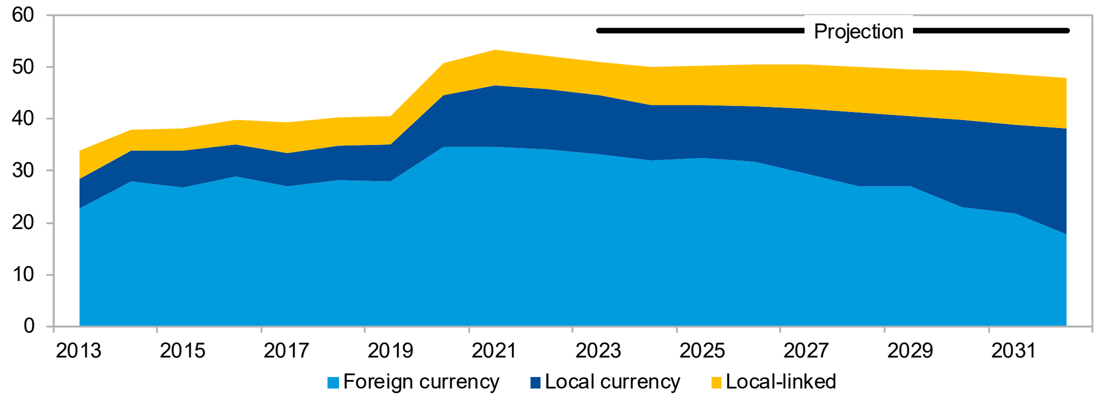
Reporting on Intra-Government Debt Holdings

Issuer \ Holder		Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
1	Budget. central govt									0
2	Extra-budget. funds									0
3	Social security funds									0
4	State govt.									0
5	Local govt.									0
6	Nonfin pub. corp.									0
7	Central bank									0
8	Oth. pub. fin. corp									0
	Total	0	0	0	0	0	0	0	0	0

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

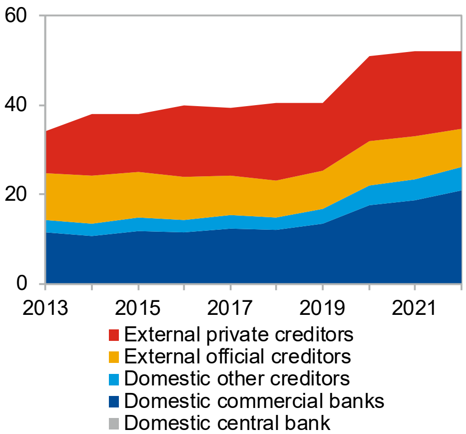
Figure 2. North Macedonia: Public Debt Structure Indicators

Debt by Currency (Percent of GDP)



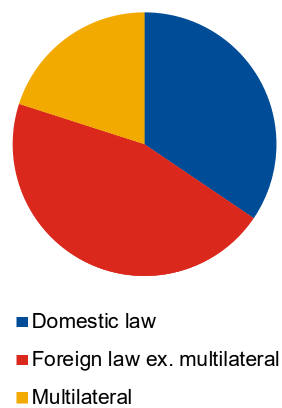
Note: The perimeter shown is general government Local-linked bonds are bonds issued with a currency clause.

Public Debt by Holder (Percent of GDP)



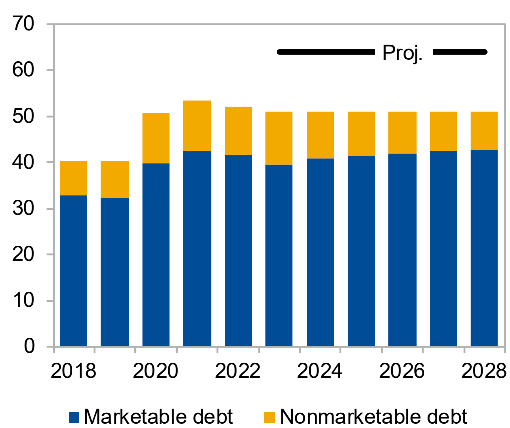
Note: The perimeter shown is general government.

Public Debt by Governing Law, 2022 (Percent)



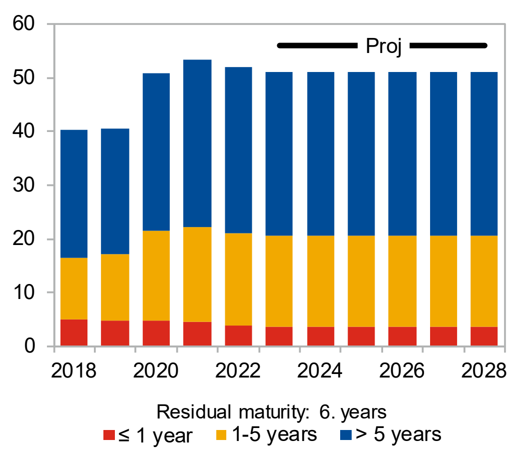
Note: The perimeter shown is general government.

Debt by Instruments (Percent of GDP)



Note: The perimeter shown is general government.

Public Debt by Maturity (Percent of GDP)



Note: The perimeter shown is general government.

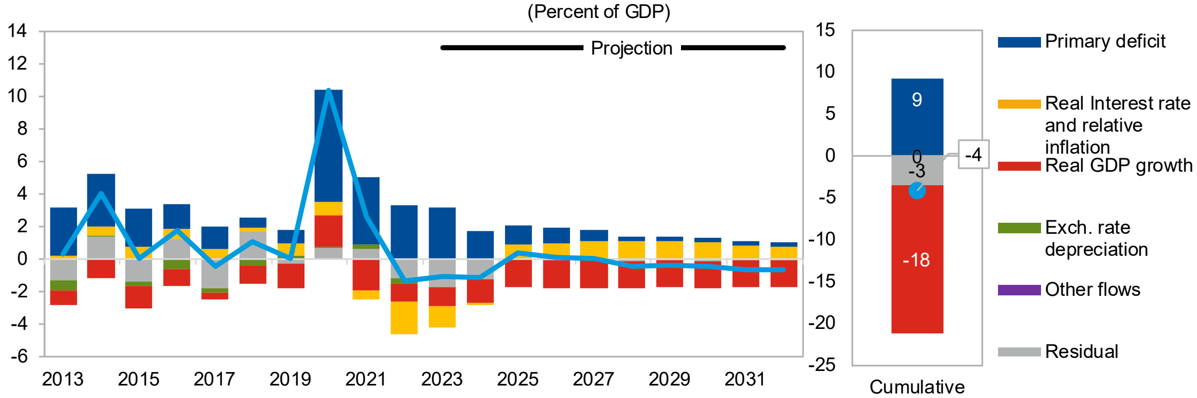
Table 2. North Macedonia: Baseline Scenario

(Percent of GDP Unless Indicated Otherwise)

	Actual	Medium-Term Projection						Extended Projection			
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Public Debt	52.1	51.1	50.0	50.3	50.4	50.5	50.0	49.7	49.2	48.6	47.9
Change in Public Debt	-1.3	-1.0	-1.1	0.4	0.1	0.0	-0.4	-0.4	-0.4	-0.6	-0.7
Contribution of Identified Flows	-0.1	0.6	0.1	0.4	0.2	0.1	-0.3	-0.3	-0.3	-0.5	-0.6
Primary Deficit	3.3	3.2	1.7	1.1	0.9	0.7	0.3	0.3	0.3	0.3	0.3
Noninterest Revenues	30.6	31.6	31.7	31.9	31.9	31.9	31.9	31.9	31.9	31.9	31.9
Noninterest Expenditures	33.9	34.8	33.4	33.0	32.8	32.6	32.1	32.1	32.1	32.1	32.1
Automatic Debt Dynamics	-3.4	-2.5	-1.6	-0.8	-0.7	-0.6	-0.6	-0.6	-0.6	-0.8	-0.9
Real Interest Rate and Relative Inflation	-2.0	-1.4	-0.1	0.9	1.0	1.1	1.1	1.1	1.1	0.9	0.8
Real Interest Rate	-2.3	-3.0	-1.3	0.9	0.9	1.0	1.0	1.0	1.0	0.8	0.7
Relative Inflation	0.3	1.7	1.2	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Real Growth Rate	-1.1	-1.2	-1.5	-1.7	-1.7	-1.7	-1.7	-1.7	-1.7	-1.7	-1.6
Real Exchange Rate	-0.3	…	…	…	…	…	…	…	…	…	…
Other Identified Flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contingent Liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(Minus) Interest Revenues	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Transactions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contribution of Residual	-1.2	-1.7	-1.2	0.0	-0.1	-0.1	-0.1	0.0	-0.1	-0.1	-0.1
Gross Financing Needs	10.7	10.8	10.7	12.9	13.2	14.0	13.2	10.7	15.8	12.1	16.3
Of Which: Debt Service	7.3	7.6	9.0	11.7	12.2	13.3	12.9	10.4	15.6	11.8	16.1
Local Currency	5.3	2.2	5.7	6.2	5.8	5.8	5.6	5.9	6.8	6.4	7.4
Foreign Currency	1.8	4.6	2.8	4.5	5.3	6.3	6.0	3.5	7.3	4.1	7.0
Memo:											
Real GDP Growth (percent)	2.1	2.3	3.0	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5
Inflation (GDP Deflator; Percent)	8.0	9.6	6.3	1.8	2.1	2.0	2.3	2.3	2.3	2.3	2.3
Nominal GDP Growth (Percent)	10.3	12.1	9.5	5.4	5.7	5.6	5.8	5.8	5.8	5.8	5.8
Effective Interest Rate (Percent)	3.2	3.0	3.5	3.8	4.0	4.2	4.3	4.4	4.3	3.9	3.8

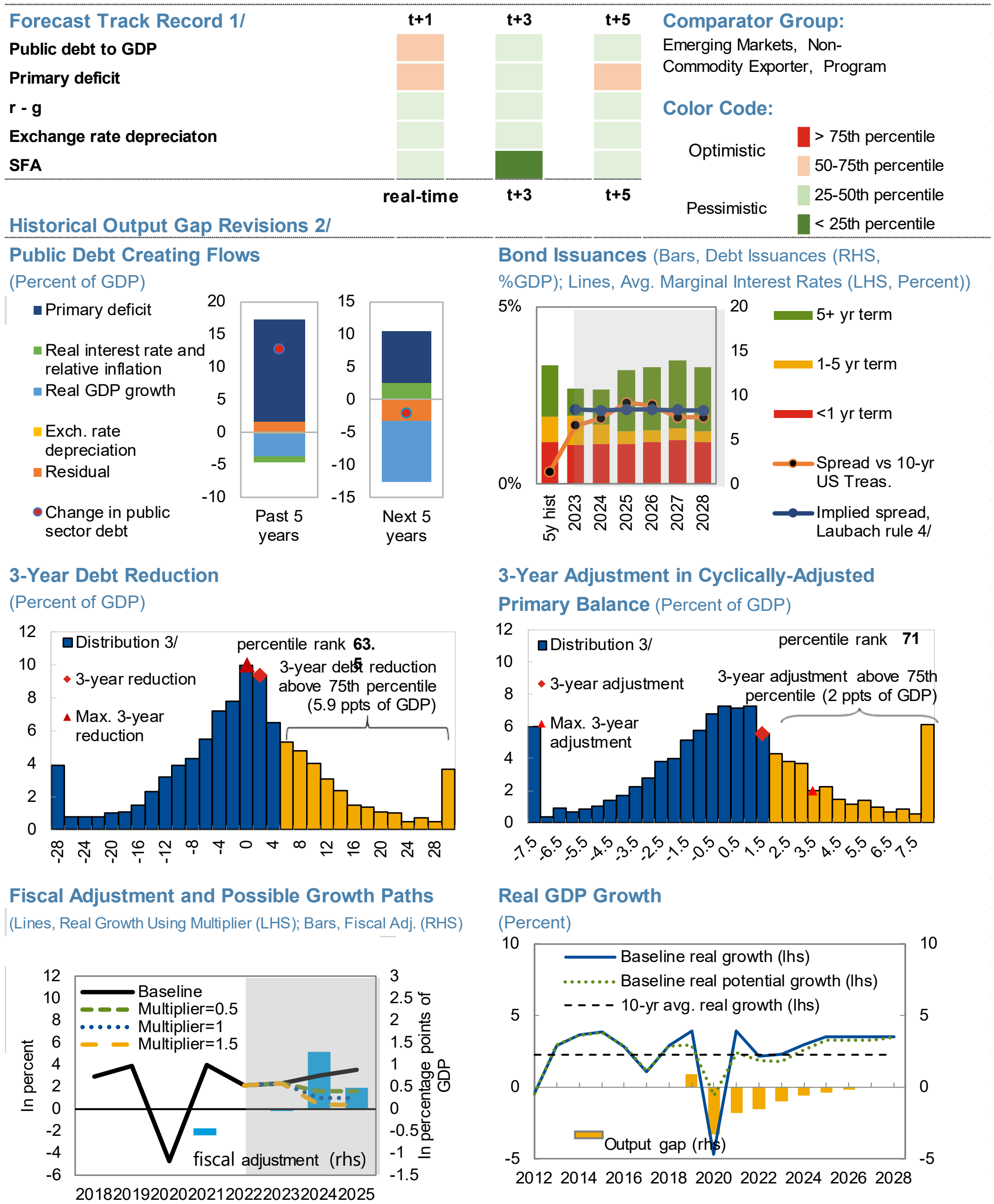
Contribution to Change in Public Debt

(Percent of GDP)



Staff commentary: The contribution of the residual in 2023 and 2024 are due to the contribution from the real exchange rate, which is not reported in the Table. Given the de facto peg to the euro, as relative inflation differences decreases from 2025, so does the contribution of the residual.

Figure 3. North Macedonia: Realism of Baseline Assumptions



Commentary: Staff's growth projections over the projection period, includes a significant scale-up of public investments and convergence to the European Union, and is therefore higher than the historical average. Taken together with the planned consolidation efforts, supported by the PLL, and given a typically low fiscal multiplier for North Macedonia, this underpins the lower debt/GDP trajectory going forward.

Source : IMF Staff.

1/ Projections made in the October and April WEO vintage.

2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates

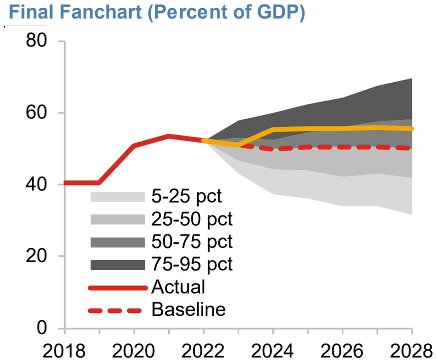
3/ Data cover annual observations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

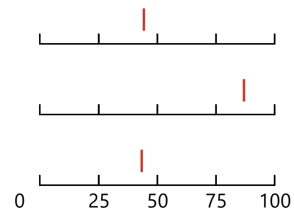
4/ The Laubach (2009) ruleis a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

Figure 4. North Macedonia: Medium-Term Risk Assessment

	Value	Contrib [1/]	Percentile in Peer Group [2/]
Debt Fanchart Module			
Fanchart width *(percent of GDP)*	38.2	0.6	
Probability of debt non-stabilizaiton *(percent)*	31.2	0.3	
Terminal debt-to-GDP x institutions index	27.6	0.6	
Debt Fanchart Index (DFI)		1.4	
Risk signal: [3/]		Moderate	

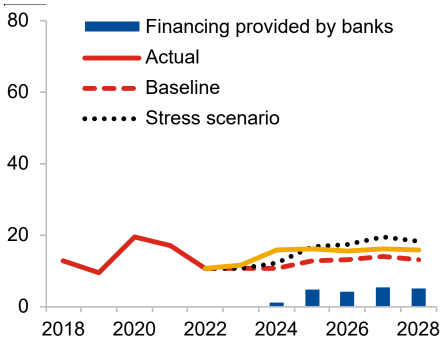
Final Fanchart (Percent of GDP)

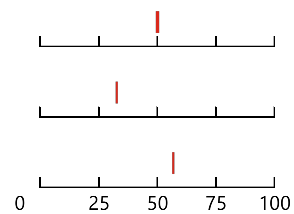




	Value	Contrib	
Gross Financing Needs (GFN) Module			
Average baseline GFN *(percent of GDP)*	12.4	4.2	
Banks' claims on the gen. govt *(pct bank assets)*	9.6	3.1	
Chg. In banks' claims in stress *(pct banks' assets)*	17.1	5.7	
GFN Financeability Index (GFI)		13.1	
Risk Signal: [4/]		Moderate	

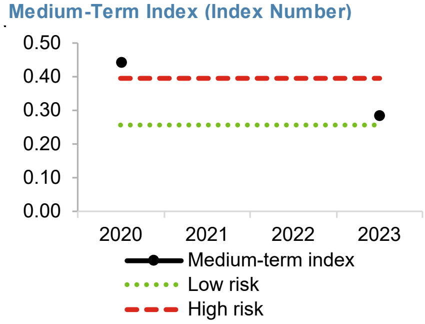
Gross Financing Needs (Percent of GDP)





Banking crisis Commodity prices Exchange rate Contingent liab. Natural disaster

Medium-Term Index (Index Number)



Medium-Term Risk Analysis

	Value	Norm. Value	Weight	Contribution
Debt fanchart index (DFI)	1.42	0.31	0.50	0.16
GFN finaceability index (GFI)	13.06	0.25	0.50	0.13
Medium-term index		0.3		
Risk signal: 5/		Moderate		
Final assessment:		Moderate		

Prob. of missed crisis, 2023-2028, if stress not predicted: 18.2 pct.
Prob. of false alarms, 2023-2028, if stress predicted: 34.1 pct.

Source: IMF staff estimates and projections.

1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.
2/ The comparison group is emerging markets, non-commodity exporter, program.
3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.
4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.
5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

Figure 5. North Macedonia: Long-term risk assessment

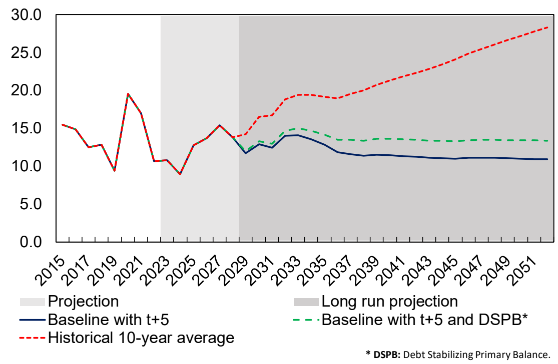
Large Amortization Trigger

Projection	Variable	Risk Indication
Medium-term extrapolation	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	
Medium-term extrapolation with debt stabilizing	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	
Historical average assumptions	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	

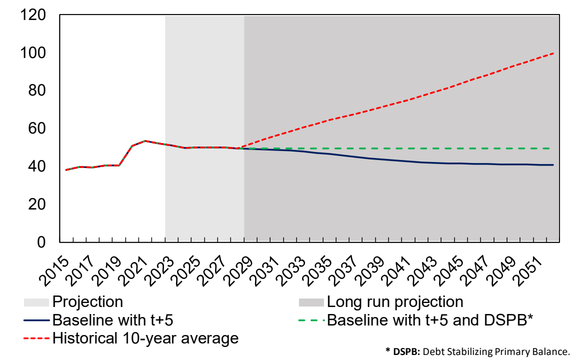
Overall Risk Indication	

Alternative Baseline Long-term Projections

GFN-to-GDP Ratio



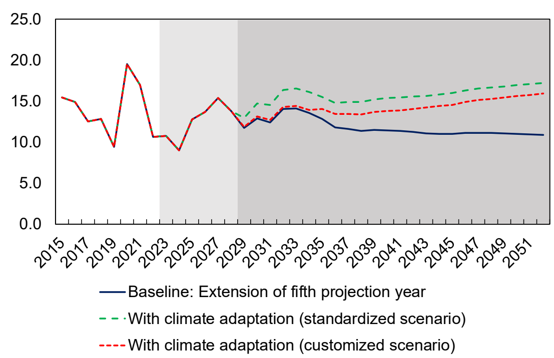
Total Public Debt-to-GDP Ratio



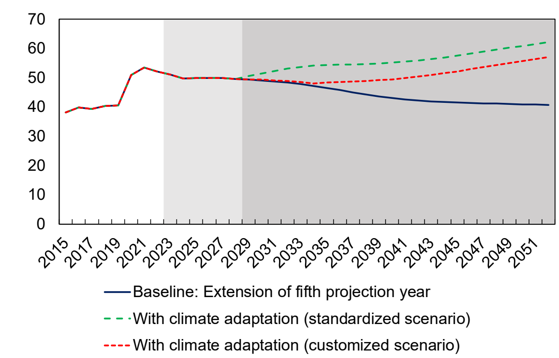
Commentary: The historical 10-year average projection is a mechanical projection using the 10-year average primary deficit to GDP. This should not be confused with staff's baseline projection.

Climate Change: Adaptation

GFN-to-GDP Ratio



Total Public Debt-to-GDP Ratio



Commentary: The standardized scenario uses standard costs for additional adaptation investment needs on new investments as well as strengthening existing assets, including coastal protection, all reflected in a higher permanent primary deficit. The customized scenario removes coastal protection as North Macedonia is land-locked.

Annex II. External Sector Assessment

Overall Assessment: *North Macedonia's external position in 2022 was broadly in line with the level implied by fundamentals and desirable policy settings, based on the results of the IMF's EBA-lite current account model.*[1]

Potential Policy Responses: *Appropriate medium-term fiscal consolidation, governance reforms, and measures to address structural challenges such as emigration and modest productivity growth will be essential for accumulating buffers, supporting external competitiveness, and promoting FDI, thus maintaining the current assessment. The NBRNM's long-standing 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.*

Foreign Assets and Liabilities: Position and Trajectory

Background. The net international investment position (NIIP) stood at -63.2% of GDP at end-2022 worsening slightly from -62.0% in 2021 after bottoming at -63.6% in 2020, driven by the widened current account deficit in 2022 following the energy price shock. The change is largely a result of the decline in foreign reserves (30.0 percent of GDP in 2022 compared to 31.2 percent in 2021) and worsened performance in other investment (-29.1 percent of GDP in 2022 compared to -27.4 percent in 2021), though this is partially offset by performance in portfolio investment, which improved from -12.9 percent of GDP in 2021 to -11.0 percent in 2022. Gross foreign asset and gross foreign liability positions were 59.6 and 122.8 percent of GDP, respectively.

Assessment. The large negative NIIP poses some risks to external sustainability, though the financing vulnerabilities are somewhat mitigated by the large share of FDI, which represents 84.0 percent of the NIIP, with FDI liabilities accounting for about 50 percent of the gross external liabilities. The NIIP is expected to deteriorate in nominal terms as the current account deficit—though narrowing—is expected in the medium term. However, the NIIP as percentage of GDP is projected to improve in medium term, falling below -58 percent by 2024 as FDI and other investment inflows are projected to moderate.

2022 (% GDP)	NIIP: -63.2	Gross Assets: 59.6	Debt Assets: 0.7	Gross Liab.: 122.8	Debt Liab.: 15.9

Current Account

Background. The current account deficit widened in 2022 to -6.2 percent of GDP (vs -2.8 percent in 2021), reflecting a high level of gross investment (35 percent of GDP) relative to national savings (29 percent of GDP), with the majority of the imbalance coming from the private sector. The change was largely driven by higher imports, which resulted mainly from higher energy prices, though the deficit was partially compensated by strong private transfers (19 percent of GDP) and stronger than expected external demand. Performance of the current account in the first half of 2023 has been strong, with the current account deficit shrinking, boosted by a temporary surplus in the first quarter.

[1] The external sector assessment is based on staff's estimates.

North Macedonia: EBA-lite Model Results, 2022

	CA model 1/	**REER model** 1/
	(in percent of GDP)	
CA-Actual	**-6.2**	
Cyclical contributions (from model) (-)	-0.8	
COVID-19 adjustors (-) 2/	-0.2	
Additional temporary/statistical factors (-)	0.0	
Natural disasters and conflicts (-)	-0.5	
Adjusted CA	**-4.6**	
CA Norm (from model) 3/	**-5.0**	
Adjustments to the norm (-)	0.0	
Adjusted CA Norm	**-5.0**	
CA Gap	**0.4**	**-5.3**
o/w Relative policy gap	2.9	
Elasticity	-0.5	
REER Gap (in percent)	**-0.8**	**10.9**

1/ Based on the EBA-lite 3.0 methodology

2/ Additional cyclical adjustment to account for the temporary impact of the pandemic on tourism (1.07% percent of GDP). 40 percent of the shock to tourism is assumed temporary.

3/ Cyclically adjusted, including multilateral consistency adjustments.

Assessment. The EBA-lite CA model indicates the cyclically-adjusted current account to be broadly in line with the CA norm (-4.6 vs -5.0 percent of GDP). On the other hand, the REER model implies that the current account deficit is substantially weaker than what is implied by fundamentals and desirable policies, with a CA gap of -5.3 percent of GDP. That said, there are large uncertainties associated with results from the REER model, as explained below. Because of this, staff attributes a small weight to the results of the REER model in the case of North Macedonia.

Real Exchange Rate

Background. The CPI-based real effective exchange rate (REER) appreciated by 4% in 2022,[2] resulting in a cumulative appreciation of about 6% since 2017. This, in part, reflects the inflation which has been higher than the Euro area in 2022 and higher than many of its peers towards end-2022.

Assessment. The cumulative real appreciation, if sustained, could lead to a loss of competitiveness in the medium term. However, given that the REER and spike in inflation differentials is a recent phenomenon, staff does not view this as an immediate threat. The CA model suggests a REER gap of -1.2, which indicates that the REER is broadly in line with what is implied by fundamentals and desirable policies, while the REER model suggests a REER gap of 10.8 percent, implying a substantial overvaluation of real exchange rate. Unidentified model residual accounts for almost two thirds of the gap in the REER model however, with

[2] Since between December 2022 and August 2023 the REER appreciated 1.4 percent.

much of the remaining gap explained by the real interest rate, implying that the interest rate would need to be set at an unrealistically high level to close the gap. The unrealistically high real interest rate that would have been needed in the REER model to close the gap and the high unidentified residual in the REER model suggests a high degree of uncertainties surrounding the results from the REER model. Because of this, staff attributes a small weight to the results of the REER model in the case of North Macedonia.

Capital and Financial Accounts: Flows and Policy Measures

Background. Net capital inflows in 2022 increased substantially to 7.6 percent of GDP (vs net inflows of 3.7 and 3.9 percent of GDP in 2021 and 2020 respectively). The increase was driven largely by a strong performance of FDI (-5.2 percent of GDP), inflows from short-term loans (partly from the NBRNM's open REPO position), and smaller outflows from currency and deposits.

Assessment. Net capital inflows in 2023 are expected to be smaller than in 2022, though still higher than in 2020 and 2021. 2023 inflows are expected to be driven largely by FDI flows, portfolio flows owing to large Eurobond issuances, and inflows from other multilateral financing. In 2022, there were no 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. Over the last decade, intervention has been volatile—range -4¼ to +3½ percent of GDP—but overall positive (net purchase of FX). In 2022, net intervention amounted -1.2 percent of GDP as a result of the adverse external conditions. Data up to 2023Q3 highlight reversion, with net intervention reaching +0.9 percent of GDP.

Assessment. Foreign exchange reserves are assessed to be adequate. Reserves covered 100 percent of the ARA metric and 3.7 months of prospective imports in 2022. The coverage is expected to reach above 110 percent of the ARA metric and 4 months of prospective imports by 2025.

Annex III. External Debt Sustainability Assessment

Table 1. North Macedonia: External Debt Sustainability Framework
(Percent of GDP, Unless Otherwise Noted)

	Actual							Projections						
	2018	2019	2020	2021	2022			2023	2024	2025	2026	2027	2028	Debt-stabilizing non-interest current account 6/
Baseline: External debt	73.0	72.4	78.7	81.9	84.2			**82.7**	**81.1**	**82.9**	**83.0**	**83.2**	**83.4**	**-7.0**
Change in external debt	-0.4	-0.6	6.3	3.3	2.2			-1.5	-1.6	1.8	0.1	0.3	0.2	
Identified external debt-creating flows (4+8+9)	-13.4	0.4	2.9	-8.4	2.2			-3.2	-3.0	-3.5	-3.6	-3.7	-3.7	
Current account deficit, excluding interest payments	-1.1	2.1	1.8	2.1	5.0			1.5	2.0	1.9	1.8	1.7	1.8	
Deficit in balance of goods and services	12.7	14.3	12.7	16.0	21.0			16.9	15.7	14.8	14.5	14.0	14.0	
Exports	60.2	61.9	57.7	66.2	74.9			68.4	66.9	67.7	67.9	67.8	67.5	
Imports	72.9	76.2	70.4	82.3	96.0			85.3	82.6	82.6	82.3	81.8	81.5	
Net non-debt creating capital inflows (negative)	-5.4	-3.1	-1.4	-3.3	-5.2			-4.0	-3.7	-3.7	-3.7	-3.7	-3.7	
Automatic debt dynamics 1/	-7.0	1.4	2.4	-7.3	2.4			-0.7	-1.3	-1.7	-1.8	-1.8	-1.8	
Contribution from nominal interest rate	0.9	0.9	1.1	1.0	1.0			1.0	0.9	1.0	1.0	1.0	1.0	
Contribution from real GDP growth	-1.9	-2.9	3.5	-2.8	-1.8			-1.7	-2.3	-2.7	-2.7	-2.8	-2.8	
Contribution from price and exchange rate changes 2/	-6.0	3.4	-2.1	-5.5	3.3			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	13.0	-1.0	3.4	11.7	0.0			1.7	1.4	5.2	3.7	4.0	3.9	
External debt-to-exports ratio (in percent)	121.4	117.0	136.3	123.7	112.3			120.9	121.2	122.3	122.2	122.7	123.6	
Gross external financing need (in billions of US dollars) 4/	2.5	3.1	3.7	3.5	3.5			4.6	4.5	5.1	5.6	5.7	6.0	
in percent of GDP	19.5	24.3	29.7	25.2	26.1	10-Year	10-Year	29.0	25.8	27.9	28.9	28.1	27.7	
Scenario with key variables at their historical averages 5/								**82.7**	**86.1**	**89.9**	**92.2**	**94.3**	**96.6**	**-5.4**
						Historical	Standard							
Key Macroeconomic Assumptions Underlying Baseline						Average	Deviation							
Real GDP growth (in percent)	2.9	3.9	-4.7	3.9	2.1	2.3	2.6	2.3	3.0	3.5	3.5	3.5	3.5	
GDP deflator in US dollars (change in percent)	8.8	-4.4	3.1	7.5	-3.8	1.4	7.3	13.2	6.8	2.2	2.3	1.6	1.9	
Nominal external interest rate (in percent)	1.3	1.2	1.5	1.4	1.2	1.1	0.3	1.3	1.2	1.3	1.2	1.2	1.2	
Growth of exports (US dollar terms, in percent)	22.7	2.2	-8.4	28.2	11.1	9.5	12.2	5.7	7.7	7.1	6.1	5.1	5.0	
Growth of imports (US dollar terms, in percent)	18.3	3.9	-9.2	30.5	14.6	7.8	12.4	2.9	6.6	5.7	5.6	4.6	5.0	
Current account balance, excluding interest payments	1.1	-2.1	-1.8	-2.1	-5.0	-1.4	1.7	-1.5	-2.0	-1.9	-1.8	-1.7	-1.8	
Net non-debt creating capital inflows	5.4	3.1	1.4	3.3	5.2	3.0	1.3	4.0	3.7	3.7	3.7	3.7	3.7	

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

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

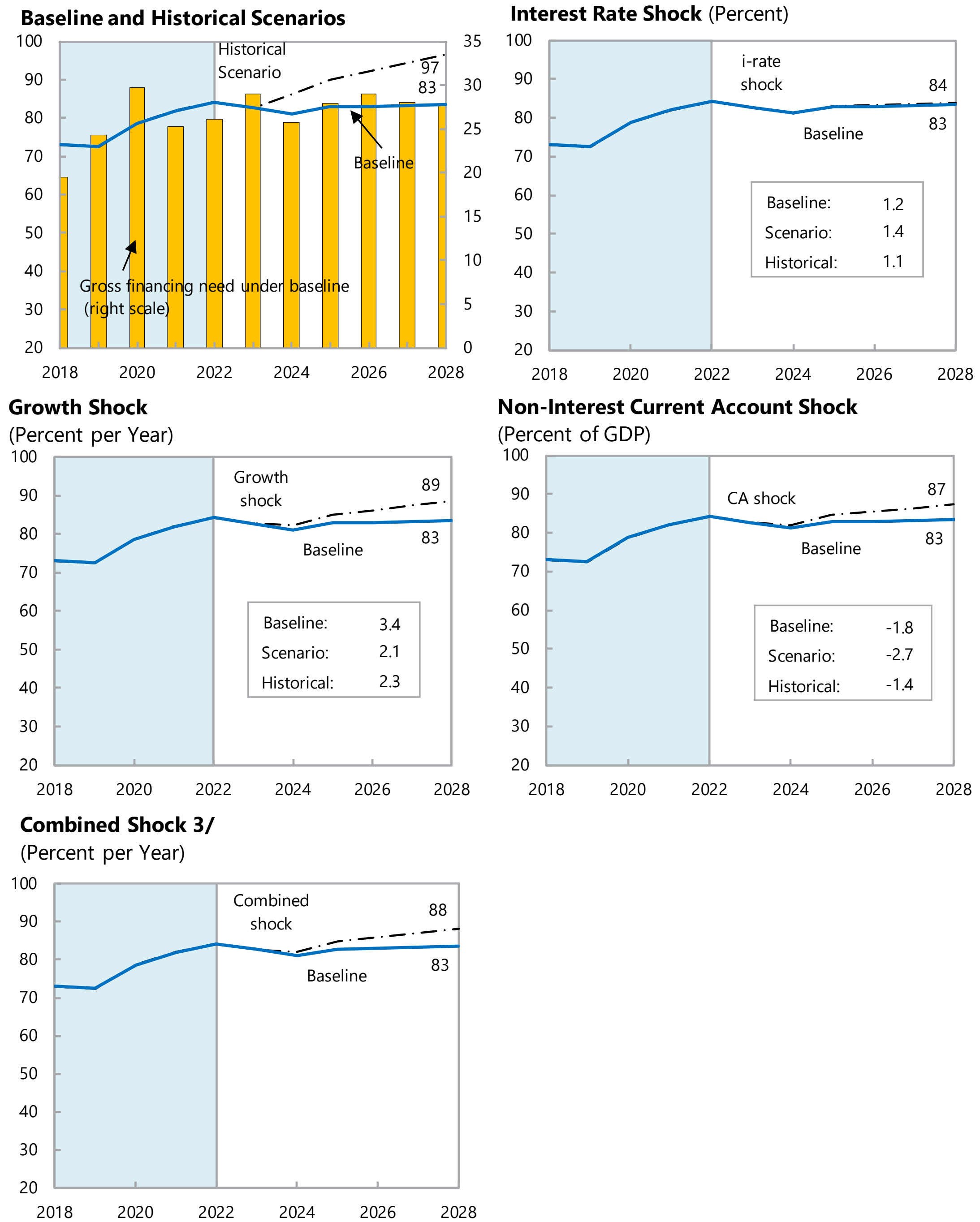
3/ For projection, line includes the impact of price and exchange rate changes.

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

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

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

Figure 1. North Macedonia: External Sustainability Bound Tests [1, 2]
(External Debt in Percent of GDP)



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

Annex IV. Risk Assessment Matrix

A. Global Risks (July 21, 2023)[1]

Source of Risks and Relative Likelihood	Expected Impact	Policy Responses
High **Intensification of regional conflict(s).** Escalation of Russia's war in Ukraine or other regional conflicts and resulting economic sanctions disrupt trade (e.g., energy, food, tourism, and/or critical supply chain components), remittances, FDI and financial flows, and payment systems, and lead to refugee flows.	**High** The direct impact is expected to be minimal due to limited linkages with Russia and Ukraine. However, an escalation of the war would affect North Macedonia through higher commodity prices, supply disruptions, tighter financial conditions, lower growth in trading partners, and lower tourism flows and remittances.	• Design targeted and temporary policies to cope with additional commodity price shocks. • Accelerate broad-based structural reforms to boost competitiveness, expand renewable energy production, and increase domestic production. • Promote energy savings through higher pass-through rates of international electricity prices for non-vulnerable clients, especially for peak-hour consumption.
High **Commodity price volatility.** A succession of supply disruptions (e.g., due to conflicts and export restrictions) and demand fluctuations causes recurrent commodity price volatility, external and fiscal pressures in EMDEs, contagion effects, and social and economic instability.	**High** Higher energy and food prices will transmit to consumer prices and dampen household disposable income, leading to lower consumption growth, and increase firms' input costs, negatively impacting profits and investment plans. Higher energy and food prices could also lead elevated inflation for longer periods risking inflation expectations become untethered. Higher energy imports to the regulated market may also weigh on the government's fiscal space.	• Design targeted and temporary policies to cope with additional commodity price shocks. • Promote energy savings through well-designed measures to increase efficiency in the use of energy; and by passing through international electricity prices for non-vulnerable clients, especially for peak-hour consumption. • Promote energy savings through higher pass-through rates of international electricity prices for non-vulnerable clients, especially for peak-hour consumption.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. The conjunctural shocks and scenarios highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon. **G-RAM operational guidance is available from the SPR Risk Unit website.**

Medium **Abrupt global slowdown or recession.** Global and idiosyncratic risk factors combine to cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and markets fragmentation. • **U.S.:** Amid tight labor markets, supply disruptions and/or commodity price shocks, inflation remains elevated, prompting the Fed to keep rates higher for longer and resulting in dollar strengthening, a more abrupt financial and housing market correction, and "hard landing". • **Europe:** Intensifying fallout from the war in Ukraine, worsening energy crisis and supply disruptions, and monetary tightening exacerbate economic downturns and housing market corrections. • **China:** Sharper-than-expected slowdown in the property sector, unexpected fiscal tightening due to local government financing stress and decline in investment, and/or rising geopolitical tensions disrupt economic activity.	**High** An economic slowdown in Europe will weigh on North Macedonia's growth through reduced exports, FDI, and diaspora and tourism flows that may lead to a higher current account deficit.	• Design targeted and temporary policies to cope with shocks. • Accelerate broad-based structural reforms, including greening the energy matrix and increase exports and domestic production. • Further strengthen monitoring of financial risks and establish contingency plans to address fiscal risks.
High **Deepening geo-economic fragmentation.** Broader and deeper conflict(s) and weakened international cooperation result in a more rapid reconfiguration of trade and FDI, supply disruptions, protectionism, technological and payments systems fragmentation, rising input costs, financial instability, a fracturing of international monetary and financial systems, and lower potential growth.	**Low** A global economic slowdown due to geo-economic fragmentation will weigh on North Macedonia's growth through reduced consumption and exports in the short term. However, it can also have positive effects through re-shoring towards North Macedonia.	• Design targeted and temporary policies to cope with additional shocks. • Accelerate broad-based structural reforms, including greening the energy matrix and increasing international competition.

B. Domestic Risks

Source of Risks and Relative Likelihood	Expected Impact	Policy Responses
High **Persistent elevation in consumer price inflation with clear second-round effects.** Inflation in North Macedonia remains high with signs of second-round effects in wage growth. Failure to lower inflation could lead to high inflation becoming entrenched.	**High** Headline and core inflation would decline more slowly than expected and may remain above the euro area for longer than desirable.	• Tighten monetary policy as needed. • Contain further increases to public wages, pensions, and other entitlements.
Medium **Cost overruns associated with the upcoming elections or the Corridor 8/10d construction running above the current budget.**	**Medium** Increased costs associated with pre-election spending or the Corridor 8/10d project could limit fiscal space and weigh on growth if other government investment and expenditure is lowered.	• Allow for a suitable buffer in the budget to account for potential cost overruns.
Medium **Renewed political instability, triggered, for example, by further delays in opening EU accession negotiations.**	**Medium** Political instability could lead to a deterioration of investor confidence, higher sovereign borrowing costs and a slowdown in policy reforms.	• Adopt targeted macro-prudential measures should there be any financial sector stress. • Durable fiscal consolidation within a credible medium-term budget framework.

Annex V. Implementation of Commitments Under the PLL

Commitment	Met	MOU	Sector	Notes
Structural Benchmarks				
Adoption and publication of a government action plan to gradually eliminate the need for government subsidies for electricity services and further improve energy efficiency.	-	7	Fiscal	The Energy Action Plan was shared with staff on February 28 and adopted by the Government on March 7. Staff advised not to publish. A revised plan was shared July 17. The staff had a meeting on 31st of August with the regulator and MoF, where areas which would require firmer commitments and further improvements were discussed. Replaced by adopted prior actions: (i) raising the price charged by the ESM to the Universal Supplier from 53 €/MWh to 57 €/MWh, and raising the charge for covering distribution losses from 100 €/MWh to 105 €/MWh and (ii) lowering the mandatory share of the demand of the regulated market to be supplied by ESM from 100 percent of demand to 95 percent of demand. All to be implemented by January 1st, 2024.
Comprehensive and independent feasibility study of Corridor 8/10d road project, shared with IMF staff.	√	6	Fiscal	The Feasibility Study was sent to staff on January 31. The feasibility study is independent and comprehensive given the information available.
Soft Commitments				
Continue discussions with the EU on MFA	√	2	Fiscal	EU (Council) has adopted MFA for €100 million. Disbursement expected in Q4 or Q1 2024.
Continue discussions with the WBG on a DPO.	√	2	Fiscal	Discussions advancing on $100 million DPO with the WBG.
Obtain External financing of at least €800 over the next 12 months.	-	2	Fiscal	An issuance of a €500 million Eurobond was completed in March. More reliance on domestic issuance and IFI financing.
Will use unused allocations under the 2022 budget primarily to clear arrears.	√	4	Fiscal	The government cleared some arrears from the unused allocations.
The draft budget for 2023 will be followed by a legislative proposal to streamline preferential treatments	√	5	Fiscal	The draft legislative proposals have been submitted for government adoption, expected to be adopted in September

Commitment	Met	MOU	Sector	Notes
and exemptions in corporate and personal income tax and value-added tax that will yield savings of approximately ½ percent of GDP				2023. The yield will be slightly lower than indicated.
Curb operating costs by reducing electricity consumption, travel and representation expenses, recourse to external consultants, as well as rental and equipment costs, and will monitor implementation by budget users on a quarterly basis	√	5	Fiscal	Fiscal overperformance on goods and services expenditures.
Not provide any broad-based permanent public sector wage increases in 2023 beyond the minimum wage adjustments	-	5	Fiscal	The new General Collective Agreement (GCA) allowed for a 10 percent increase in September, on top of the linear adjustment to the minimum wage. While this is in principle a violation of the soft commitment, it is in a higher inflation environment than expected at the time of PLL approval, and considered a prepayment for 2024, as agreed in the GCA.
Any anti-crisis support to households and companies will be strictly targeted and temporary.	-	5	Fiscal	The Government has normalized VAT on electricity to 18 percent. The energy tariffs were raised and steepened in January while there was a step back in July. Meanwhile, electricity prices remain subsidized for the large majority of households.
Unused budget allocations from lower-than-anticipated global energy prices will be used to reduce the fiscal deficit and we will consult with Fund staff ahead of any major reallocations between capital and current spending	-	5	Fiscal	Parts of the unused budget in 2022 was used for clearing arrears and lower the deficit, but unused funds in 2023 have been partly used in the revised budget on current expenditure, incl. public wages.
An independent advisor will review the contract (for corridor 8/10d) to ensure that it reflects all project deliverables and that associated costs and risks are clearly allocated to the contracting parties	√	6	Fiscal	IRD Engineering is overseeing the contract, advising the Government, and monitoring the construction of the C8/10d road project through regular monitoring reports.

Commitment	Met	MOU	Sector	Notes
If the feasibility study (corridor 8/10d) finds that the likely fiscal cost is significantly higher or risks do not appear manageable, we will adjust the timeline of the project implementation in order to fit into a sustainable medium-term fiscal framework, and/or implement a part of the project with IFI involvement and financing, consistent with the program targets and the fiscal rules of the organic budget law	-	6	Fiscal	The authorities did not engage with staff as expected on the costing of the C8/10d road project ahead of signing the full contract with BECHTEL/ENKA on March 8, 2023. The financing and risks may still be in line with the medium-term fiscal framework.
The independent advisor will regularly monitor the project (corridor 8/10d), prior to signing the contract and during the course of the project, and report to the government on a monthly basis or more frequently, including with updated project costs.	√	6	Fiscal	This is a requirement in the signed contract between the Government and BECHTEL/ENKA.
We will ensure transparency and accountability through publication of project (corridor 8/10d) monitoring reports and audits.	√	6	Fiscal	Staff discussed with the authorities (PESR), Transactional advisor, and Bechtel during the June 2023 mission. The parties agreed on publication of the reports.
We plan to adjust tariffs further in January 2023 to take into account market prices and to further reduce the loss and related budget transfers consistent with the budget deficit target.	√	7	Fiscal	Electricity tariffs were increased by around 5 percent on average on January 1st, 2023, and steepened. In addition to the first phase of the VAT normalization from 5% to 10%.
We will continue increasing electricity tariffs to gradually eliminate the need for untargeted government subsidies by the end of 2025 and further improve energy efficiency.	√	7	Fiscal	See above. The energy action plan falls short of eliminate tariffs by end-2025. This measure is replaced by prior actions for the 1st review, which will lead to meaningful tariff increases.
We will incentivize, through tariff adjustments, small- and medium-sized enterprises (“small consumers”) to move to the liberalized electricity market.	√	7	Fiscal	The tariff for SMEs is significantly higher than the average household tariff. The tariff for SMEs is broadly in line with current prices in the open market in September. However, forward electricity

Commitment	Met	MOU	Sector	Notes
				prices indicate that this may not be the case by year-end.
We will review the experience with block tariffs and expand the existing programs for energy vulnerable customers in coverage and adequacy.	√	7	Fiscal	The block-tariff structure has been reviewed by the World Bank, as well as Fund-provided TA in January 2023 assessed the distributional effects. The results have been provided to the Faculty of Electrical Engineering, and results are expected by October.
We are committed to adopting a modern approach to revenue administration and tax compliance. In particular, the Public Revenue office will strengthen its centralized compliance risk management (CRM), including by establishing a CRM committee, staffing the existing CRM unit appropriately, and creating a single reform governance structure within the organization by December 2022. We will not provide any tax amnesties.	√	9	Fiscal	Reform program has been drafted and FAD TA staff has advised the necessary improvements to make it complete. A reform management committee and a working body were established, but establishment of a reform unit is still needed. The CRM is in the structure but is not operational.
We will adopt the legal acts for the establishment of a PIM Department in the Ministry of Finance by December 2022.	√	9	Fiscal	The legal acts were adopted in December 2022.
To further enhance transparency, we will connect the procurement system with the newly created register of ultimate beneficial ownership by January 2023.	-	9	Fiscal	The authorities are in the process of doing so and acknowledge their commitment. However, some legal constraints are currently delaying implementation.
We will continue the monetary policy tightening and stand ready to act as needed to address any large and persistent inflation differential with the euro area or significant pressures on international reserves.	√	10	Monetary	NBRNM has increased the policy rate by 280 basis points since early Nov. 2022.
We will preserve central bank independence. In particular, following up on the recommendations of the 2020	√	10	Monetary	The central bank was removed from the law of administrative servants. A new draft law on public sector wages —which has not been approved yet—as that

Commitment	Met	MOU	Sector	Notes
Safeguards Assessment, we will take steps to ensure that the NBRNM has the autonomy to determine the employment conditions of its staff, through amendments to the relevant legislation.				would constrain the central bank's ability to set its compensation and thus compromise its independence.
We remain committed to continuously improving the implementation of the supervisory framework, including bank stress testing.	√	11	Financi al	The authorities outlined a medium term plan with the IMF support to develop stress testing including a sequence of TAs.. Three missions will be provided, the first one is a long-term coaching process starting in Sep/Oct. A second TA will focus on building technical capacity to analyze what CB is receiving from banks. The final TA will be defined on the base on the second progress.
To guard against a build-up of such risks, we have introduced a 0.5 percent counter-cyclical capital buffer for banks' exposure to the domestic economy, effective August 2023, and will take any further action that would become necessary.	√	11	Financi al	Most banks are already compliant with the capital requirements, and the NBRNM has announced in June 2023 that starting in Q3 2024 the countercyclical buffer will be increased to 1 percent (from 0.75 in Q2 2024).
We will also submit to parliament amendments to the National Bank law, by November 2022, granting a formal macroprudential mandate to the NBRNM.	√	12	Financi al	The amendments were submitted to Parliament in January 2023.
The NBRNM will present a macroprudential strategy for the overall financial sector for adoption by the Financial Stability Committee.	√	12	Financi al	The macroprudential strategy was adopted on April 20th, and it followed recommendations of ESRB and IMF-MCM. The NBRNM plans to also introduce borrower-based measures as needed.
New laws to strengthen frameworks for deposit insurance and bank resolution are also under preparation, with World Bank technical assistance, with the aim of submitting the legislative package to parliament by June 2023.	-	12	Financi al	The law on deposit insurance may be delayed, while the law on bank resolution was approved by parliament in October.

Commitment	Met	MOU	Sector	Notes
MONEYVAL Mutual Evaluation was concluded in May 2023. The report flags that while the country has a sound AML/CFT framework, further efforts are needed notably on investigation and prosecution.	√	13	Financial	Staff encourages the authorities to implement the Recommended Actions of the MONEYVAL Mutual Evaluation Report and will monitor the progress made.
We aim to reduce skills shortages and reverse the decline in labor force participation by strengthening education outcomes and support job-to-job transitions.	-	14	Structural	Unknown. Need to be assessed.
Future increases in the minimum wage will take into consideration productivity levels and trends, to preserve jobs and competitiveness.	-	14	Structural	On February 25, the Government announced that the net minimum wage increased by 12,55 percent. The system is rules-based and there is no link to productivity in the rules.
We will provide IMF staff with the data and information it requests for the purpose of monitoring program implementation. I	√	15	PLL General	Fund staff is receiving data, although sometimes with a delay. Budget execution data is provided in line with commitments.
We believe that the policies contained in this communication are adequate for achieving the macroeconomic and financial objectives of the program, but we will take any additional measures that may be appropriate for this purpose. We will consult with IMF staff on the adoption of these measures, and in advance of revisions to the policies contained in this communication, in accordance with the IMF's policies on such consultation	√	16	PLL General	There is a good dialogue with the authorities.

Annex VI. Implementation of Article IV and FSAP Recommendations

Table 1. North Macedonia: Implementation of Article IV Recommendations	
Key Recommendations	**Implementation Status**
Fiscal Policy	
Set a credible medium-term fiscal strategy to rebuild buffers and create room for investment.	
• Bring the primary fiscal deficit closer to 1 percent of GDP in the medium term.	• **Some progress.** The authorities are implementing a fiscal consolidation plan, which will be strengthened by the organic budget rule.
• Focus consolidation efforts on tax policy and revenue administration measures.	• **Some progress.** The tax reform was adopted in September 2023, and the reforms of the Public Revenue Office is continuing, including through Fund-provided TA.
• Expenditure consolidation should include rationalization of agricultural subsidies and re-organization of public administration.	• **Some progress.** The government is implementing a hiring freeze on retirements as part of strategy to restructure and improve efficiency.
Improve in public financial management to support the scale up of investment and limit fiscal risks.	
• Implement the action plan formulated for the Public Investment Management (PIM) Assessment and operationalize the PIM unit in the MoF.	• **Some progress.** Parliament has adopted the legal acts establishing the PIM unit, and the Ministry of Finance has started to staff the PIM Unit.
• Integrate PPPs into the PIM framework, with the MoF controlling decisions regarding the fiscal impact of PPPs.	• **Some progress.** The PPP law has not yet been adopted but is under the process of inter-institutional consultation.
• Improve safeguards to manage fiscal risks related to state-owned enterprises and local government finances.	• **Some progress.** The authorities have included a fiscal risk section, although still under development, in the annual budgetary review report, and continue to strengthen their fiscal risks assessment, including thorough Fund provided TA.
• Adopt and implement the Organic Budget Law and increase public procurement transparency and accountability.	• **Implemented.** Organic Budget Law was approved by Parliament in Sep. 2022. It has started to be implemented for the articles that came into effect immediately, and the authorities are making progress towards implementing articles than comes into effect later.
Monetary Policy	
• NBRNM should stand ready to tighten policies if inflation is expected to become persistently higher than inflation in the euro area, or	• **Some progress.** NBRNM increased the main policy rate by 505 basis points since the last staff report as inflation remained above Euro area. The

Table 1. North Macedonia: Implementation of Article IV Recommendations (Continued)	
Key Recommendations	**Implementation Status**
significant and sustained pressures materialize on foreign currency reserves.	effective reserve requirement was increased by about 1 percentage point.
Financial sector	
The frameworks for macroprudential policy be strengthened.	
• NBRNM should calibrate measures to limit households FX lending and foster denarization. • With rising private sector debt and the high growth in mortgage lending, requires close monitoring.	• **Some progress.** To foster denarization NBRNM has reduced denar reserve requirement from 8 to 5 percent and increased the foreign currency reserve requirement from 15 to 21 percent. • **Implemented.** To prevent the build-up of systemic risks, NBRNM deployed LTVs (85 percent) and DSTIs of 55 percent for denars loan and 50 percent for FX loans starting in July 2023.
Upgrade the financial safety net	
• Modernize the bank resolution framework • Strengthen deposit insurance (introducing depositor preference in line with EU law).	• **Implemented.** Parliament approved a new bank resolution law (Oct. 2023) that transposes EU regulation. • **Some progress.** The authorities are drafting a new deposit insurance law with the FINSAC support
Maintaining central bank operational independence	
• NBRNM staff should be excluded from the law on public administration staff.	• **Not implemented.** NBRNM is currently included in the law of public administration staff (LoPAS). Draft legislation removing NBRNM from the was submitted to parliament, but political fragmentation prevented the discussion. A new draft law on public wages system includes NBRNM and it is parliamentary procedure.
• To ensure timely decisions and preserve the operational autonomy, operational supervisory decisions should be taken by the executive part of the NBRNM Council (not the full Council)	• **Not implemented.** Amendments to the NBRNM law that address this shortcoming have been submitted to parliament in January 2023, but they have not been approved. The government will resubmit NBRNM law amendments including additional recommendations from the IMF safeguard report.
Structural	
Reduce the informal economy:	
• Ensure that workers have adequate protection under labor laws and social policies.	• **Some progress.** The authorities continue working to reduce informality, but there are no new significant initiatives.

Table 1. North Macedonia: Implementation of Article IV Recommendations (Concluded)	
Key Recommendations	**Implementation Status**
Increase the labor force participation, reallocate labor, and boost labor productivity	
• Support reskilling and retraining of the labor force and strengthen education outcomes	• **Partially implemented.** The authorities are implementing several programs for retraining labor. Among them is the "youth guarantee" program that offers a 4-month training for youth unemployed.
• Guide minimum wage by productivity developments	• **Partially implemented.** The minimum wage is rules-based and adjusted according to half CPI and half average wages in the past year. To the extent that average wages. There is thus an indirect link to productivity developments through average wages.
Strengthen the bankruptcy and insolvency framework	
	• Some progress. The government is working in a new insolvency law with the World Bank support.

Table 2. North Macedonia: Implementation of FSAP Recommendations

FSAP Recommendations	Time	Authorities' Actions
Financial Stability Assessment		
Create a centralized macrofinancial database; collect granular household data.	MT	As borrower based macroprudential instruments entered into force on July 1st 2023,[1] starting from July 2023 banks are collecting more granular data on households which is reported to the NBRNM Credit registry on the level of borrower-based indicators (DSTI, DTI and LTV). Efforts to obtain data on individuals' salary by amending the NBRNM Law have not succeeded.
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. Upgraded regulation on liquidity risk management,[2] which transposes 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 (LCR) 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 Financial Stability Law that entered into force in August 2023,[3] grants the NBRNM macroprudential mandate for the banking sector. However, the amendments of the NBRNM Law that enhances this new central bank function and grant a clear macroprudential mandate to the NBRNM are in the Parliamentary procedure.
Reconstitute the Financial Stability Committee (FSC) as principal domestic coordination body for macroprudential policy and crisis management.	MT	The Financial Stability Law formalizes the FSC as an inter-institutional body (It includes all financial regulators) responsible for monitoring the implementation of macroprudential policy and for coordinating activities to monitor systemic risks in certain segments of the financial system, to implement macroprudential measures, and to prepare for crisis management. As determined by the Law the FSC meets regulary (semiannually), while two subcommittees (for Monitoring of systemic risks and suggesting macroprudential measures and for Crisis management) meet quarterly.

1/ Official gazette 2/23, 96/23 and 193/23.
2/ NBRNM decision 146/2020.
3/ Official gazette of RNM, 173/22.

Table 2. North Macedonia: Implementation of FSAP Recommendations

FSAP Recommendations	Time	Authorities' Actions
Further develop the systemic risk monitoring framework.	ST	In April 2023, the FSC adopted the Macroprudential Strategy that outlines the key risks and monitoring framework. 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 and in 2023 was engaged in discussions with IMF staff for the deployment of macroprudential tools. To enhance the macroprudential framework, the NBRNM upgraded its organizational structure by dividing the (former) 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 allows for a more focused approach to financial stability issues and for adequate development of macroprudential tools. The new organizational structure was implemented from January 1, 2022.
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. Draft amendments to the NBRNM Law, establishing an Executive Board (EB) as a collegiate decision-making body, entered into the parliamentary procedure in January 2023. The EB is composed of the governor and the three vice-governors, as one of NBRNM's governing bodies. The Governor's mandate for issuing/revoking licenses and consents for financial institutions, taking measures against banks and other financial institutions as well as against payment institutions, electronic money institutions and payment system operators that are subject to supervision, shall be transferred to the EB. Also, the EB will have the authority to conduct monetary and exchange rate policies and take macro-prudential measures. There are still risk to the institutional and financial independence of NBRNM. Draft amendments to the Law on the National Bank deleting the problematic status of NBRNM's employees as administrative servants, entered parliamentary procedure in January 2023, but are still pending. However, the NBRNM should also be clearly excluded from the scope of the Law on Administrative Servants and the Law on Public Sector Employees. In January 2023 a draft Law on Public Sector Salaries has been posted for public discussion, that explicitly mentions the wages of the NBRNM's employees as subject of limitations by the Government, which is yet another risk of breach of the NBRNM's independence.

Table 2. North Macedonia: Implementation of FSAP Recommendations

FSAP Recommendations	Time	Authorities' Actions
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 year since then, 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 in the past 2 years and there is ongoing training process in order to develop the necessary skills and expertise for supervisors.
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	Discussions about the amendment of the Law of the National Bank of the Republic of North Macedonia and other relevant laws aiming to extend the NBRNM's oversight to all FMIs have started among the National Bank, the Ministry of Finance, and the Securities Exchange Commission. Discussions are in progress and once the appropriate solution is identified based on the regulatory framework and experience in the EU, the relevant laws will be amended.
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 has been approved by on Oct. 3, 2023, which transposes EU standards, and will be implemented starting from October 13, 2025. The NBRNM received CD for the preparation of the law and its implementation and will continue its work on developing of the necessary by-laws, as defined in the New Law. The new NBRNM organizational structure separates Banking Regulations and Bank Resolution Department, 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 resolution activities, if needed. A new law on Deposit Insurance is being drafted by the Ministry of Finance seeking to set a clear transition path to the EU standards. The law is expected to be submitted to parliament in 2024.
Establish he NBRNM's new resolution unit, develop resolution toolkit, and initiate resolvability assessments and resolution planning for at least all D-SIBs.	MT	A new Banking Regulations and Bank Resolution Department was established in 2021, which is be responsible for performing the resolution function within the National bank. Even before 2021, there was a separate organizational unit – Financial Stability, Banking Regulations and Bank Resolution that was responsible for capacity building for performing the new function. With the adoption of the Bank Resolution Law, the Banking Regulations and Bank Resolution Department will continue to build its capacity, develop appropriate by-laws (secondary legislation) and toolkits. Within the transitional period prescribed in the Bank Resolution Law, the National Bank

Table 2. North Macedonia: Implementation of FSAP Recommendations		
FSAP Recommendations	**Time**	**Authorities' Actions**
		will initiate resolvability assessments, develop resolution plans, define MREL requirements, etc. These activities will cover all banks, not just systemically important banks.
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 2023.
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.] In 2022 the National bank adopted a new Decision on the scope of audit of bank`s annual financial statements and operations with more stringent requirements on the scope of the audit of banks annual financial reports.[1] In addition, in 2018 the NBRNM adopted a new Decision on good corporate governance rules for banks (amended in 2019), which follows the latest international standards on banks' corporate governance.
[1] Official gazette 83/22.		

Annex VII. Assessment of Qualification Criteria for a PLL

1. Staff assess that North Macedonia meets the qualification criteria for a PLL arrangement. The country's policies were assessed as generally positive by the Executive Board in the context of the 2021 Article IV consultation completed in February 2022. Executive Directors were on balance supportive during the November 2022 Board meeting discussing PLL qualification. The Staff Report for the 2023 Article IV supports this assessment.

2. Economic fundamentals and institutional policy frameworks are sound.

- Following the shocks from the pandemic and the war in Ukraine, growth has slowed, inflation has increased, and the external balance initially deteriorated, as in many other countries. However, economic fundamentals remain overall strong, the authorities took appropriate measures to mitigate the impact of the shock, and they have started to scale those back, including lower deficits.

- The fiscal framework continues to be generally sound in line with the assessment at the time of PLL arrangement approval, aided by the Organic Budget Law approved by parliament, the recent appointment of a Fiscal Council, and a more rules-based framework for public sector wages, from 2025. The government is implementing an action plan to address the recommendations of the IMF's 2020 PIMA, including adopting the legislative acts and staffing the PIM unit in the Ministry of Finance.

- Central bank independence is anchored in law, and a 2022 review under the IMF's central bank transparency code found that the NRBNM is implementing advanced transparency practices. The 2023 Safeguards Assessment found that the NBRNM continues to have a strong safeguards framework in place, and the authorities are working on the few remaining gaps. The NRBNM's strong track record has cultivated a high level of public trust.

- Important progress has been made to strengthen the governance framework toward EU standards, although further actions are needed. Judicial independence has been improved, including through the 2020 Law on the Public Prosecutor's Office. The institutional framework for the prevention of corruption has also been strengthened and there are proactive investigations, prosecutions, and final convictions in corruption cases, including at high levels. Parliament adopted a national strategy for prevention of corruption and conflict of interest in April 2021 and a new AML/CFT law in July 2022. The MONEYVAL report confirmed that the country has a sound AML/CFT framework and identified some deficiencies that the authorities are committed to addressing. However, as part of preparing for the formal EU Accession process, parliament adopted a new criminal code in September. The government has stated that the changes are in accordance with EU legislation, but the EU (as well as the US embassy in Skopje) are currently reviewing the changes to ensure that they do not render prosecution of corruption more difficult or lessen penalties. Staff's assessment of the Criminal Code amendments is that the changes such as the reduction of maximum legal penalties for specific corruption related criminal offences and abolition of offences such as misuse of official position may result into expiration of some high-profile corruption cases. It may also hinder investigation and prosecution of other corruption cases. This has been raising concerns about the authorities' commitment to anti- corruption reforms. However, at this stage, the changes to the Criminal Code do not significantly affect the PLL qualification criteria in relation to institutional strength and the ability to respond to shocks in particular.

- Relative to other emerging market economies and Western Balkan countries, as well as previous arrangements under the FCL/PLL for other countries, North Macedonia performs well on governance indicators such as government effectiveness, regulatory quality, and rule of law from the Worldwide Governance Indicators (Figure 1). The indicator for control of corruption improved between 2020 and 2022 but does show some deterioration after 2015.

3. The authorities are implementing, and have a track record of implementing, generally sound policies, and remain committed to maintaining such policies in the future. The authorities responded timely and adequately to dampen the economic impact of the pandemic, and appropriately scaled back support as the need declined. In the context of the worsening in global financial conditions and the commodity price shock following the war in Ukraine, they requested a PLL arrangement. As laid out in their Written Communication, they are taking strong measures to address these shocks and are committed to taking any further action that becomes necessary. They have, on the whole, implemented or are in the process of implementing most of the commitments agreed as part of the arrangement under the PLL. The 2024 elections could pose an upside risk to public spending, but this is mitigated by legislation prohibiting additional spending (beyond the approved budget) in the run-up to elections. The process toward EU accession is expected to further strengthen the reform momentum.

4. North Macedonia performs strongly in four out of the five qualification areas and does not substantially underperform in the fiscal policy area.

External Position and Market Access. *North Macedonia performs strongly.*

- ***Criterion 1. Sustainable external position.*** Based on the 2021 external sector assessment (ESA) presented to the Board in February 2022 and the latest 2022 ESA, North Macedonia's external position is estimated to be broadly in line with medium-term fundamentals and desirable policies. At end-2022, gross external debt stood at 84 percent of GDP, of which about a third is short-term debt. The external liabilities are somewhat mitigated by the large share of FDI, which represents 84.0 percent of the NIIP. The 2022 current account deficit is lower than projected at program approval (6.2 percent of GDP vs. projected 7.5 percent of GDP) and is expected to continue to improve, with the 2023 deficit expected to be fully financed by FDI.

- ***Criterion 2. A capital account position dominated by private flows.*** Private capital flows constitute the largest share of capital flows, amounting to about 70 percent, on average, in the three-year period from 2020 through 2022. Net FDI inflows in the last five years represented about three-fourths of net financial account flows. The net international investment position (IIP) stood at -63 percent of GDP at end-2022, with FDI representing about half of the external liabilities (over 80 percent of the net IIP) and portfolio investment accounting for 13 percent of external liabilities.

- ***Criterion 3. A track record of steady sovereign access to international capital markets at favorable terms.*** Following its first Eurobond issuance in 2005, North Macedonia has accessed international capital markets regularly, with three Eurobond issuances totaling €1.9 billion over the last five years, more than ten times the Fund quota. The most recent issuance in March 2023 was at a 6.96% percent yield and a 4-year maturity (Table 1). Sovereign spreads have fallen gradually in 2023, reaching 271 bps at end-August—in line with peers in the Western Balkans.

- ***Criterion 4. A reserve position that is relatively comfortable when the arrangement is requested on a precautionary basis.*** As indicated at PLL arrangement approval, there is an actual, not precautionary, BOP need during the first year of the arrangement, with the first tranche purchased after PLL arrangement approval and the second tranche intended to be purchased after completion of the first review. Reserve coverage has been broadly adequate, with gross international reserves representing 108 percent of the ARA metric for fixed exchange rate regimes on average over 2020–22, and not falling below 100 percent in any of these three years. Without Fund disbursements under the PLL, reserve coverage between 2022–24 is projected to be 101 percent of the ARA metric in the baseline scenario and 99 percent in the downside scenario.

Table 1. North Macedonia: Eurobond Issuances to Date

(Million euros, basis points, percent)

	Issue Date	Due Date	Amount (€ million)	Spread with Bund (bps)	Yield-to-maturity (percent)	Coupon (percent)	Over-subscription
Eurobond I	2005	2015	150	N.A.	4.69	4.625	N.A.
Eurobond II	2009	2013	175	N.A.	10	9.875	N.A.
Eurobond III	2014	2021	500	362.2	4.25	3.975	2.4
Eurobond IV	2015	2020	270	526.1	5.125	4.875	2.2
Eurobond V	2016	2023	450	628	5.875	5.625	1.6
Eurobond VI	2018	2025	500	280.3	3	2.75	7
Eurobond VII	2020	2026	700	455.2	3.95	3.675	4.4
Eurobond VIII	2021	2028	700	236.9	1.866	1.625	2
Eurobond IX	2023	2027	500	369.3	6.96	7.25	3

Source: Ministry of Finance; Bond Radar; and IMF staff calculations.

Fiscal Policy. *North Macedonia does not substantially underperform in the fiscal area.*

- Criterion 5. Sound public finance, including a sustainable public debt position determined by a rigorous and systematic debt sustainability analysis.

- The overall fiscal deficit averaged 2½ percent of GDP in the five years prior to the pandemic and the energy crisis. It increased to 5.4 percent of GDP in 2021, on the back of the Covid-pandemic, while reduced to 4.5 in 2022, better than projected at the time of PLL arrangement approval. The authorities are committed to reduce the deficit to 3.4 percent of GDP by 2024 and are committed to further consolidation thereafter, consistent with the 3 percent of GDP deficit limit introduced OBL.

- Staff assess debt as sustainable in the medium term with a high probability. Public debt increased to close to 60 percent of GDP in 2020, reflecting the temporary increase in the deficit and the shock to GDP. Debt would remain below 60 percent of GDP during the projection period and gradually decline over the medium term, staying below the high-risk threshold in the baseline. However, as in the past, gross financing needs are large in years with Eurobond amortizations, hovering around the 15 percent of GDP benchmark. To address this, the authorities have taken steps to lengthen domestic debt maturities over the past decade and have generally relied more on domestic issuance.

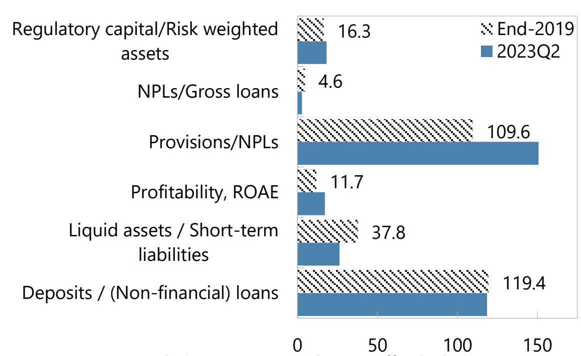
Monetary Policy. *North Macedonia performs strongly.*

- ***Criterion 6. Low and stable inflation, in the context of a sound monetary and exchange rate policy framework.*** North Macedonia has maintained a de-facto stabilized arrangement since 1997 and the central bank has a strong record of reacting adequately to maintain stability and defend the peg in times of turbulence. Helped by policy actions to increase the use of the denar, loan euroization has increased slightly from 42.6 percent in November 2022 to 43.1 in June 2023. Deposit euroization has been reduced from about 45.1 percent in November 2022 to 44.1 percent in June 2023, and is on a downward trend from the peak in mid-2022. Inflation has been low, averaging 4.2 percent over the past five years, and the average inflation pre-2022 was 1.6 percent. The recent rise in inflation was mainly driven by global commodity prices, energy, and food, and has been easing since October 2022, narrowing the spread to the euro area. At the same time, the NBRNM has widened the policy rate spread with the ECB.

Financial Sector Soundness and Supervision. *North Macedonia performs strongly.*

- ***Criterion 7. Sound financial system and the absence of solvency problems that may threaten systemic stability.*** Banks' profitability soared to 2.1 percent in 2Q-23 from 1.7 percent in 2Q-22 and the CAR increased to 18.3 percent in 2Q-23. NPLs have remained stable at a low level of 2.9 percent. With a solid bank performance, and prompted by fast growth in residential property prices, the NBRNM has increased the countercyclical capital buffer from 0.5 to 1 percent by 3Q-24 and introduced LTVs

Financial Soundness Indicators: Banking Sector, Latest
(Percent)



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

(85 percent) and DSTIs (55 percent denars loan/50 percent FX loans). Macroprudential policy was strengthened with the adoption of a Macroprudential Strategy in April 2023. A new bank resolution law was approved by parliament in October 2023.Stress tests by the NBRNM indicate that the banking system could withstand a severe macro-financial shock. The recent policy tightening has had almost no direct impact on bank profits, or indirect impact via the credit portfolio. The 2021 Article IV consultation and upcoming 2023 Article IV have not identified any solvency problems that may threaten systemic stability.

- ***Criterion 8. Effective financial sector supervision.*** The 2018 FSAP considered that the NBRNM's supervisory approach has a strong legislative and regulatory basis, and well developed onsite and offsite supervisory practices. Since then, the authorities have complied with many of the FSAP recommendations for financial sector supervision and taken steps to improve systemic risk monitoring, liquidity monitoring, and the crisis preparedness and crisis management framework. The 2023 Safeguards Assessment did not find evidence of legislation impeding on the operational independence of the NBRNM. During 2021, the NBRNM received IMF technical assistance to strengthen its stress-testing framework, which has continued in 2023. In November 2021, the European Commission determined that the supervisory and regulatory framework of North Macedonia could be regarded as equivalent to that applied in the EU.

Data Adequacy. *North Macedonia performs strongly.*

- ***Criterion 9. Data transparency and integrity.*** North Macedonia has been a Special Data Dissemination Standard (SDDS) subscriber since 2011 and has adhered to the SDDS Plus since January 2019.

5. North Macedonia does not face any of the circumstances under which the Fund may not approve a PLL arrangement. More specifically, North Macedonia (i) has demonstrated a sustained ability to access international capital markets; (ii) needs to undertake moderate, but not large, fiscal and structural adjustments; (iii) has a public debt position that, with a high probability, is sustainable in the medium term; and (iv) does not have widespread bank insolvencies.

Annex VIII. New General Collective Agreement for Public Sector Wages

The government and labor unions reached a new General Collective Agreement (GCA) on public sector wages in August. The agreement covers approximately 107,000 public sector employees. The GCA included a 10 percent wage increase in September as well as an annual leave allowance, but it is explicit that there won't be further wage increases in 2024, beyond an adjustment for inflation above a 3 percent threshold. From 2025, public sector wages will be anchored to average wages, capped by nominal GDP.

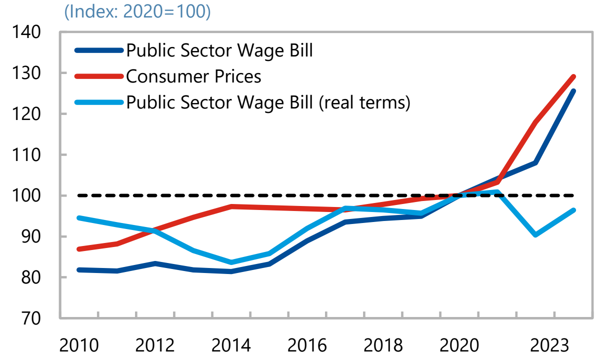
1. **The government and labor unions reached a new GCA on public sector wages in August 2023.** The agreement covers approximately 107,000 public sector employees across budget users, local municipalities, and health care. The GCA sets a minimum for the public sector and additional decentralized collective wage agreements can be agreed, but the Ministry of Finance is required to issue an opinion on any decentralized collective wage agreements with a fiscal impact.

2. **There will be 10 percent wage increase in September, as a prepayment for 2024, and return of the annual leave allowance.** The GCA includes a 10 percent wage increase in the September wage (paid from October). It is considered a prepayment for 2024, where the GCA includes only a safeguard for inflation above 3.0 percent y/y in the first six months of 2024, expected to have minor impact. In addition, the GCA includes a return of the annual leave allowance of 10,000 MKD in 2023, rising modestly in 2024.

3. **Public sector wages are catching-up to inflation.** Public sector wages rose by 6.4 percent on average in 2022, which was significantly less than the CPI inflation rate of 14.2 percent in 2022. Through July 2023, public sector wages have risen by 11.8 percent on a sequential average, slightly below CPI inflation over the same period (12.8 percent). The rise in public sector wages in 2023 is mostly driven by a linear adjustment for public sector employees to the minimum wage increase in March. The minimum wage increases annually as defined by law by half CPI and half average wages in the previous year, which led to a 12.6 percent increase in the minimum wage in March. The linear adjustment is the absolute increase in the minimum wage in denar terms. Staff estimate this linear adjustment to be equivalent to around a 4.75 percent wage increase. The 10 percent increase in September, as part of the new GCA, is in addition to the linear increase.

4. From 2025, public sector wages will be anchored by average wages in the economy and capped by nominal GDP. The ratio of public sector wages to general average wages will be fixed towards the end of 2024 through a complexity coefficient (fixed as a ratio to the average wage). This ratio will be the subject of negotiations, but its increase into 2025 is capped at 5 percent. From March 2025, public sector wages will be adjusted by the average wage and, crucially, capped by growth in nominal GDP. This is a great improvement relative to the current system, which has no upward anchor. The linear adjustment to the minimum wage increase will no longer apply. Another important advantage of the new system is its broad-based coverage of the public sector, versus the highly atomized current system whereby different institutions negotiate independently.

Public Sector Wage Bill
(Index: 2020=100)



Sources: SSO, Ministry of Finance, IMF staff calculations.

Annex IX. Developments in the Electricity Sector, Tariffs, and Subsidies

Electricity prices for households have increased on average by 40 percent since July-2020. The authorities introduced electricity block-tariffs on 1st July 2022, which was a significant reform to incentivize lower electricity consumption among households. The block-tariffs consist of four blocks with marginally increasing tariffs and is applicable during the peak-hours of the day. While the tariff structure was further steepened on January 1st, 2023, most households consume electricity in the lower blocks at low tariffs, and electricity prices remain subsidized for most households, which continues to be a fiscal burden and vulnerability.[1]

1. Electricity prices for households have increased on average by 40 percent since July-2020. During the latest tariff adjustments in January and July 2023, tariffs were on average adjusted downwards, which allowed the government to normalize the preferential VAT rate on electricity from 5 to 10 percent in January 2023 and from 10 to 18 percent in July 2023. At the same time, the block-tariff structure was steepened, enhancing the incentive structure for electricity efficiency.

2. Electricity block-tariffs for households were introduced in July 2022. Block-tariffs apply in four consumption blocks that gradually increase the marginal consumption tariff during the daily 'peak' consumption period from 7 am to 10 pm from 69.2 €/MWh in the first block to 270.2 €/MWh in the top block. During the 'non-peak' consumption period, a non-peak tariff of 22.8 €/MWh applies. Small consumers (small companies) are not subject to block-tariffs but pay a higher flat tariff of 182.3 €/MWh during peak hours and 134.0 €/MWh during non-peak hours. In addition, a flat transmission and distribution fee of 42.6 €/MWh is added for all consumers. Most electricity is consumed in the first two blocks, and close to 50 percent of total electricity is consumed during the non-peak hours.

3. While the electricity market was deregulated in 2018, most households and small companies today purchase electricity in the regulated market. The state-owned electricity generator, ESM, is currently obliged to provide 100 percent of the electricity needs of the regulated market, in addition to selling electricity to cover transmission and distribution losses at a subsidized price (for distribution losses). Following the rise in electricity prices in the open market, households and SMVs have moved back to the regulated market. The regulated market consumed about 4,300 GWh including network losses in 2022. As a result of a mild winter, higher prices, block-tariffs, as well as greater awareness of the need to save electricity, households electricity consumption fell during the latter part of 2022, and North Macedonia temporarily became an electricity exporter.

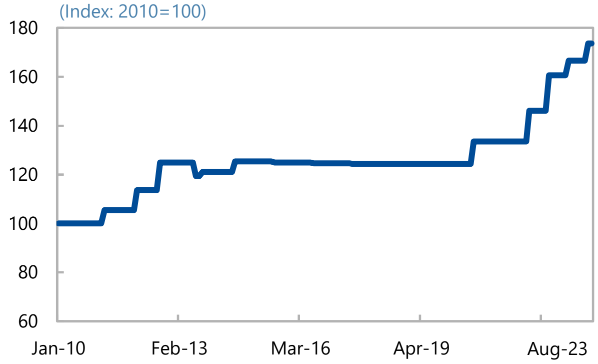
4. The own production of the state-owned electricity generator, ESM, is not enough to cover 100 percent of the demand of the regulated market, in line with current regulation. The ESM had an own production of about 3,650 GWh, and thus had to obtain the rest of the needs of the regulated market from re-commissioned power plants or in the open market (domestic or imports). This increased the financial loss of the ESM in 2022, while the loss has narrowed in 2023. In addition,

[1] See Selected Issues Paper, North Macedonia: Climate Change: Challenges and Policies for additional information on the electricity sector and its role in the green transition.

the ESM has managed to increase its own electricity production by around 12 percent thus far in 2023, which has also helped narrow the financial loss to the ESM from open market purchases. The government transferred around 1.3 percent of GDP to the ESM (for electricity production) in 2022.

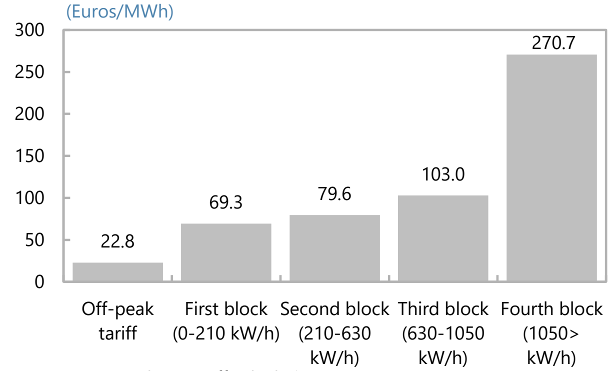
5. **The electricity prices for most households remain subsidized as the ESM is currently selling electricity for the regulated market below its cost-recovery price.** In addition, the consumption thresholds in the block-tariff system implies that most households consume electricity at a price below the open market price and around 40 percent below the ESM's cost recovery price, according to staff estimates. Meanwhile, the social support system for energy vulnerable households remains limited and operationally challenged. In September, the government announced that it would have new measures better targeting vulnerable households through the winter. Discussions on further assistance for vulnerable households are taking place in the context of the World Bank DPO.

Electricity Price for Households
(Index: 2010=100)



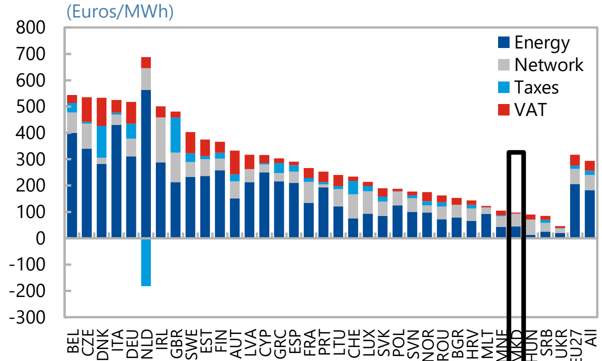
Sources: Haver Analytics; SSO; and IMF staff calculations.

Block-Tariffs for Households, July 2023
(Euros/MWh)



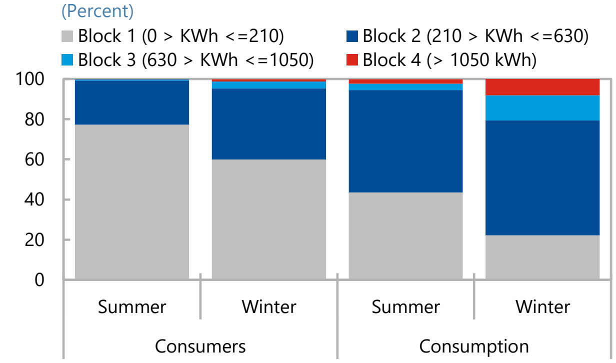
Sources: ERC and IMF staff calculations.

Electricity Tariffs, December 2022
(Euros/MWh)



Sources: HEPI 2023; ERC; World Bank; and IMF staff calculations .

Consumer and Consumption Shares Across Blocks
(Percent)



Sources: ERC and IMF staff calculations.

Annex X. Adverse Scenario

1. This adverse scenario represents an extension and a worsening of the current global conditions in line with the global downside scenario of the October 2023 WEO.[1] Subdued confidence and deeper-than-expected contraction in real estate in China, combined with longer transmission lags and greater-than-expected impacts from global monetary policy tightening, weighs down on global outlook, tightening financial conditions in emerging economies, and lower growth of North Macedonia's main trading partners.

2. Growth declines by 1 percentage point in 2024 and 2025, before slowly recovering in 2026–2028. North Macedonia's GDP growth follows a similar path to that of the EU, reflecting weaker exports, lower consumption, and tighter financing conditions in 2024–2025. GDP growth then recovers somewhat in the later years, recuperating some of the lost output.

3. While the adverse scenario at PLL approval assumed higher energy prices and accelerated inflation, the WEO's adverse scenario assumes a more modest impact on inflation, given that the upward pressure from core inflation outweighs a modest negative effect from lower commodity prices.

Table 1. North Macedonia: Macro Variables in Baseline and Downside Scenario

	2023	2024	2025	2026	2027	2028
North Macedonia developments						
Baseline (Percent)						
Gross Domestic Product	2.3	3.0	3.5	3.5	3.5	3.5
Inflation	9.5	4.5	2.1	2.0	2.0	2.0
Current Account / GDP	-2.5	-3.0	-2.9	-2.8	-2.7	-2.7
Fiscal Balance / GDP	-4.7	-3.4	-3.0	-2.9	-2.8	-2.7
Downside Scenario (Percent)						
Gross Domestic Product	2.3	2.0	2.5	4.7	4.3	3.5
Inflation	9.5	4.8	2.4	1.6	2.0	2.0
Current Account / GDP	-2.5	-3.6	-3.3	-2.9	-2.7	-2.7
Fiscal Balance /GDP	-4.7	-3.7	-3.5	-3.2	-2.8	-2.8
Impact						
Gross Domestic Product (p.p.)	0.0	-1.0	-1.0	1.2	0.8	0.0

4. Key assumptions for North Macedonia on the current account, foreign direct investment, and external market financing are informed by past shocks:

[1] See: IMF World Economic Outlook, October 2023, Box 1.2.

- **Current account.** While weaker export growth is partially offset by weaker demand for imports, overall balance in trade in goods and services deteriorate by about 0.6 percentage point of GDP relative to the baseline. This, combined with a slowdown in remittances, implies that the current account deficit would be 3.6 percent of GDP in 2024, compared to 3.0 percent of GDP in the baseline.

- **Foreign direct investment.** While the baseline already assumes a decline in FDI from 4.0 percent of GDP in 2023 to 3.7 percent of GDP in 2024, the adverse scenario assumes that the FDI in 2024 drops further by 0.7 percentage points of GDP relative to the baseline scenario, reflecting the worsening of global financial conditions. Given the resilient nature of FDI in the past, FDI in 2025 is then assumed to recover somewhat to 3.3 percent of GDP (compared to 3.7 percent in baseline).

- **External market financing.** The adverse scenario assumes no public external market financing in 2024 vs. an external market financing of €300 million in the baseline. Most is instead partially replaced by PLL financing. Some is also absorbed by increasing net domestic issuance.

Table 2. North Macedonia: Shock Scenario

(Millions of euros, unless specified otherwise)

	2023	2024	2025	Total
Gross total shock	**0**	**-520**	**-143**	**-663**
External market financing	0	-300	0	-300
Downside scenario	0	-220	-143	-363
o/w Impact on net exports	0	-79	-44	-123
o/w Impact on primary and secondary income	0	-25	-23	-48
o/w Impact on FDI and trade credits	0	-116	-77	-192

Sources: NBRNM; and IMF staff estimates.

5. **Financing sources.** This analysis assumes that North Macedonia will fully draw the PLL resources in 2024 to fulfill the external financing need, resulting in a reserve level of about 103 percent of the ARA metric (compared to 109 percent in the baseline) before recovering to 105 percent in 2025. Without the drawdown of precautionary PLL resources, reserves would drop to 97 percent of the ARA in 2024.

Table 3. North Macedonia: External Financing Requirements

(Millions of euros, unless specified otherwise)

	2023	2024		2025		2026	2027	2028
		Baseline	Downside	Baseline	Downside			
Gross financing needs	**846**	**1041**	**1144**	**884**	**951**	**898**	**917**	**912**
Current account deficit 1/	433	476	580	481	548	489	502	537
MLT debt amortization 2/	413	565	565	403	403	409	415	375
Financing sources	**703**	**1311**	**748**	**1342**	**1265**	**1182**	**1238**	**1195**
FDI (net)	578	586	471	617	543	652	689	729
ST (net)	15	11	11	15	15	15	13	14
MLT debt disbursements (excl. exceptional)	432	516	369	696	696	724	756	783
Government private external financing	600	300	0	700	700	700	600	600
Other 3/	-922	-101	-103	-687	-689	-909	-820	-932
Net change in reserves (-: increase)	**-263**	**-525**	**-110**	**-457**	**-314**	**-284**	**-321**	**-283**
Financing gap	**406**	**255**	**506**	**0**	**0**	**0**	**0**	**0**
Exceptional financing	406	255	506	0	0	0	0	0
IMF PLL Disbursement	0	147	398	0	0	0	0	0
IFI Financing	406	108	108	0	0	0	0	0
Of which: EU Grant	72	8	8	0	0	0	0	0
Of which: MFA	50	50	50	0	0	0	0	0
Of which: DPO	94	0	0	0	0	0	0	0
Of which: OPEC	50	0	0	0	0	0	0	0
Of which: KfW	90	0	0	0	0	0	0	0
Of which: EBRD	50	50	50	0	0	0	0	0
Remaining financing gap	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Memorandum items								
Gross International Reserves (GIR)	4126	4652	4383	5109	4697	5393	5713	5997
Short-term debt (residual maturity)	4472	5041	5039	5438	5471	5542	5814	6036
GIR as % of ST debt	92	92	87	94	86	97	98	99
GIR as % of ARA Metric	104	109	103	113	105	113	115	114

Sources: NBRNM; and IMF staff estimates.

1/ Excluding EU Grant, which is included in exceptional financing.

2/ Excluding the amortization of MLT intercompany loans, which is included in FDI (net).

3/ Including the capital account balance, net errors and omissions, currency and deposits, portfolio investments, and trade credit.

Annex XI. The Challenge of Emigration

Emigration has been a challenge for North Macedonia over the last two decades; arresting emigration is a key priority to improve medium-term prospects. This Annex summarizes the findings in Li and Gade (2023) showing that a 1 percent increase in emigration leads to around a 2.9 percent loss of firms in North Macedonia and has a disproportionately negative effect on GDP per capita. Policies should focus on creating the right environment retaining the young population, such as lowering youth unemployment, improving the education system, matching the need of the labor market, and strengthening governance.

1. **Ten percent of the total population have emigrated to other countries in Europe over the last two decades.** The recent 2021 Population Census of North Macedonia allowed North Macedonians living abroad for more than a year to register for the Census. The Census showed a non-resident population of 260,606, out of a total population (resident and non-resident) of 2.1 million. However, due to self-registration, the Census may still underestimate the actual number of non-residents but provides some evidence that at least 10 percent of the population lives abroad.

2. **Mainly the young and well-educated part of the population emigrate.** The demographics of the emigrating population indicate that emigration is especially pronounced among the youngest of the working age population, i.e., people in the age range 20–30 years of age accounting for almost 50 percent of those emigrating. 52 percent of those emigrating from North Macedonia have a secondary education, while 20 percent have a tertiary education, indicating a 'youth drain' and 'brain drain'.

3. **As a novel exercise, the empirical approach aims to estimate the impact of emigration on the number of companies in North Macedonia.** Using SSO data on number of emigrants and population estimates for 73 municipalities, and the business entities database from the SSO, which provides the number of active business entities at the municipal level across 21 industries, Li and Gade (2023) estimates the impact of emigration on the number of firms in North Macedonia.

Specifically, we estimate the following:

$$\frac{\Delta y_{c,t}}{pop_{c,t}} = \alpha_t + \beta \frac{m_{c,t}}{pop_{c,t}} + \varphi_r + \gamma X_{r,t} + \varepsilon_{c,t} \qquad (1)$$

The dependent variable is the change in the total number of firms per capita in municipality c, at year t. The explanatory variable is the emigration rate in municipality c at year t. β represents the coefficient of interests, which captures the impact of emigration on the number of firms.
We normalize the number of emigrants with population size pop. Similarly, we also normalize the change in firm stocks. This normalization method helps to address concerns related to scale effects that the size of municipality might drive large changes in both the number of firms and emigrants.

We include controls for the business cycle such as the regional unemployment rate and GDP per capita which are denoted as $X_{r,t}$, where regions are indexed by r. To account for time-specific effects, we introduce a year-dummy variable α_t and to capture regional-specific effects, we introduce a region-dummy variable φ_r. The inclusion of time fixed effects helps control for macroeconomic shocks, while the region-specific effects absorb regional characteristics such as the initial industrial structure or age distribution in 2013. Standard errors are clustered at the municipal level.

To mitigate endogeneity concerns, we use a shift-share instrumental variable (IV) in our regression analysis, summing the pull force across destination countries, as follows:

$$Pull_{c,t} = \sum_d NTWK_{c,d} * \frac{GDP_{d,t}}{GDP_{d,t-1}} \tag{2}$$

$Pull_{c,t}$ is the pull force of migration in municipality c at year t. $NTWK_{c,d}$ represents the network factor between municipality c and destination country d. $GDP_{d,t}$ indicates the GDP level of destination country d at year t. It is less likely that North Macedonia has a substantial impact on the GDP growth rate of destination countries, and concerns of reverse causality are thus mitigated in the IV approach.

Table 1. North Macedonia: Fixed Effects Panel Regressions with IV Using Annual Changes

	Short-Run				Long-Run			
	Overall IV	Weighted IV	Industrial Sector	Service Sector	Overall IV	Weighted IV	Industrial Sector	Service Sector
Emigration Rate	-0.763***	-0.161***	-0.058***	-0.039***	-0.363***	-0.0715***	-0.039***	-0.015***
Std. error	(0.0469)	(0.00998)	(0.00319)	(0.00193)	(0.0386)	(0.0157)	(0.00275)	(0.00205)
F-stat	13.61	18.49	13.89	13.93	13.78	23.83	13.78	13.78
Obs.	282	972	1410	3666	47	162	235	611

Standard errors in parentheses
* p < 0.10, ** p < 0.05, *** p < 0.01

4. **Emigration impacts the number of companies in North Macedonia more in the short-run than in the long-run, and more in the industrial sector than in services.** The empirical estimates suggest that there is a significant negative effect across most regressions. The overall effect of a 1 percent increase in the emigration rate is -0.76 firms per 1000 people in the short-run and -0.36 firms per 1000 people in the long-run. This corresponds to a 2.9 percent reduction in the number of companies in the short run and 1.4 percent reduction in the long run, suggesting some adaptation in the long run. The effect becomes smaller when weighing by firm size, indicating a larger reduction of small firms than of large firms, suggesting that larger firms can better adapt and attract/retain labor. Also, it is possible that in the long-run, there is other adjustment in the labor market due to wage/labor supply dynamics, such that some people outside of the labor market, may decide to enter the labor market due to labor shortages and higher wages.

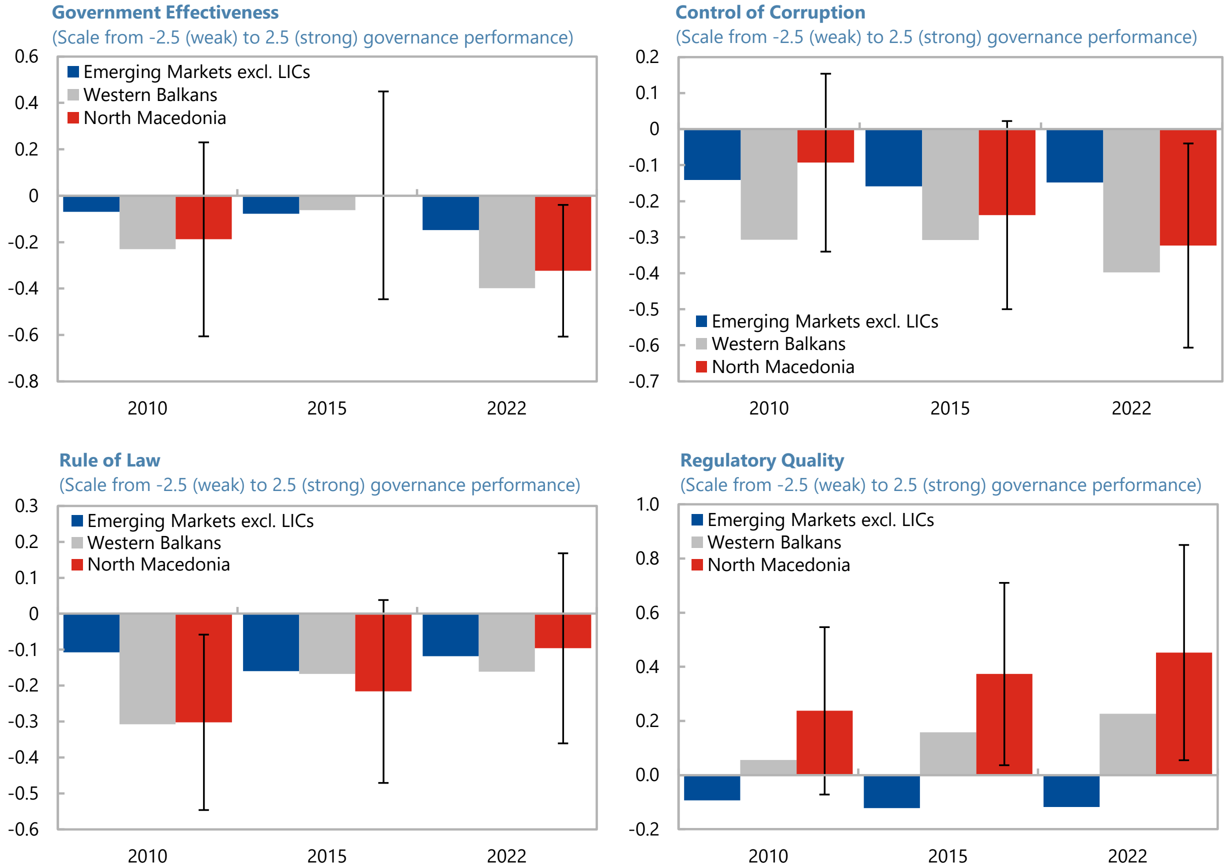
5. The loss to GDP is disproportionate given the loss of young, skilled, educated people. In the North Macedonian economy, there are many small companies with less value added per company. In contrast, there are fewer large companies in the industrial sector, but with large value added. However, across regressions, the corresponding loss of output is in the range of 1–3 percent of GDP, suggesting a loss in GDP per capita in the short-term and long-term, and across sectors, and through all channels.

Annex XII. Fiscal Governance, Rule of Law, and Anti-Corruption Measures

Over the past several years, North Macedonia has taken important steps to strengthen the governance framework, including in fiscal governance, rule of law and anti-corruption. While the recent amendment in the Criminal Code is a step in the wrong direction that should be promptly remedied and further actions are necessary to strengthen rule of law and the fight against corruption, North Macedonia continues to perform well across a variety of indicators in the Worldwide Governance Indicators relative to other emerging markets and Western Balkans countries.

1. **Significant progress has been made in the area of fiscal governance, though further steps are essential to address remaining vulnerabilities.** The authorities have introduced several reforms to address the weaknesses identified by the 2020 Public Investment Management Assessment (PIMA). These include: (i) the adoption of the ambitious Action Plan to implement the PIMA recommendations; (ii) the approval of the 2022 Organic Budget Law (OBL), which helps improve fiscal policymaking, budget preparation and execution, and fiscal reporting; (iii) the establishment of the PIM Department in the MoF to perform the functions envisaged in the new OBL; and (iv) the ongoing revision process of the 2021 Law on Concessions and PPP to align with EU directives. To strengthen the centralized compliance risk management (CRM) of the Public Revenue office, the authorities have also drafted a reform program and established a CRM reform management committee and a working body and are working towards establishing a reform unit. Nonetheless, additional actions are still needed, including increasing resources and strengthening the established PIM Department and relevant units for CRM, adopting OBL bylaws, completing the revision of the PPP law, and completing the process of connecting the procurement system with the recently created register of beneficial ownership.

2. **The authorities have made some progress on multiple fronts to address weaknesses in rule of law and regulations.** The Worldwide Governance Indicators (WGI) for regulatory quality and rule of law have improved steadily, with the 2022 indicators performing better than other emerging market economies and Western Balkans countries average. In addition, the second compliance report of the Fifth Round Evaluation Report from the Group of States against Corruption (GRECO) noted that more resources have been made available for the State Commission for Prevention of Corruption (SCPC)—the main body to prevent and promote the fight against corruption—which helps strengthen SCPC's ability to fulfill its mandate, though continued efforts to strengthen the SCPC are essential. Steps to promote integrity have also been implemented. The oversight of declarations of interests and assets have been improved, including through development of new electronic tools. The Council of Public Prosecutors adopted a new code of ethics in 2021, which provides a comprehensive set of integrity rules for all prosecutors in North Macedonia. Additional guidance related to gifts, lobbying, and conflicts of interests have been made available to persons who are entrusted with top executive functions, and trainings on Code of Ethics and conflicts of interests have been provided for Members of government.



Source: Worldwide Governance Indicators; D. Kaufmann (Natural Resource Governance Institute and Brookings Institution) and A. Kraay (World Bank); and IMF staff calculations.
Note: The WGI is a perception-based indicator which aggregates data from more than 30 think tanks, international organizations, nongovernmental organizations, and private firms. The accuracy of perception-based indicators can be biased by experts' views. Non-IMF indicators provide qualitative information about corruption, they do not represent IMF's assessment of the level of corruption. Upper/lower 90 percent confidence band shown on North Macedonia.

3. **While some progress has been made, further actions are still necessary to strengthen the governance and anti-corruption framework.** The WGI for government effectiveness and control of corruption—though still performing better than the average across other Western Balkans countries—has declined over recent years, in part reflecting weak and selective enforcement of rule of law, resource constraints of key anti-corruption agencies, and political influence exerted over institutions. The second compliance report of the Fifth Round Evaluation Report from GRECO identified several recommendations that have not yet been implemented satisfactorily. This includes ensuring that the current system of sanctions for conflict of interest and other integrity violations for Members of the Parliament is adequate, ensuring operational independence and political of the police in practice, and improving their internal and external oversight mechanisms. In addition, recent amendments to the Criminal Code in September, which was amended through an expedited parliamentary procedure, provide for the reduction of maximum legal penalties for specific corruption-related criminal offences and the abolition of sentences in specific cases of misuse of official position. The amendments result in expirations of some high-profile corruption cases, cause some corruption cases brought previously under deleted offences to be dropped, and may hinder

the future investigation and prosecution of corruption cases. While the amendments do not significantly affect the PLL qualification criteria in relation to institutional framework and the ability to respond to shocks, the changes brought about by the amendments are of serious concern.

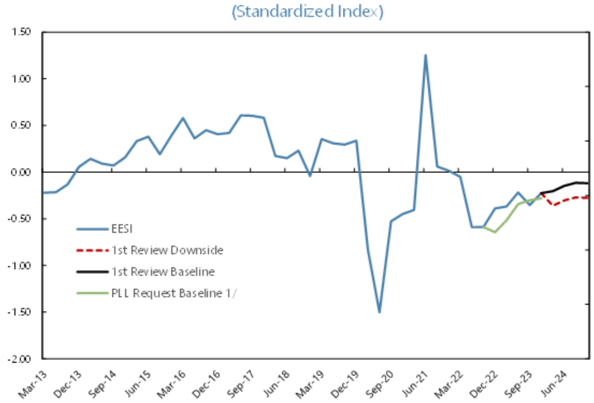
Annex XIII. External Economic Stress Index (EESI)

1. **The External Economic Stress Index (EESI) is based on five major variables which capture external risks for North Macedonia.** The variables include (i) the real growth rate of euro area imports (a proxy for net exports in the current account); (ii) the real growth rate of GDP in Germany (a proxy for remittances, FDI, and other diaspora-related flows in the current and financial accounts); (iii) the VIX index (a proxy for the volatility in global financial markets);[1] (iv) an index of prices of food commodities (from IMF GAS, a proxy for risks from further imported food price increases); and (v) an index of energy commodities (from IMF GAS, a proxy for risks from further imported fuel commodity price increases). The index is calculated as a weighted sum of standardized deviations of the above variables from their means, with signs reversed in the case of the VIX and price indices. The weights are estimated using the importance of each variable in GDP. The weight on euro area import growth corresponds to net exports in GDP. The weight of German real GDP growth corresponds to the share of remittances plus FDI in GDP. The weight of the VIX corresponds to the share of portfolio liabilities in the international investment position. The weight of the food commodity price index corresponds to the share of food in imports, and the weight of the energy commodity price index corresponds to the share of energy in imports.

External Risks	Channels	External Proxy Variables	Weights
External demand	Net exports	Euro area import growth	0.15
	Food imports	Food commodity price index (-)	0.10
	Energy imports	Energy commodity price index	0.11
Financial inflows	Remittances, FDI	Germany GDP growth	0.20
	Portfolio flows	VIX Index	0.18

2. **External economic stress—though improving—is projected to remain high relative to pre-2019.** Development of EESI has been in line, albeit slightly better, with the projection at the time of PLL approval. The improvement in the EESI suggests that external stress has reduced relative to November 2022, but still is and projected to remain higher than historical average for the remaining duration of the program. The adverse scenario reflects external risks in line with developments outlined in the adverse scenario, including lower global growth and slower import growth for the euro area. On average in 2024, the EESI is -0.15 in the baseline and -0.30 in the downside, compared to the EESI of -0.39 at end-2022.

External Economic Stress Index
(Standardized Index)



1/ EESI for PLL request baseline shown above is calculated by replacing the FCI with VIX index.
Sources: Haver Analytics; WEO; FRED; and IMF staff calculations.
Note: Negative values indicate above-average stress.

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[1] At PLL approval, the Financial Conditions Index (FCI) compiled by Banque de France was used as a proxy for risk premia and financial conditions. However, given that the FCI series from Banque de France has been discontinued, the financial conditions are now proxied by the VIX index.

Appendix I. Written Communication

Skopje, December 22, 2023
Ms. Kristalina Georgieva
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Ms. Georgieva:

1. Following the energy crisis brought on by Russia's war in Ukraine, North Macedonia has experienced macroeconomic stability and economic growth has begun to recover. We have continued to implement sound policies and adopt the key reform measures in the PLL. After growing by 2.1 percent in 2022, 2023 growth is expected to be in the range of 1.9 to 2.5 percent. Growth is expected to accelerate to 3.0 to 3.5 percent in 2024, as exports recover and investment picks up, not least due to the Corridor 8/10d road project. Inflation has declined significantly below its peak in late 2022, and faster than in the Euro Area, thus markedly narrowing the inflation differential. Yet it remains a challenge, as in other emerging economies. Inflation is expected to continue its downward path, averaging around 9.5 percent in 2023 and to 3.5 to 4.0 percent in 2024.

2. In this context, we consider that the PLL continues to support macro-financial stability and our reform agenda. We request a rephasing of availability under the PLL arrangement to 115 percent of quota for the 1st Review and 115 percent of quota for the 2nd Review given the uncertain external environment. As indicated in the previous written communication, we intend to draw 85 percent of quota upon completion of this review and treat the remainder, including from subsequent reviews, as precautionary. The drawn amounts will be channeled to the government's account at the NBRNM and used for budget financing. Since program approval, we have completed the negotiations for a €100 million Macro-Financial Assistance (MFA) from the EU Council, with expected disbursement in Q4 2023 and Q32024. We are also in advanced discussions with the World Bank on a €93.8 million DPO. Further IFI financing is expected from KfW (€90 million) and OPEC fund (€50 million). We maintain market access and we will ensure that the program remains fully financed. We plan to obtain additional external financing of €500 million over the next 12 months. On top, we have €400 million repo line with the ECB, which can provide euro liquidity to the NBRNM. This repo expires in January 2024, but we are in discussions with the ECB to renew it.

3. We continue to make progress with our reform agenda since the approval of the PLL arrangement. Our policy efforts within the program focus on: (i) safeguarding public finances; (ii) strengthening revenue collection and public investment management; (iii) scaling up public investment and ensuring investment projects fit within a sustainable medium-term fiscal framework; (iv) reducing energy subsidies while protecting the vulnerable, and improving energy efficiency; (v) tackling inflation; and (vi) further buttressing financial stability.

4. Our fiscal policy supports economic growth, protects priority investment, and safeguards public finances. The 2022 fiscal deficit was 4.5 percent of GDP, lower than the programmed 5.3 percent of GDP, driven by a lower-than-expected need for subsidies on energy. The revised 2023 budget projects an unchanged deficit in nominal terms relative to the original 2023 budget (42.8 billion denars) that we are committed to meet and confident of meeting. The 2023 deficit target is supported by a one-off windfall tax on exceptional 2021 and 2022 profits. The tax is not targeted at any particular sector and is thus modeled on similar tax measures adopted in several EU states. In 2021 and 2022 Parliament also adopted tax reforms, which benefitted from IMF advice, that streamlines preferential treatments and exemptions in corporate and personal income tax and value-added tax. We will continue to not increase the stock of payment arrears to the private sector, and we commit to use unused allocations under the revised 2023 budget only to prepay €30 million of the Corridor 8/10d road project for 2024, clear arrears, and/or reduce the 2023 deficit.

5. We have adopted in cabinet and submitted to parliament a 2024 budget that will reduce the deficit to 3.4 percent of GDP (**Prior Action**). We view it as important to continue reducing the deficit so as to move towards the Organic Budget Law's maximum deficit of 3 percent in 2025, and to continue to build buffers for future crises or in the event of cost overruns on the Corridor 8/10d road project. A lower budget deficit will also help in the fight against inflation, and we will avoid near-term expenditure increases beyond those agreed as part of the 2023 revised budget and the 2024 budget. To support the 3.4 percent of GDP budget deficit in 2024:

a. On the expenditure side, we have lowered operating costs, and intend to stay on this path. We signed a general collective agreement in July 2023, providing a 10 percent public-sector wage increase in September 2023. Regarding 2023 and 2024 wages, we will adhere to the General Collective Agreement. The Law on Administrative Servants will be amended in line with the General Collective Agreement with respect to the minimum wage adjustment. Additionally, we will transpose into law the content of the general collective agreement as needed and ensure that the draft Law on the Salary System of the Public Sector does not introduce provisions which are inconsistent with the general collective agreement. More generally, the new quantitative performance criterion setting a ceiling on primary current expenditure, and the new indicative target setting a ceiling on wages and salaries, will ensure that current spending remains contained.

b. The draft 2024 budget includes an envelope to cover electricity subsidies for households and small companies. In July 2023, we normalized the VAT rate on electricity to 18 percent, in line with our commitment in the previous written communication. Following the adoption of the energy action plan in February 2023, we will further reduce energy subsidies in 2024 through continued efforts to lower losses in the State-Owned electricity generator, ESM. To this end, we have adopted a government decision to lower the ceiling for the share of the demand of the regulated electricity market (households and small companies) that the state-owned electricity is obliged to provide from 100 percent to 95 percent starting January 1st, 2024, and 85 percent starting July 1st, 2024 (**Prior Action**). This ceiling will become the maximum share of the demand of the regulated market to be supplied by the ESM, and will introduce an element of competition for the ESM and further expose the regulated market to price signals. The government decision will also raise the price for electricity charged by the ESM to the universal supplier from €53/MWh to €57/MWh starting January 1st, 2024 (**Prior Action**). Finally, the government decision has increased the price charged by ESM for distribution losses from €100 to €105 per MWh starting January 1st 2024 These substantive measures are expected to result in a meaningful increase in tariffs in January, and are expected to lower the 2024 budget deficit by €65 million, or 0.45 percent of GDP. We will continue to work towards fully eliminating the need for untargeted government subsidies by the end of 2025 and to further improve energy efficiency. In parallel, we have received World Bank and IMF-provided TA on the distributional impacts of the block-tariff structure and are in the process of using the findings to help expand existing programs for energy vulnerable customers in both coverage and adequacy.

c. We have also recently changed the methodology for agricultural subsidies, from a fixed, guaranteed subsidy, to a blend of a lower guaranteed amount and an output-based subsidy. We have enhanced inspections to ensure compliance. The reform aims to incentivize greater agricultural production output, and will provide savings on agricultural subsidies (0.1 percent of GDP).

6. We will continue to prioritize public investment. To preserve space for capital expenditures, the 2024 budget sets prudent envelopes for current spending, which will be bolstered through new quantitative ceilings on current primary expenditure and on wages and salaries under the PLL arrangement. Regarding the Corridor 8/10d road project, we contracted an independent feasibility study from a reputable international company and shared it with IMF staff, together with relevant documentation for project appraisal (**Structural Benchmark, January 31st, 2023**). An independent advisor has reviewed the contract to ensure that it reflects the project deliverables and associated costs and that risks are clearly allocated to contracting parties. The contract includes important safeguards, including provisions allowing the State to choose the least-cost design that is validated by technical studies. The independent advisor continues to provide regular monitoring of the project and report to the government. We will ensure transparency and accountability for this project, including through publishing the independent advisor's monthly monitoring reports, edited only for what is stated as confidential in the contract **(New Structural Benchmark, first publication by December 31st, 2023).** The project's estimated fiscal cost (€1.5 billion, including expropriations) has been incorporated in the medium-term fiscal framework. We are aware that this cost estimate is preliminary, since key geotechnical studies that will validate the initial design are still ongoing. In this context, we will complete geotechnical studies for Section I, II, and IV of the road project and, if the studies indicate that an updated design of the road is required, we will provide said design, and with it an updated bill of quantities (costs), to the IMF (**New Structural Benchmark, April 15th, 2024**). If cost estimates resulting from the new designs and bills-of-quantities become significantly higher or do not appear manageable, we will adjust the timeline of the project implementation in order to fit it into a sustainable medium-term fiscal framework and/or implement a part of the project with concessional involvement and financing, consistent with the agreed program targets

and the fiscal rules of the organic budget law. In this context, we have initiated discussions with the US EXIM bank for possible financing of the road.

7. In September 2022, we adopted an organic budget law prepared in consultation with the European Commission, the World Bank, and the IMF. The law establishes a fiscal rule, effective 2023, setting a ceiling for the fiscal deficit of 3 percent of GDP and general government debt of 60 percent of GDP, with limited escape clauses; expands the coverage of the general government to include non-market state-owned enterprises by 2027; and foresees annual reporting of tax expenditures as part of the final account of the annual budget. Further, it establishes a fiscal council tasked with assessing the government's macroeconomic and budgetary projections and monitoring adherence to the rules and to good fiscal principles. The council should be fully operational by mid-2024.

8. We will continue our efforts to improve revenue collection and enhance public financial management.

a. Revenue administration. We are committed to adopting a modern approach to revenue administration and tax compliance. In particular, the Public Revenue office is continuing to strengthen its centralized compliance risk management (CRM) in line with the previous Written Communication. The office has established a CRM reform management committee and a working body and are working towards establishing a reform unit. The reform program has been drafted and is currently being updated with feedback from IMF TA. We will not provide tax amnesties.

b. Public investment management (PIM). We adopted legal acts for the establishment of a PIM department in the Ministry of Finance in December 2022 based on the IMF's 2020 PIM assessment. The PIM department has started its staffing and is expected to reach its full capacity in 2024. Training of staff has started and the PIM department will develop the methodology for identification and appraisal by mid-2024. The new PPP law will be submitted to Parliament in 2024.

c. Public procurement. All procurements conducted through the dedicated electronic portal include the contract as a part of the award notification. To further enhance transparency, we are in the process of connecting the procurement system with the newly created register of ultimate beneficial ownership.

9. Inflation is slowing down markedly, amidst monetary tightening and abating pressures from global factors. But inflation risks are increasing, however. We will continue to take actions to combat high inflation:

a. We have raised the policy rate from 1.25 percent in March 2022 to 6.3 percent in September 2023, so as to contain inflationary pressures and ensure that inflation expectations remain anchored. We have also tightened effective reserve requirements, which will contribute to further withdrawing liquidity. As a result of these efforts, credit growth is slowing, and both headline and core inflation continue to fall along our predicted path. This being said, we recognize that there are latent inflationary risks stemming from fast growth in wages. Should these risks materialize, we stand ready to act as needed to contain inflation and keep inflationary expectations anchored.

b. We see our monetary framework as robust, with a clear mandate and instruments to deliver it. In the last eighteen months, inflation expectations have remained anchored, and the foreign exchange market has been stable in the face of shocks. However, structural features of the economy—such as excess bank liquidity—pose challenges for the transmission of the headline policy rate into market rates. This is only one aspect and one channel of monetary policy, but an important one. In this context, we are developing an internal roadmap to further improve the monetary operations framework in close consultation with Fund-provided technical assistance, including a transition plan for changes in the operational framework **(New Structural Benchmark, March 31st 2024**).

c. In addition to monetary policy, significant fiscal tightening in the year ahead, including through a budget targeting a 3.4 percent of GDP deficit, will also contribute to keeping inflationary pressures contained.

10. Reflecting a strong supervisory and regulatory framework, the banking system remains well-capitalized and liquid, and it has been resilient to tightening global financial conditions. The capital adequacy ratio has increased from 16.3 percent at end 2019 to 18.2 percent now. New stringent regulations on credit risk management are being enforced in 2024 and enhancements on bank disclosure have been enacted. We remain committed to continuously improving the implementation of the supervisory framework, including bank stress testing. We have outlined a medium-term plan to develop stress testing with support from IMF TA. We are closely monitoring risks in the financial system, including from mortgage lending and real estate prices, and higher interest rates. We will also continue intensified monitoring of systemic banks.

11. To guard against a build-up of systemic risks, we have strengthened the macroprudential framework. After the approval of the financial stability law—that grants a formal macroprudential mandate to the NBRNM—the macroprudential strategy for the overall financial sector was prepared by the NBRNM and adopted by the Financial Stability Committee. The strategy has been fully operationalized and is key to financial regulators' risk monitoring. In addition, we announced an increase in the counter-cyclical capital buffer to 0.75 percent in Q1 and Q2 2024, to 1.00 percent in Q3 2024, and to 1.25 percent by Q4 2024. We have also introduced borrower-based macro-prudential measures, specifically debt-service-to-income and loan-to-value limits on mortgages. These capital and borrower-based macro-prudential measures are strengthening monetary policy transmission and helping to slow down mortgage credit growth and real estate prices, thereby reducing risks to the financial sector coming from this segment. We will take any further action that becomes necessary to ensure financial stability.

12. We are progressing on a legislative agenda to strengthen the financial safety net, thereby bolstering the financial system's resilience to shocks. A new law on bank resolution was approved by parliament in October 2023, and we are giving priority to readying the by-laws to operationalize the

resolution framework. We are also working on a new law on deposit insurance to upgrade the deposit fund operations and governance. We will submit the draft law to parliament in 2024.

13. We are committed to ensuring the independence of the NBRNM. Following the recommendations of the 2020 and 2023 Safeguards Assessments, we will take steps to ensure that the NBRNM has the autonomy to determine the employment conditions of its staff, including through amendments to the relevant legislation (Draft National Bank Law, Draft Law on Administrative Servants, Draft Law on Public Sector Employees, and Draft Law on the Salary System of the Public Sector). We will also amend and expeditiously resubmit to parliament before the end of the year the NBRNM Law that strengthens the independence of the central bank, provides for it a formal macroprudential [and bank resolution] mandate, and improves the NBRNM's governance framework.

14. The 2023 MONEYVAL report confirmed that North Macedonia has a sound AML/CFT framework, but we continue to address remaining deficiencies identified in the recent Mutual Evaluation Report (MER). We have prepared draft amendments to the AML/CFT law. We have also started the process of updating the national risk assessment and action plan aimed at addressing all Recommended Actions in the MER.

15. We are committed to addressing structural issues in the economy to boost productivity and growth. We will continue to improve the rule of law and governance to support the formal business environment and help attract foreign investment. Continued improvements in tax compliance, such as ongoing efforts within the Public Revenue Office, will also help tackle the informal economy. We recognize that structural issues in the labor market are a hurdle to lowering unemployment, raising labor force participation, tackling informal employment, reducing emigration, and can contribute to inflation and loss of competitiveness, especially when wage growth exceeds productivity growth over long periods. With this in mind, we will focus on improving education quality and improving active labor market policies aimed at reskilling and retraining workers, in particular groups that suffer from higher and more persistent unemployment and underemployment, such as less-educated youths. Additionally, future increases in the minimum wage will take into consideration productivity levels and trends, to preserve jobs and competitiveness.

16. We will continue to provide IMF staff with the data and information it requests for the purpose of monitoring program implementation. In line with the requirements of the PLL arrangement, we will also continue to observe the standard criteria on trade and exchange restrictions, bilateral payment agreements, multiple currency practices, and the non-accumulation of payment arrears on external debt. In the areas of data provision, we will ensure continued compliance with requirements under SDDS+.

17. We believe that the policies contained in this communication are adequate for achieving the macroeconomic and financial objectives of the program, but we will take any additional measures that may be appropriate for this purpose. We will consult with IMF staff on the adoption of these measures, and in advance of revisions to the policies contained in this communication, in accordance with the IMF's policies on such consultation. By continuing to reinforce the economy's

resilience, including by further strengthening fiscal and external buffers, we believe that North Macedonia should be well positioned to exit the PLL arrangement when it expires in November 2024. Reaffirming commitment to our policy of transparency, we consent to the IMF's publication of this Communication, the Technical Memorandum of Understanding, and the accompanying Executive Board documents.

Table 1. North Macedonia: Quantitative Targets Under the Precautionary and Liquidity Line (PLL)

(Millions of euros, unless otherwise indicated)

	2023								2024	
	end-March				end-September				end-March	
	Prog. QT	Adj. Prog.	Actual	Status	Prog. QT	Adj. Prog.	Actual	Status	Prog. QT	Proposed Rev. QT
	CR 22/354				CR 22/354				CR 22/354	
I. Quantitative Performance Criteria										
1. Ceiling for current primary expenditure										69,746
II. Indicative Targets										
2. Floor on central government cash balance	-17,560	-18,052	-3,603	Met	-29,538	-30,030	-27,643	Met	-10,881	-12,066
3. Non-accumulation of domestic payment arrears	0		-1,709	Met	0		-1,969	Met	0	0
4. Ceiling for wages and salaries										9,951
5. Floor on net international reserves (million euros)	2,919	2,726	2,860	Met	2,862	2,692	2,461	Not met	2,759	2,759
III. Continuouts Performance Criteria										
6. Non-accumulation of new external debt payment arrears	0		0	Met	0		0	Met	0	0

Table 2. North Macedonia: Proposed New Prior Actions (PA) and Structural Benchmarks (SB) Under the PLL

No.	Measure	Deadline
Prior Actions		
1	The government adopts a 2024 budget consistent with the PLL program target of a deficit of 3.4 percent of GDP.	Met
2	The government adopts a decision to raise the price for electricity charged by the ESM to the universal supplier from 53 €/MWh to 57 €/MWh starting January 1st, 2024, and the price charged by ESM for covering distribution losses from 100 €/MWh to 105 €/MWh.	Met
3	The government adopts a decision to lower the mandatory provision of electricity by the ESM to the regulated market from currently 100 percent of the demand to 95 percent of demand, to be implemented from January 1st, 2024, and to 85 percent to be implemented from 1st, July 2024. This is to be regarded as a ceiling.	Met
Structural Benchmarks		
4	Monthly publication of Corridor 8/10d monitoring reports, edited only for what is stated as confidential in the contract, starting from December 2023.	Met
5	Geotechnical studies on sections I, II, and IV, of the road project, are completed, and an updated design for these sections informed by the studies is agreed by the parties, as is the updated bill of quantities (costs).	April 15, 2024
6	Developing an internal roadmap to improve the monetary operations framework in close consultation with Fund-provided technical assistance, including a transition plan for changes in the operational framework.	March 31, 2024

Source: Fund staff.

Skopje, December 22, 2023

___________________/s___________________

Mr. Fatmir Besimi, Minister of Finance

Skopje, December 22, 2023

___________________/s___________________

Ms. Anita Angelovska Bezhoska, Governor, National Bank of the Republic of North Macedonia

Attachment I. Technical Memorandum of Understanding (TMU)

This Technical Memorandum of Understanding (TMU) sets out the understandings regarding the definitions of the performance criteria and indicative targets that will be applied under the PLL arrangement. It also describes the methods to be used in assessing the program's performance and the information requirements to ensure adequate monitoring of the targets.

Indicative Targets

A. Central Government Cash Balance

1. **For the purpose of the program, the central government covers the central government as defined in the Annual Budget Document** (including Special Revenue Accounts, the Pension and Disability Fund, the Health Insurance Fund and the Employment Agency, which are treated by the Ministry of Finance as part of the consolidated central government).

2. **The central government cash balance from "above the line" is defined as total revenue (tax revenue, social security contributions, non-tax revenue, capital revenue, grants) minus total expenditure recorded on a cash basis.** The Ministry of Finance will inform IMF staff of the creation or reclassification of any funds, programs, or entities in a timely manner. Privatization receipts are classified as a financial transaction and are recorded "below the line" ("other inflows") in the central government fiscal accounts. Privatization receipts are defined in this context as financial transactions.

8. **The central government cash balance from "below the line" is defined as inflows** (net domestic borrowing, foreign loans, change in government deposit (a positive sign means drawdown; a negative sign means accumulation), other inflows) minus outflows (repayment of domestic structural bonds, repayment of foreign loans (principal), other outflows).

9. **For the purpose of the program, the central government cash balance will be measured from above the line.**

10. **The floor on the central government cash balance in each year will be measured cumulatively from the start of that year.** Fiscal underperformance relative to the cash balance floor will require specifying compensatory measures to bring performance in line with the specified floors.

11. **The floor on the central government cash balance at end-March 2024 will be adjusted downward (upward) in the event of a shortfall (surplus) of multilateral program financing (specifically related to the EU grant) relative to baseline projections as detailed in Table 1.** The central government cash balance will be adjusted upwards by the amount of the EBRD loan for the ESM, used for electricity purchases (replacing current spending in the form of subsidies). The adjustor is cumulative from end-December 2023.

Reporting: The Ministry of Finance will report to the IMF in monthly and cumulative flows from January 1 of each year the central government cash balance, from both above and below the line, on a monthly basis no later than one week after the end of the month.

B. Wages and Salaries

12. Wages and salaries are as defined in the central government budget. Wages and salaries are measured cumulative on a monthly basis from end-December 2023, i.e., the 2024 fiscal year. The end-March indicative target is set as a ceiling. Reporting is on a monthly basis with the monthly budget execution data as outlined above for the central government cash balance.

C. Domestic Arrears

13. For the purpose of the program, domestic arrears of the public sector are defined as liabilities of public sector entities to natural persons, domestic legal entities, citizens' associations, and other non-profit organizations that are overdue and unpaid as of the end of the relevant reporting period, as per the rulebook on the reporting and disclosure of liabilities of the public sector adopted by the Ministry of Finance on May 16, 2018,[1] as well as the stock of VAT refund claims that have not been settled (through a cash refund, netting out against obligations of taxpayers, or an official decision to reject the claims) within 30 days after the VAT refund claim has been submitted to the Public Revenue Office, as of the end of the reporting period.

14. The change in the stock of public sector domestic arrears to the private sector will be measured relative to the stock at end-December 2022 for the assessment of the 2023 budget, and at end-December 2023, for the assessment of the 2024 budget.

Reporting: The Ministry of Finance will report the stock of domestic arrears on a monthly basis, no later than two weeks after the end of the month based on the information from the budget users about their arrears and the Public Revenue Office for the stock of VAT refund claims.

D. Net International Reserves (NIR)

15. For the purpose of the program, NIR is defined as the difference between NBRNM's reserve assets and its reserve-related liabilities. Reserve assets include monetary gold, SDRs, foreign currency cash, securities, deposits abroad, and the reserve position at the Fund. Reserve-related liabilities are defined as all foreign exchange liabilities of the NBRNM to nonresidents and residents (excluding central and local government foreign exchange deposits at the NBRNM), including all credit outstanding to the Fund, arrears on principal or interest payments to commercial banks, suppliers, or official export credit agencies, and future and contingent commitments to sell foreign exchange arising from transactions in derivative assets (future, forwards, swaps, and options). The exchange rate that will be used to monitor NIR during the second year of the program

[1] https://peo.finance.gov.mk/Home/downloadPravilnikPEO?Length=4

is Macedonian denar (MKD) 61.4928 per euro, the rate prevailing on September 1, 2023. Foreign currency accounts denominated in currencies other than the euro will be valued in euros at the exchange rates and gold prices prevailing on September 1, 2023.

16. The floor on NIR of the NBRNM will be adjusted downward (upward) by end-March 2024 in the event of a shortfall (surplus) of multilateral program financing relative to baseline projections as detailed in Table 1. The adjustor is cumulative from end-September 2023.

Table 1. North Macedonia: Multilateral Program Financing Included in Baseline NIR Indicative Target

(Baseline Projection, cumulative) 1/

End-March 2024	
EU grant	8
EU-MFA	50
WB-DPO	93.8
OPEC	50
EBRD	100
KfW	90

1/ In millions of euros.

Reporting: The NBRNM will report on international reserves to the IMF on a daily basis.

Quantitative Performance Criteria

E. Current Primary Expenditure

17. Current primary expenditure is defined as total expenditure (defined as in the definition of the government cash balance above) excluding capital expenditure and interest payments. Current primary expenditure is measured cumulatively on a monthly basis from end-December 2023, i.e., the 2024 fiscal year. The end-March quantitative performance criteria is set as a ceiling. Reporting is on a monthly basis with the monthly budget execution data as outlined above for the central government cash balance. ESM subsidies, some of which the authorities classify under capital expenditure, will be entirely counted as part of primary current expenditure as is normal practice by IMF staff (and as reflected in staff's fiscal tables). The authorities will inform IMF staff of any re-classification of current expenditure to capital expenditure (or vice-versa) during the time of the arrangement under the PLL.

Continuous Performance Criteria

F. External Debt Payment Arrears

18. For the purpose of the program, an external debt payment arrear is defined as a payment by public sector entities to nonresidents, which has not been made within the due date (including grace period, if any). This includes direct and guaranteed debt by the general government. Arrears resulting from nonpayment of debt service for which a clearance framework has been agreed or for which a restructuring agreement is being sought are excluded from this definition. The performance criterion will apply on a continuous basis throughout the program period.

G. Other Continuous Performance Criteria

19. During the period of the program, North Macedonia will not (i) impose or intensify restrictions on the making of payments and transfers for current international transactions; (ii) introduce or modify multiple currency practices; (iii) conclude bilateral payments agreements that are inconsistent with Article VIII; and (iv) impose or intensify import restrictions for balance of payments reasons.

H. Other Reporting Requirements

20. The Ministry of Finance will report to the IMF in monthly and cumulative flows from January 1 the profits and losses of ESM (Power Plants of North Macedonia), as well as the expected profits and losses for the remainder of the year, on a monthly basis no later than four weeks after the end of the month.

21. Assuming the approval of this arrangement by the IMF Executive Board on November 21, 2022, the six-monthly reviews under this arrangement will be completed no later than May 20, 2023, November 20, 2023, and May 20, 2024

INTERNATIONAL MONETARY FUND

REPUBLIC OF NORTH MACEDONIA

January 4, 2024

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION AND FIRST REVIEW UNDER THE PRECAUTIONARY AND LIQUIDITY LINE—INFORMATIONAL ANNEX

Prepared By

European Department
(In Consultation with Other Departments)

CONTENTS

FUND RELATIONS 2

IMF–WORLD BANK COLLABORATION 7

STATISTICAL ISSUES 7

FUND RELATIONS

(As of December 31, 2022)

Missions. Article IV and 1st Review under the Precautionary and Liquidity Line (PLL), October 31–November 14, 2023. Concluding statement is available at: (Link)

Staff team. The staff team comprised Mr. Miniane (head), Ms. Kyobe, Messrs. Ayerst, Cabezon and Gade (all EUR), Ms. Laoprapassorn (SPR) and Mr. Sosa (Resident Representative), Ms. Kovachevska Stefanova and Mr. Sulejmani (IMF Local Economists).

Discussions. The staff team met with Finance Minister Besimi, Governor Angelovska Bezhoska, other senior officials, and representatives from the banking, business, political, and international communities.

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

As of Nov. 30th, 2023

General Resources Account:	SDR Million	Percent of Quota
Quota	140.30	100.00
Fund holdings of currency	329.71	235.00
Reserve position	0.00	0.00

SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	200.09	100.00
Holdings	0.18	0.09

Outstanding Purchases and Loans:	SDR Million	Percent of Quota
Precautionary Liquidity Line (PLL)	84.18	60.00
Emergency assistance (RFI)	105.23	75.00

Latest Financial Commitments:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PLL [1/]	11/21/2022	11/20/2024	406.87	84.18
RFI	04/10/2020	04/15/2020	140.30	140.30
PLL [1/]	01/19/2011	01/18/2013	413.40	197.00
Stand-By	08/31/2005	08/30/2008	51.68	10.50

[1/] Formerly PCL.

Projected Payments to the Fund (Expectation Basis)[1]

(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming			
	2024	2025	2026	2027
Principal	70.15	35.08	42.09	42.09
Charges/Interest	16.62	13.30	11.98	9.84
Total	86.77	48.37	54.07	51.93

Exchange Arrangement:

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

Article IV Consultations:

The first consultation with the Republic of North Macedonia was concluded in August 1993. The last consultation was concluded on February 15, 2022 (IMF Country Report 22/47). North Macedonia is on the standard 12-month Article IV consultation cycle.

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

Table 1. Republic of North Macedonia: Technical Assistance Since 2016		
Purpose	**Department**	**Date**
Public Debt Management	MCM/WB	January 2017
Public Expenditure and Financial Accountability	FAD/WB	December 2021
Public Financial Management	FAD	September 2019
Public Investment Management	FAD	February 2020 July 2021
Public-Private Partnership Law	FAD	January 2021
Cash Management (in the context of broader PFM reforms)	FAD	October 2017
Organic Budget Law	FAD	December 2017
Fiscal Rule and Fiscal Council	FAD	February 2018
Fiscal Transparency Evaluation	FAD	April 2018
Credit Guarantee Scheme	FAD	July 2020
Tax Policy	FAD	January 2017 September 2017
Tax Administration	FAD	April 2016 May 2016 July 2016 May 2017 September 2017 March 2018 December 2018 March 2019 May 2019 January 2021
Tax IT System Improvement	FAD	May 2017 September 2017 May 2021
Taxpayer Registration	FAD	November 2018
Tax Treaty Policy	FAD	October 2019
Tax Audit Function	FAD	February 2016 November 2016 March 2017 February 2018 March 2020 May 2021
Tax Arrears Management	FAD	September 2018 November 2019 April 2021 December 2021
Taxpayer Services	FAD	November 2021
Management Reporting System and KPIs	FAD	March 2021
Large Taxpayers Office	FAD	March 2016 October 2019

Table 1. Republic of North Macedonia: Technical Assistance Since 2016 (continued)

Personal Income Taxation	FAD	December 2021
Property Tax System	FAD	September 2017 April 2018
Transfer Pricing and Related International Issues	FAD	September 2017 December 2018
Tax Compliance Management	FAD	October 2016 November 2016 October 2018 October 2019 February 2020 October 2021
Tax Policy Analysis Capacity	FAD	March 2023
Value Added Tax	FAD	August 2021
PFM Budget Preparations	FAD	June 2023
PFM Laws and Institutions	FAD	Jun 2023
Government Finance Statistics	STA	June 2016 November 2016 February 2017 July 2017 November 2017 March 2018 June 2018 November 2018 March 2019 July 2019 November 2019 September 2020 April 2021 November 2021 April 2022
External Sector Statistics	STA	April 2017 December 2023
Sectoral Financial Accounts and Balance Sheet Statistics	STA	October 2018 February 2022
Stress Testing the Banking Sector	MCM	June/July 2021
Emergency Liquidity Assistance	MCM	February 2021
Central Bank Governance	MCM	September 2020
Cash supervision	MCM	December 2021 May/July 2023
Central Bank Operations (Liquidity Forecasting and Organization of Monetary Policy Operations)	MCM	May 2022
Supervisory stress testing	MCM	June 2023
Central Bank Operations (FX Market Operations and Functioning)	MCM	July 2023
Calibrating OMOs and FX Operations	MCM	December 2023

Table 1. Republic of North Macedonia: Technical Assistance Since 2016 (concluded)		
National Bank Law	LEG	October 2020 March 2021
Regional Advisors		
Revenue Administration	FAD	2015-
Public Financial Management	FAD	2015-
FSAP Participation and ROSCs (since 2003)		
FSAP	MCM/WB	May-June 2003
FSAP update	MCM/WB	March 2008 April 2018 July 2018 September 2018
Central Bank Transparency Review		
Central Bank Transparency Review (Pilot)	MCM/LEG	June 2021

IMF-WORLD BANK COLLABORATION

Background

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

Key Areas of World Bank Involvement

- The new World Bank Country Partnership Framework (CPF) for the period 2024–2028 is tentatively scheduled for Board discussion on January 16, 2024, and it maintains the strategic directions of the CPF FY18–FY23, with a sharpened focus on competitiveness, human capital development and environmental sustainability in response to the country's evolving development challenges as outlined in the FY23 Systematic Country Diagnostic (SCD) Update, the draft Public Finance Review: Ensuring Stability and Boosting Resilience, as well as other major analytical works, such as the Trade Competitiveness Diagnostic and State Aid Effectiveness Reports and the draft Country Climate and Development Report (CCDR).

- The CPF strategy is articulated along three high-level outcomes (HLOs): (i) improved quality of public service delivery, (ii) more productive private sector jobs, and (iii) increased climate resilience. Objective I aims to support strengthening financial management and accountability of public institutions, strengthen fiscal sustainability, and improve social services, in particular for vulnerable groups. Objective 2 aims to support increasing market access to private sector and strengthen foundational skills of workers. Objective 3 aims to provide support to transition to greener energy sources and scale up climate resilient infrastructure.

- As of today, the IBRD active portfolio amounts to $404mn in commitments and $9mn in trust funds. Nine operations were approved during the previous CPF period, including eight investment lending (IPF) operations and one development policy loan (DPO), with total commitments of US$528.37 million. Seven projects closed during the same period. The World Bank implemented two recipient-executed EU trust funds, totaling US$34.94 million, on tourism and municipal services. Two additional EU-financed recipient-executed trust funds (US$9.54 million) were approved in FY23 to provide co-financing for the Agriculture Modernization and BETA PFM projects, but these have yet to be implemented.

- The new CPF envisages total commitments of up to $695mn, based on government's demand and availability of lending space. There are three projects in the FY24 lending program, all pending negotiations. The Sustainability and Resilience DPO of $100mn (plus tentatively $50 mn in parallel financing) is expected to be approved on December 19, 2023, while two IPFs (Second Social Services Improvement and Road Upgrading and Development AF Projects (total $60mn)) will likely be approved on January 16, 2024, together with the CPF. The ratifications of the projects by Parliament are expected to take place before the announcement of the Parliamentary and Presidential elections, tentatively planned for the spring of 2024.

Republic of North Macedonia: IBRD Lending
FY 2019–23

Proposed lending	Focus area	CPF Delivered Lending Program	Realized lending (US$ million)
FY19 (Proposed lending US$ 100 million)	Focus Area 1: Export-Led Growth: Improve the Environment for a Competitive Private Sector	Western Balkans Trade and Transport Facilitation (FY19)	30
	Focus Area 2: Inclusive Growth: Expand Skills and Opportunities for the Most Vulnerable	Public Finance and Competitiveness DPO (FY20)	139,3
FY20-FY21 (Proposed Lending about US$120 million	Focus Area 1: Export-Led Growth: Improve the Environment for a Competitive Private Sector	Local Roads Connectivity Project (FY20) Local Roads Connectivity Project Additional Financing (FY21) Agriculture Modernization Project (FY20)	78 44.8 50.5
	Focus Area 2: Inclusive Growth: Expand Skills and Opportunities for the Most Vulnerable	Social Insurance Administration Project (FY20) Primary Education Improvement Project (FY21)	15.17 25.0
	Focus Area 3: Sustainable Growth: Enhance Sustainability and Build Resilience to Shocks	Public Sector Energy Efficiency Project (FY20) Emergency COVID-19 Response Project (FY20)	27.4 98.5
FY22-FY23 (Proposed lending of around US$ 200 million	Focus Area 3: Sustainable Growth: Enhance Sustainability and Build Resilience to Shocks	Building Efficient, Transparent and Accountable PFM Institutions Project (FY23)	19.7
US$420 million		**Total:**	**528.3**

STATISTICAL ISSUES

(As of November 27, 2023)

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings but is broadly adequate for surveillance. Areas that would benefit most from further improvement are national accounts and government finance statistics. The authorities are working to close the gaps with STA support.
National accounts: The quality of national account measurement needs to be improved. Currently, the Republic of North Macedonia State Statistical Office (SSO) publishes quarterly GDP by activity and expenditure in current prices and real growth rates. In 2013, by Decision of the Government of the Republic of North Macedonia, amendments were made to the National Classification of Activities—NKD Rev.2 and entailed significant changes in the decomposition of historical data. The primary objective of the Classification of Activities is to provide a basis for comparing statistical data of the Republic of North Macedonia on European and world level, i.e., in its content and structure is completely harmonized with the European Classification of Activities NACE Rev.2. The National Bank of the Republic of North Macedonia (NBRNM) published Sectoral Balance Sheet data in October 2023. **Price statistics:** The SSO disseminates a monthly CPI compiled in accordance with international standards within one week of the reference period. Monthly industrial producer price indexes (PPIs), monthly agriculture output and input indexes, and quarterly construction cost indexes are also produced. PPIs for selected services activities are disseminated quarterly.
Government finance statistics (GFS): North Macedonia's GFS data has been improving over recent years, assisted by GFS Technical Assistance. The authorities disseminate both monthly central government operations, and quarterly central government debt data on their own website and on their SDDS Plus National Summary Data Page. While this data is disseminated in a national presentation, on a cash basis, and does not cover the whole of general government as defined in *GFSM 2001/14*, the data is of generally good quality. The authorities report detailed data on revenues, expenditures and transactions in financial assets and liabilities of general government and its subsectors for inclusion in the Annual GFS database (formerly the *Government Finance Statistics Yearbook*) and are taking steps toward publishing general government data in the *GFSM 2014* presentation for inclusion in *International Finance Statistics*. The authorities report central and general government debt data, as well as the debt of nonfinancial public corporations to the *IMF / World Bank Quarterly Public Sector Debt (QPSD) Database*.
Monetary and financial statistics: The NBRNM compiles monetary data in line with the recommendations of the 2016 *Monetary and Financial Statistics Manual and Compilation Guide (MFSMCG)*. Data are reported through the Standardized Report Forms for the central bank, other

depository corporations, and other financial corporations to the IMF's Statistics Department on a regular and timely basis. North Macedonia reports data on several series of the Financial Access Survey (FAS) including mobile and internet banking, SMEs, gender disaggregated data, and the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs). **Financial sector surveillance:** The NBRNM compiles and reports all core Financial Soundness Indicators - FSIs (except for Net Stable Funding Ratio) and eleven additional FSIs for deposit-takers, four additional encouraged FSIs for other financial corporations, and two additional FSIs on real estate markets on a quarterly basis; seven additional FSIs on nonfinancial corporations, other sectors, and three additional FSIs on households on an annual basis,, all of which are published on the IMF's FSI website.	
External sector: External sector statistics meet international standards. In additional to quarterly balance of payments data, the authorities compile and disseminate quarterly international investment position (IIP) data, reserve assets and foreign currency liquidity data, and external debt statistics. Also, North Macedonia participates in the Coordinated Direct Investment Survey and in the Coordinated Portfolio Investment Survey. The authorities are working to resolve the long-standing discrepancy between the changes in IIP stock and the corresponding balance of payments transactions for currency and deposits assets of nonfinancial sectors as well as improving the estimates of personal transfers.	
II. Data Standards and Quality	
The Republic of North Macedonia is an adherent to the Special Data Dissemination Standard Plus (SDDS Plus) since January 28, 2019, and its metadata are posted on the Dissemination Standards Bulletin Board (DSBB). Two data categories are under SDDS Plus transition plans: general government operations and general government gross debt. The Republic of North Macedonia's latest SDDS Plus Annual Observance Report is available on the DSBB.	A Data ROSC was published on September 29, 2004.

Table 2. Republic of North Macedonia: Table of Common Indicators Required Surveillance
(As of November 27th, 2023)

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	10/23	11/14/23	M	M	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Sep. 2023	10/13/2023	M	M	M
Reserve/Base Money	Sep. 2023	10/13/2023	M	M	M
Broad Money	Sep. 2023	10/13/2023	M	M	M
Central Bank Balance Sheet	Sep. 2023	10/13/2023	M	M	M
Consolidated Balance Sheet of the Banking System	Sep. 2023	10/22/2023	M	M	M
Interest Rates[2]	Sep. 2023	10/31/2023	M	M	M
Consumer Price Index	Jul. 2023	08/22/2023	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Sep. 2021 / Dec. 2022	11/15/21 / 12/29/2022	Q/A	Q/A	Q/A
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Dec. 2021	01/04/22	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Sep. 2021	10/29/21	Q	Q	Q
External Current Account Balance	Jun. 2023	09/29/2023	M	Q	Q
Exports and Imports of Goods and Services	Jun. 2023	09/29/2023	M	Q	Q
GDP/GNP	2023Q1	06/30/2023	Q	Q	Q
Gross External Debt	Jun. 2023	09/29/2023	Q	Q	Q
International Investment Position[6]	Jun. 2023	09/29/2023	Q	Q	Q

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

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

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

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

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

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

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

Statement by Mr. Dresse and Mr. Verhelst on Republic of North Macedonia
January 19, 2024

On behalf of the authorities of North Macedonia, we thank Mr. Miniane, outgoing Mission Chief, Ms. Kyobe, incoming Mission Chief, Mr. Sosa, Resident Representative, and their teams for the constructive engagement. North Macedonia's Precautionary and Liquidity Line (PLL) continues to help withstand the economic uncertainty caused by high inflation worldwide, Russia's invasion of Ukraine, and the related energy crisis. In a fragmented and challenging political environment, the program serves as a solid and useful anchor for economic policymaking. The authorities have furthermore been able to leverage the program through its catalytic role and its positive impact on financing conditions.

The authorities have shown substantial ownership under the program, despite the difficult external environment. The growth rate of 2.3 percent in 2023 was lower than anticipated at the start of the PLL, mainly due to lower external demand. However, this lower growth did not affect the authorities' ability to meet the program's fiscal deficit targets. The authorities expect growth to pick up to 3 percent or more in 2024, in part due to infrastructure investments. Official reserves have increased to more than €4.5 billion in December 2023, further enhancing North Macedonia's buffers to withstand shocks.

With strong commitment and effective policies, the authorities are on track to achieve the program's objectives and request the completion of the first review under the PLL. The PLL has been instrumental in bringing about ambitious policy actions over the past period. The review faced some delay due to factors largely outside of the authorities' control, as the external geotechnical studies on complex terrains involved in the Corridor 8/10d road project take time and should not be rushed. This additional time has allowed the authorities to further build consensus and ownership around key policy measures. They agree with the rephasing of the PLL arrangement, which takes into account the revised timing of the review. In line with what was communicated when the program was approved, the authorities intend to treat half of the access available under the PLL as precautionary. The authorities commit to maintaining close policy dialogue with the Fund in the period ahead.

As noted by staff, North Macedonia continues to qualify for access under the PLL, given the country's sound fundamentals and sustained track record of implementing strong policies. North Macedonia performs strongly in most qualification areas, i.e., external position and market access, monetary policy, financial sector soundness and supervision, and data adequacy. Since the start of the PLL negotiations, the country has furthermore made substantial progress in the fiscal area, including through the establishment of a Fiscal Council and implementation of well-elaborated fiscal rules in its Organic Budget Law. North Macedonia has adequate capacity to repay the Fund and an excellent track record in meeting its financial obligations.

Fiscal policy

The authorities have faithfully adhered to the fiscal targets under the PLL and are committed to continue doing so going forward. The achieved 2022 fiscal deficit of 4.5 percent of GDP has been lower than the program target of 5.3 percent. The 2023 budget will also fully meet the program's 4.7 percent deficit limit. For 2024, the authorities are committed to further reducing the deficit to 3.4 percent. Adjustments to public sector wages in 2024 will adhere to the general collective agreement that was concluded in 2023. The authorities intend to move to a 3 percent deficit in 2025, in line with the Organic Budget Law. The newly created Fiscal Council is advancing toward full capacity and will provide independent and impartial opinions on future budgets and other issues related to fiscal policy.

Palpable, decisive actions to reduce energy spending are well underway and all prior actions on energy subsidies have been met. The authorities have also increased VAT on electricity up to the statutory rate in 2023 and additional measures will be taken in 2024 to further reduce energy subsidies. Close attention is being paid to protecting the most vulnerable. The authorities aim to fully eliminate untargeted energy subsidies by the end of 2025 and are developing an action plan that details specific steps toward meeting this goal. The authorities thank the IMF for their assistance in reducing and better targeting energy support.

Enhancing revenue collection and broader public financial management are high on the authorities' agenda. Ambitious tax policy reforms were adopted in 2022 and 2023 in the areas of personal income tax, corporate income tax, VAT, excises, and motor vehicle tax, which are expected to bring additional revenues of about 0.7 percent of GDP annually, from 2024. The Public Revenue Office will be further strengthened in 2024, including through strengthening centralized compliance risk management. A Public Investment Management (PIM) Department has been established at the Ministry of Finance, following IMF assistance. This department continues to expand, and the authorities expect it to be at full capacity already later this year. Electronic public procurement has become widely used in North Macedonia and legal work is underway to link the procurement system to the register of beneficial ownership.

The authorities continue to prioritize efficient and productive public investment. Sound investment is a key element in enhancing the growth potential of North Macedonia, thereby working towards gradual convergence with EU member states. An independent feasibility study of the Corridor 8/10d road project has been conducted. The authorities continue their commitment to transparency in executing the road project and have started publishing the monitoring reports by the independent advisor. Parts of the road project expenditure in 2024 have already been prefinanced, thanks to budget over-performance in 2023 and in line with agreements with staff. The authorities are ready to revise the road project's design and implementation timeline if needed to ensure that the costs of the project remain manageable.

Monetary and financial sector policies

The authorities will continue their efforts to reduce inflation. Inflation dropped to 3.1 percent on an annual basis in November 2023 and is expected to average 4.5 percent in 2024. The drop in inflation in North Macedonia has been substantially more pronounced than in the euro area, thereby reducing the inflation differential between the two to a minimal level. Underscoring that conditions remain uncertain and impose further careful monitoring, the National Bank of the Republic of North

Macedonia (NBRNM) remains prepared to use all necessary instruments to maintain exchange rate and medium-term price stability. Fiscal tightening by the government will furthermore help reduce inflationary pressures in the period ahead.

The National Bank has a robust monetary policy framework in place and continues to monitor its effectiveness. The policy rate has been raised to 6.3 percent in September 2023, resulting in an increase of more than 5 percentage points since early 2022. In addition, reserve requirement tightening has taken place. These measures have been successful in reducing credit growth. Inflation expectations and foreign exchange markets remained stable despite the shocks faced by the economy, signaling the well-functioning of monetary policy. The de-facto exchange rate peg to the euro has furthermore served as an effective anchor for 25 years. In line with international best practice, the National Bank continues to review its monetary policy framework and adjust it where necessary. In this respect, a roadmap is being developed to further improve the monetary operations framework, including the transmission channel. Staff's Selected Issues Paper (SIP) provides most useful input for this roadmap. Legislative work is also underway to further strengthen the National Bank's operational independence.

The banking system in North Macedonia is sound, and subject to strong supervision and regulation. The capital adequacy ratio has increased to over 18 percent by end-2023, which is the highest level in the past seventeen years. The quality of the banks' credit portfolio is solid, with the share of non-performing loans at a historic low of less than 3 percent. Building on EU rules, financial regulation is being further strengthened, including through enhancements to credit risk management and disclosure requirements that were enacted in 2023. A law on bank resolution has also been adopted in 2023 and the operationalization is well underway. A new law on deposit insurance is in its final drafting stages and will be submitted to Parliament later this year. The 2023 report by MONEYVAL found that North Macedonia has a sound AML/CFT framework. The report's recommendations will be used to further improve the AML/CFT framework. Considering the importance of the financial system's resilience to climate change risks, the National Bank adopted its first medium-term plan of activities on climate change risk management for the period 2023 – 2025.

Macroprudential policy has become an integral part of the toolkit, with a further increase in the countercyclical buffer decided end-December 2023. The National Bank has been endowed with a formal macroprudential mandate. The Financial Stability Committee has been active in monitoring systemic risks and appropriate actions have been implemented by the authorities. The counter-cyclical buffer will be gradually increased to 1.5 percent by the first quarter of 2025. This buffer comes in addition to borrower-based measures that have been introduced in 2023, comprising both loan-to-value and debt-service-to-income caps. The authorities will take additional steps when necessary to ensure financial stability in North Macedonia.

Structural policies

Forceful actions have been taken to address structural challenges in the economy and the authorities will continue to labor towards improving the country's growth potential. Staff's annex on emigration and the SIP on productivity usefully show that re-invigorating the North Macedonian economy is key to stimulating the long-term growth outlook. Further improving governance and the rule of law are important to the authorities, as well as to boost foreign investments. A National Council for the Formalization of the Informal Economy has been established in 2023, under the chairmanship of the Minister of Finance. The Council will be instrumental in working towards reducing the footprint of the informal economy. The authorities are mindful of the structural hurdles in the labor market and attach great importance to addressing them. They will notably work towards enhancing education, training, and broader active labor market policies.

Addressing climate change is essential to the authorities, and they reiterate their commitment to reduce greenhouse gas emissions in 2030 by more than 50 percent compared to 1990 levels. The authorities welcome the SIP on climate, which provides insights into the available policy options. North Macedonia has made considerable efforts to improve energy efficiency and plans to continue these efforts going forward. With the assistance of international public and private partners, the authorities launched a just energy transition investment platform during COP28. The platform will be instrumental in phasing out coal-fired power –historically representing about 40 percent of energy generation in North Macedonia– and massively scale up renewable energy to compensate.

<u>Conclusions and next steps</u>

North Macedonia welcomes the strong interaction with the Fund, as well as the catalytical role the PLL has already played in attracting additional sources of financing. The authorities thoroughly appreciate the collaboration with IMF staff and look forward to continuing the good collaboration during the remainder of the PLL and beyond. The spread on government debt has decreased substantially since program approval, helped by the PLL. The Fund program has furthermore been instrumental in obtaining financing from other multilateral partners. In addition to IMF financing, North Macedonia is appreciative of the financing arrangements with the EU, the World Bank, the OPEC Fund, the EBRD, the German KfW Development Bank, and the French Development Agency (AFD). Cooperation with these partners will continue going forward, notably building on IMF assistance and the World Bank's 2023 update of the Systematic Country Diagnostic for North Macedonia.

The authorities are confident that the measures agreed under the program are making the economy more resilient, and are ready to take additional measures if needed, in close consultation with the Fund. The authorities are strongly committed to achieving the macroeconomic and financial objectives of the program. Additional measures would be taken if helpful. North Macedonia is heading to the polls in April-May 2024, electing both a new Parliament and a new President. In line with past practice, a technical government will assume office preceding the elections, starting on January 28. There is widespread support in North Macedonia to engage openly and constructively with international partners, including the Fund.

Accession to the European Union is and remains a key objective of North Macedonia. The authorities appreciate the EU's close engagement with North Macedonia, as well as with the broader Western Balkans. North Macedonia has had fruitful discussions with the EU institutions following the opening phase of accession negotiations in 2020. The authorities welcome the EU's readiness to complete the opening phase of the accession negotiations once relevant constitutional changes have been implemented. Efforts towards these constitutional changes have been underway and will continue after the Parliamentary and Presidential elections in April-May 2024.

The authorities intend to exit the PLL at the expiry of the arrangement in November 2024, provided external conditions allow. The timing of the planned exit was announced by the authorities at the start of the program in November 2022. The two-year duration corresponds to the length of North Macedonia's previous PLL in the period 2011-2013, following the European sovereign debt crisis, which has served the country well.