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Ratings

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North Macedonia

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North Macedonia

Key Rating Factors

Sovereign Credit Rating
BB-/Stable/B

Institutional and economic profile	Flexibility and performance profile
Per capita income levels are modest but there is potential for growth acceleration, including from reform momentum connected to the EU accession process. • We expect a positive decision on opening EU accession talks, originally scheduled for October 2019, to be taken in the next few weeks. • This could underpin reform momentum, but much would depend on the outcome of North Macedonia's early general elections on April 12. • We estimate that the economy grew 3.5% in 2019 across different sectors, which should continue over the medium term, provided there is no major slowdown in key European trading partners.	The North Macedonian denar's peg to the euro dictates monetary policy, but moderate public debt still leaves some room to manuever. • At slightly above 40% of GDP, North Macedonia's net general government debt remains moderate in a global context, but fiscal space has eroded in recent years. • We forecast contained current account deficits averaging 2% of GDP through 2023 and largely financed through net foreign direct investment (FDI) inflows. • The denar's peg to the euro acts as a stability anchor, but limits room for independent monetary policy.

Outlook

The stable outlook reflects the balance between the risks from North Macedonia's rising public debt and still comparatively modest income levels, and its favorable economic prospects alongside the potential for institutional settings to strengthen over time.

We could raise our ratings on North Macedonia if timely reform implementation, for instance, as part of EU accession negotiations, strengthened North Macedonia's institutional arrangements and improved its economic prospects. We could also consider an upgrade if North Macedonia displayed a stronger fiscal performance that set net general government debt firmly on a downward path.

We could lower the ratings if major political tensions returned or reform momentum waned over the next 12 months, impairing growth and FDI and undermining the country's longer term growth prospects. We could also lower the ratings if large fiscal slippages or off-budget activities were to call into question the sustainability of North Macedonia's public debt, raise the sovereign's borrowing costs, and substantially increase its external obligations, given the constraints of the exchange-rate regime.

Rationale

The ratings on North Macedonia reflect our view of its relatively low income levels; still comparatively weak institutional settings despite recent improvements; and limited monetary policy flexibility arising from the fixed exchange-rate regime. The ratings are primarily supported by moderate external and public debt levels and favorable growth potential.

Institutional and economic profile: The economy continues to grow and we expect EU accession negotiations to begin in the next few months

North Macedonia's economy continued to grow throughout 2019 and we estimate that real GDP increased by 3.5% last year, slightly exceeding our earlier 3.0% forecast. Positively, the expansion appears broad-based, with agriculture, industry, and construction all posting 3%-5% year-on-year real growth. Consumption and exports were strong, while investments returned to growth (we estimate it at 5% for 2019) following two years of contraction that was largely caused by earlier political uncertainty and delays affecting a number of public investment projects.

Our medium-term forecasts remain unchanged and we anticipate economic growth of just over 3% annually. We also expect growth to remain fairly broad-based in terms of sectors and by expenditure components. Importantly, our forecast hinges on there being no major further slowdown in North Macedonia's key trading partners. Its exports remain heavily focused on Europe, particularly Germany which accounts for close to half of the total. We forecast that the German economy will stagnate in 2020.

We also see downside risks from the ongoing global coronavirus outbreak. While the direct economic effect on North Macedonia will likely be contained (due to its tourism sector being relatively small), it could suffer from second-round effects on trading partners, especially given possible disruptions to global supply chains.

We view positively the government's sustained efforts to attract FDI into the free economic zones, which it has expanded in recent years. This is particularly visible in the export statistics: real exports have grown by more than 10% on average every year since 2015 while, in U.S. dollar terms, goods exports have almost doubled. Nevertheless, we note that the economic structure remains fairly basic, with a prevalence of lower-value added goods exports. Companies in the free economic zones are concentrated in the electronics and automotive sectors, but a large proportion of inputs are still imported, rather than sourced domestically, which limits the free zones' wider integration into the domestic economy. Correspondingly, at close to $6,400, GDP per capita remains modest in a global context.

The timeframe for opening North Macedonia's EU accession talks suffered a set-back in October 2019 when--contrary to our previous expectations--France blocked the start of negotiations and demanded reforms to the EU accession framework. Although repeated delays could pose risks to continued reform momentum, we consider any short-term economic implications to be limited (see "Repeated EU Delays To Open North Macedonia And Albania Accession Talks Could Weigh On Reform Momentum," Oct. 21, 2019).

Despite the earlier delay, we believe accession talks will kick off in the next few months. In early February 2020, the European Commission (EC) proposed a revamped accession process focussing on key fundamental reforms such as the rule of law and functioning democratic institutions; improved political dialogue; and better predictability. The EC has also recently explicitly stated that it stands by its earlier recommendation to open talks with North Macedonia and Albania. It appears that France's position has now shifted in response to the amended accession framework. Ultimately, we think the EU will recognize North Macedonia's substantial progress in a number of areas, most notably the 2019 resolution of a long-running name dispute with Greece whereby the country changed its name to Republic of North Macedonia. All factors considered, we believe that negotiations are likely to start soon.

Meanwhile, North Macedonia is gearing up for general elections scheduled for April 12. These are early elections taking place eight months before the normal cycle of December elections. The major political parties agreed to bring the elections forward after the EU delayed the accession talks. The prime minister, Zoran Zaev, stepped down and the snap poll was called. We foresee a risk of an inconclusive election, resulting in a hung parliament. This happened after the December 2016 general election and led to a protracted period of government formation, weighing on investments and economic growth.

Despite reforms in recent years, we think North Macedonia's institutions still have shortcomings. For example, the so-called "extortion" case recently came to public attention and subsequently a court put North Macedonia's chief special prosecutor in detention over potential abuse of office. The Special Prosecutor's Office (SPO) was set up in 2015 to investigate a number of criminal offences. We consider that the latest developments could undermine public trust in the country's institutions and the opposition has called for protests on multiple occasions. Positively, the authorities have made progress in strengthening the judiciary and the new law on the Public Prosecutor's Office has recently been adopted.

Flexibility and performance profile: After a period of growth, we expect net general government debt will gradually stabilize at close to 40% of GDP

North Macedonia has historically run fiscal deficits. While indebtedness is still favorable compared globally, its fiscal space has somewhat eroded in recent years. This is particularly important given that North Macedonia runs a fixed exchange rate regime and, as such, fiscal policy is the main lever by which the government can influence domestic economic developments.

The general government deficit amounted to just over 2% of GDP last year, which is slightly lower than our forecast. We expect that the deficit will widen to 2.5% of GDP in 2020 given partial backtracking on several past fiscal consolidation measures, as well as an increase in spending in an election year. Nevertheless, deficits should remain contained over the medium term, not deviating substantially from 2% of GDP.

Reflecting our budgetary forecasts, North Macedonia's net general government debt will continue to rise until 2022, although it should stabilize at close to 43% of GDP thereafter. This compares to net general government debt of just 21% of GDP in 2010. Our calculation includes increasing debt at Public Enterprise for State Roads (PESR) because we believe PESR may need to rely on government transfers to service its debt in the future. In particular, a government-guaranteed €580 million loan from the Export-Import Bank of China, contracted in 2013 for the construction of two highway sections, will keep contributing to the increasing debt burden.

We forecast that North Macedonia will run modest current account deficits over the medium term. While we expect trade and services balances to improve, the primary income deficit will widen reflecting profit repatriation from companies operating in the free economic zones. We anticipate that deficits will be covered by net FDI inflows and, consequently, net external leverage metrics will remain stable.

The denar of North Macedonia is pegged to the euro and we believe the existing foreign-exchange regime restricts monetary policy flexibility. However, central bank measures, such as lower reserve requirements for denar-denominated liabilities, have contributed to reduced euroization in North Macedonia. Foreign currency-denominated deposits and loans have stayed at around 40% of total deposits and loans in recent years. This is lower than in other Balkan economies and affords the National Bank of the Republic of North Macedonia (NBRNM) additional room for policy response. We also consider that the limited nature of portfolio flows between North Macedonia and the rest of the world affords NBRNM some extra monetary flexibility, allowing for temporary deviations from the ECB's stance.

NBRNM's foreign exchange reserves continued to grow in 2019, rising by 10% since the beginning of the year to reach almost €3.3 billion (about 29% of GDP). However, we note that given that the current account remains in deficit, these foreign exchange reserves are effectively "liability-financed," accumulated on the back of net FDI inflows and therefore not bolstering the country's net international investment position.

Although the North Macedonian banking system has seen volatility in the past, we currently consider it to be stable. It remains liquid and predominantly domestic-deposit funded, with almost no external debt on a net basis (about 2% of GDP). Bank lending in North Macedonia has continued to increase in recent years. We expect the overall stock of domestic credit to grow by an annual average of 6% over the next four years. Meanwhile, the level of nonperforming loans (NPLs) has trended downward. Following the recent regulatory amendments now requiring banks to write-off loans that have remained fully provisioned for over a year, NPLs amount to around 5%.

Key Statistics

Table 1

North Macedonia Selected Indicators

MKD mil.	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Economic indicators (%)										
Nominal GDP (bil. MKD)	528	559	595	617	660	692	728	769	813	859
Nominal GDP (bil. $)	11	10	11	11	13	13	13	14	16	17
GDP per capita (000s $)	5.5	4.9	5.2	5.4	6.1	6.1	6.4	6.9	7.5	7.9
Real GDP growth	3.6	3.9	2.8	1.1	2.7	3.5	3.2	3.2	3.2	3.2
Real GDP per capita growth	3.5	3.7	2.7	1.0	2.6	3.4	3.1	3.1	3.1	3.1
Real investment growth	10.7	8.3	12.5	(2.2)	(7.3)	5.0	4.0	3.5	3.5	3.5
Investment/GDP	30.3	30.4	32.5	33.0	33.0	33.7	33.8	33.6	33.5	33.4
Savings/GDP	29.7	28.5	29.6	32.1	32.8	30.9	31.3	31.2	31.2	31.2
Exports/GDP	47.7	48.7	50.7	55.4	60.3	64.0	64.5	65.4	67.5	69.8
Real exports growth	16.5	8.5	9.1	8.3	15.6	12.2	4.0	4.0	5.0	5.0
Unemployment rate	28.0	26.1	23.7	22.4	20.7	16.8	16.5	16.0	15.5	15.5

Table 1

North Macedonia Selected Indicators (cont.)

MKD mil.	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
External indicators (%)										
Current account balance/GDP	(0.6)	(1.9)	(2.9)	(0.9)	(0.2)	(2.8)	(2.5)	(2.4)	(2.3)	(2.2)
Current account balance/CARs	(0.9)	(2.8)	(4.2)	(1.1)	(0.3)	(3.5)	(3.1)	(2.9)	(2.7)	(2.6)
CARs/GDP	69.1	68.8	69.9	75.3	79.5	80.0	80.6	80.8	82.2	84.3
Trade balance/GDP	(21.7)	(20.1)	(18.8)	(17.9)	(16.2)	(17.5)	(16.9)	(16.5)	(16.6)	(16.7)
Net FDI/GDP	2.3	2.3	3.3	1.8	5.6	2.6	2.0	2.5	2.5	2.5
Net portfolio equity inflow/GDP	(0.4)	(0.4)	(0.2)	(0.4)	(0.8)	(0.0)	(0.5)	(0.7)	(0.7)	(0.7)
Gross external financing needs/CARs plus usable reserves	108.6	108.3	109.9	106.4	109.5	111.5	113.7	112.8	112.4	112.3
Narrow net external debt/CARs	25.1	26.9	28.3	32.6	24.4	26.5	27.7	26.5	23.6	22.4
Narrow net external debt/CAPs	24.9	26.1	27.1	32.2	24.3	25.6	26.8	25.7	23.0	21.8
Net external liabilities/CARs	70.4	80.1	78.7	82.2	68.7	71.8	70.6	67.9	63.2	61.0
Net external liabilities/CAPs	69.8	77.9	75.6	81.3	68.5	69.4	68.5	65.9	61.5	59.5
Short-term external debt by remaining maturity/CARs	25.8	27.1	21.3	20.3	20.3	20.8	22.8	22.0	20.5	19.5
Usable reserves/CAPs (months)	2.0	2.3	1.6	1.7	1.2	1.3	1.2	1.3	1.1	1.0
Usable reserves (mil. $)	1,381	1,055	1,198	1,010	1,153	1,136	1,246	1,240	1,225	1,233
Fiscal indicators (general government; %)										
Balance/GDP	(4.2)	(3.4)	(2.7)	(2.8)	(1.1)	(2.2)	(2.5)	(2.5)	(2.0)	(2.0)
Change in net debt/GDP	5.3	5.0	4.4	3.2	1.6	2.9	3.5	3.1	2.6	2.2
Primary balance/GDP	(3.2)	(2.3)	(1.5)	(1.5)	0.1	(1.0)	(1.2)	(1.0)	(0.4)	(0.3)
Revenue/GDP	29.7	31.0	30.6	31.0	30.4	31.4	30.5	30.0	30.0	30.0
Expenditures/GDP	33.9	34.4	33.2	33.9	31.5	33.6	33.0	32.5	32.0	32.0
Interest/revenues	3.3	3.8	3.8	4.4	3.9	3.8	4.4	4.8	5.4	5.8
Debt/GDP*	40.7	41.6	44.7	44.5	45.9	46.7	48.0	48.5	48.5	48.0
Debt/revenues*	137.2	134.3	146.2	143.3	150.8	148.7	157.2	161.6	161.5	160.2
Net debt/GDP*	33.2	36.4	38.6	40.5	39.4	40.5	42.0	42.9	43.2	43.0
Liquid assets/GDP	7.5	5.2	6.1	4.0	6.5	6.2	5.9	5.6	5.3	5.0
Monetary indicators (%)										
CPI growth	(0.3)	(0.3)	(0.2)	1.4	1.5	0.8	1.2	1.8	2.0	2.5
GDP deflator growth	1.4	2.0	3.5	2.6	4.3	1.2	2.0	2.4	2.4	2.4
Exchange rate, year-end (LC/$)	50.56	56.37	58.33	51.27	53.69	54.95	54.71	53.06	51.29	51.29
Banks' claims on resident non-gov't sector growth	9.9	9.6	0.2	5.4	7.3	6.4	6.0	6.0	6.0	6.0
Banks' claims on resident non-gov't sector/GDP	49.4	51.1	48.1	48.9	49.0	49.7	50.1	50.2	50.4	50.6
Foreign currency share of claims by banks on residents	47.5	44.8	43.8	41.7	40.3	41.2	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	41.0	41.2	41.6	40.9	40.0	38.4	N/A	N/A	N/A	N/A

Table 1

North Macedonia Selected Indicators (cont.)

MKD mil.	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Real effective exchange rate growth	1.0	(0.3)	1.1	(0.5)	1.4	(1.7)	N/A	N/A	N/A	N/A

Sources: National Bank of the Republic of North Macedonia,International Monetary Fund, Eurostat, State Statistical Office of Republic of North Macedonia (Economic Indicators); National Bank of the Republic of North Macedonia,International Monetary Fund (Monetary Indicators); Ministry of Finance, National Bank of the Republic of North Macedonia (Fiscal and Debt Indicators); National Bank of the Republic of North Macedonia (External Indicators).
Adjustments: 1) We adjust usable reserves by subtracting monetary base and required bank reserves on resident foreign-currency deposits from the reported international reserves. 2) Government debt is adjusted by including the debt of Public Enterprise for State Roads.
*Our definition includes debt of the Public Enterprise for State Roads (PESR). Definitions: Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. N/A--Not applicable. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. e--Estimate. f--Forecast. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

North Macedonia Ratings Score Snapshot

Key rating factors	Score	Explanation
Institutional assessment	5	Future policy responses are difficult to predict because of a still-polarized political landscape as reflected in the ongoing tensions between the governing SDSM and opposition VMRO parties. Transparency is impaired owing to high levels of perceived corruption.
Economic assessment	4	Based on GDP per capita (US$) and growth trends as per Selected Indicators in table 1.
External assessment	3	Based on narrow net external debt and gross external financing needs/(CAR + usable reserves) as per Selected Indicators in table 1.
Fiscal assessment: flexibility and performance	3	Based on the change in net general government debt (% of GDP) as per Selected Indicators in table 1.
Fiscal assessment: debt burden	3	Based on net general government debt (% of GDP) and general government interest expenditures (% of general government revenues) as per Selected Indicators in table 1.
		Around 80% of the gross government debt is denominated in foreign currency.
Monetary assessment	4	The North Macedonian denar is pegged to the euro.
		National Bank of the Republic of North Macedonia benefits from a degree of operational independence; it uses market-based monetary instruments, but their effectiveness may be untested in a downside scenario; it has some ability to act as a lender of last resort for the financial system; Annual CPI is low and in line with that of its peers.
Indicative rating	bb	As per Table 1 of "Sovereign Rating Methodology."
Notches of supplemental adjustments and flexibility	(1)	Although domestic political stability has improved, risks remain. A return of political uncertainty, for example triggered by rising ethnic tensions or a hung Parliament in the aftermath of next parliamentary election, could have a negative impact on North Macedonia's headline growth and investment dynamics, including FDI inflows. It could also negatively impact the comparatively modest per capita income levels.
Final rating		
Foreign currency	BB-	
Notches of uplift	0	Default risks do not apply differently to foreign- and local-currency debt.

Table 2

North Macedonia Ratings Score Snapshot (cont.)		
Key rating factors	**Score**	**Explanation**
Local currency	BB-	

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Sovereign Ratings History, Feb. 10, 2020
- Sovereign Ratings List, Feb. 10, 2020
- Sovereign Ratings Score Snapshot, Feb. 4, 2020
- Global Sovereign Rating Trends 2020: Sovereign Debt Buildup Continues, Jan. 29 2020
- Default, Transition, and Recovery: 2018 Annual Sovereign Default And Rating Transition Study, March 15, 2019

Ratings Detail (As Of March 6, 2020)*		
North Macedonia		
Sovereign Credit Rating		BB-/Stable/B
Transfer & Convertibility Assessment		BB
Senior Unsecured		BB-
Sovereign Credit Ratings History		
24-May-2013	*Foreign Currency*	BB-/Stable/B
21-Sep-2009		BB/Stable/B
30-Apr-2009		BB/Negative/B
24-May-2013	*Local Currency*	BB-/Stable/B
24-Aug-2011		BB/Stable/B
21-Sep-2009		BB+/Stable/B

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings’ credit ratings on the global scale are comparable across countries. S&P Global Ratings’ credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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