S&P Global
Ratings

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North Macedonia

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North Macedonia

This report does not constitute a rating action.

Key Rating Factors

Sovereign Credit Rating
BB-/Stable/B

Institutional and economic profile

The recovery is in progress.

- We project that North Macedonia's economy will expand by 3.7% in 2021, barring renewed pandemic-induced restrictions.
- Higher public and private investment, recovering foreign demand, and private consumption will drive growth in 2021-2024.
- The authorities will seek progress to resolve Bulgaria's veto on starting EU accession talks.

Flexibility and performance profile

Government debt continues to rise while external performance remains solid.

- We project general government deficits will average 4% over 2021-2024.
- Consequently, net general government debt will rise to 58% of GDP by 2024.
- The current account deficit will remain moderate at about 2% of GDP through 2024, fully covered by solid foreign direct investment (FDI).

Outlook

The stable outlook reflects our expectation that North Macedonia's projected economic recovery will help curb fiscal and external deficits over the coming year.

Upside scenario

We could raise the ratings if continued structural reforms strengthened the sovereign's institutional arrangements while preserving sustainable fiscal policies. North Macedonia's EU accession aspirations could remain an anchor for such institutional improvements and structural reform progress.

Downside scenario

We could lower the ratings if fiscal and current account deficits are higher than we project over the next one-to-two years, coupled with a continuous surge in net government debt or the buildup of external financing pressures. The ratings could also come under pressure if, contrary to our expectations, domestic financial system stability were to weaken under a hypothetical scenario of sustained asset quality deterioration and persistent deposit conversion to foreign currency.

Rationale

North Macedonia's economy is recovering from the fallout of the pandemic. We expect the economy will expand by 3.7% in 2021, despite a contraction in the first quarter. The robust recovery of foreign demand is driving growth, reflecting the specifics of North Macedonia's integration in international supply chains, as well as private consumption, which benefits from recovering private transfers and government support measures that have cushioned disposable incomes, as well as an accommodative monetary policy stance. A potential resurgence of the pandemic and accompanying restrictions remains a risk to the economic recovery although we note that the country's exports proved resilient to the imposed restrictions, and financial conditions remain supportive. North Macedonia's mass vaccination campaign has been accelerating, but started only in May.

As a result of several stimulus measures deployed in 2020-2021, we project a still-high general government deficit of 5.7% of GDP in 2021, which will only gradually narrow by 2024. Consequently, net government debt continues to rise--we estimate it will reach 58% of GDP by 2024, up by 20 percentage points compared with 2016. We think that it could prove challenging to reduce fiscal risks and government deficits and hence slow debt accumulation because of ambitious investment spending targets, the need to withdraw stimulus only gradually to preserve the recovery, revenue collection challenges, and potentially lower official funding availability. But access to funding from market and official sources, as well as the growth outlook underpin our assessment of North Macedonia's still-moderate debt burden. At the same time, the organic budget law, currently in the legislative process, could help entrench prudent fiscal policies and strengthen the fiscal framework.

North Macedonia's moderate external leverage reflects contained current account deficits and the country's success in attracting foreign investment, generally in excess of these deficits, particularly in the export-oriented manufacturing sector. We expect this development will continue over 2021-2024.

Our ratings on North Macedonia remain constrained by our view of the country's comparably low income levels in terms of GDP per capita; still-developing institutional settings, despite recent improvements; and monetary policy flexibility that is limited by the fixed exchange-rate regime.

Institutional and economic profile: The economy is recovering while EU integration roadblocks persist

We now project North Macedonia's economy will expand by 3.7% in 2021. This reflects recovering domestic demand toward the end of the year: Several sets of government support measures have cushioned the pandemic's economic impact, as for example reflected in declining unemployment rate in the first quarter of 2021 compared with 2020. This benefits disposable incomes and hence private consumption. Private consumption also benefits from the ongoing recovery of cash remittances, which are an important household income determinant (one-quarter of disposable incomes) and a transmission channel of the pandemic's economic repercussions to North Macedonia.

Exports have continued to recover in 2021 after the ruptures to supply chains in spring 2020, and remained resilient despite restrictions on economic activity. We expect exports to maintain sound growth, as North Macedonia is integrated in global supply chains, especially in the auto sector, where it benefits from positive demand. At the same time, this means that North Macedonia is dependent on developments in key trading partners--for example, Germany accounts for about 50% of the country's exports.

The country's COVID-19 vaccination campaign started comparably late, since mass vaccinations took off only in May 2021. With currently well below one-third of the population vaccinated, a resurgence of the pandemic and new variants remains a key risk for the ongoing economic recovery. This, against the background of recently rising case numbers, ensuing new restrictions on social gatherings, and reported vaccine hesitancy. Nevertheless, the economy is relatively resilient, with less reliance on services than regional peers. Therefore, apart from risks to external demand more generally, the remaining risks from the pandemic's resurgence would stem from a potential impact on FDI or private transfers, and particularly on fiscal performance if further large-scale government support was needed.

We expect that fiscal stimulus will persist, and be withdrawn only gradually, as also reflected in the recently passed supplementary budget. This will further underpin domestic demand at least through 2021-2022.

Investment will be a key growth driver in 2021-2024. Raising public investment is one of the government's key policy priorities and capital investment amounting to almost 30% of GDP is projected over 2021-2025. These investments aim at addressing structural impediments regarding physical transport infrastructure, the health sector, and education. But we continue to assume that it will be very challenging to mobilize and implement the full capital expenditure envelope, given the track record of under-execution in past years. We note the government's efforts to improve public investment management and accelerate implementation of allocated budget funds.

Wages continued to rise in 2020, not least as a result of government support measures, and have outpaced rather stagnant productivity. However, labor costs are still among the lowest in the region. Persistent net emigration out of North Macedonia adds to the shortage of skilled labor and could fuel further wage pressures. At the same time, better-paid employment opportunities are needed to curb net emigration in the longer term. This hinges on structural improvements, for example in education, and an improvement of perceived economic perspectives as well. We note positively the government's sustained efforts to attract FDI into the free economic zones, which it has expanded in recent years and have boosted the country's goods exports. Nevertheless, 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 auto 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.

We think that a start of EU accession negotiations could serve as an anchor for structural and institutional improvements and for confidence in the country's longer-term economic perspective. Frustration could rise without an EU accession perspective, since the country's membership bid dates back to 2004. It faced a roadblock stemming from the name dispute with Greece, which was resolved through the Prespa agreement in 2018, leading to the country changing its name to North Macedonia. Despite these efforts, the country received another setback when Bulgaria vetoed the negotiating framework and effectively blocked the start of EU accession talks late last year. We understand that the resolution of the issues with Bulgaria will be a key foreign policy priority and ultimately, we note that North Macedonia remains committed to the Euro-Atlantic integration course.

At the same time, domestic political polarization between the two main parties, SDSM and nationalist VMRO-DPMNE, remains high. Close election outcomes have occurred many times, including in 2020, and often resulted in a parliamentary gridlock, with neither side easily securing a working majority. However, SDSM and the ethnic Albanian party DUI have agreed to continue their coalition government. Despite reforms in recent years, we think North Macedonia's institutions have shortcomings, which the government is committed to address.

Flexibility and performance profile: Government debt is rising, but North Macedonia's external profile remains sound

We now project North Macedonia's general government deficit at 5.7% in 2021, 0.8 percentage points (pps) higher than our previous projection. This reflects the government's supplemental budget which, on the back of better-than-expected revenue performance, includes further pandemic-related support measures for affected sectors and individuals and fiscal stimulus, as well as higher capital spending. Despite the upward revision, our deficit projection still compares favorably with the government's own projection. This reflects our expectation of continued sound revenue performance and underspending on some expenditure items.

We expect the general government deficit to narrow to 3.1% by 2024, a more gradual decrease compared with the government's forecast. This takes into account our lower growth forecast and the only gradual withdrawal of support measures. It also reflects past revenue collection weaknesses, a narrow tax base, and high informality. We note that tax revenue has increased significantly so far in 2021, tax arrears have been reduced, and various reforms to increase revenue are being implemented. While the government is hence determined to improve revenue collection and public financial management in a decisive manner, we still expect the comparably low revenue-to-GDP ratio to pose a challenge for fiscal consolidation.

The projected fiscal path means that government debt net of liquid assets will continue to rise, reaching 58% of GDP by 2024 from 50% in 2020. North Macedonia has used its fiscal space to cushion the pandemic impact, but debt has still surged--the net debt-to-GDP ratio had been about 40% before the pandemic. As debt inches up, fiscal risks could increase over time. But currently, North Macedonia is benefitting from good relations with international financial institutions and access to their financing facilities and, notably, from strong access to capital markets. In March 2021, the country issued a €700 million Eurobond (its eighth) at record low interest rates.

The government's current efforts to strengthen the fiscal framework could help provide an anchor for sustainable public finances, if successfully implemented. The government adopted the tax system reform strategy in December 2020, aiming to improve revenue collection and ultimately support economic growth. The Organic Budget Law is in the legislative process and includes the introduction of fiscal rules (which in essence mirror the eurozone's Maastricht criteria) and establishment of a fiscal council.

We project North Macedonia's current account deficit will narrow gradually to 2.1% of GDP by 2024 from 2.7% in 2021. At the same time, we expect net FDI to average just below 3% of GDP over 2021-2024. This reflects a gradual recovery following the 2020 pandemic-induced drop. With reduced uncertainty about the pandemic, foreign companies are expected to resume investments to extend existing capacities. However, shifts in the supply chain, particularly in the automotive sector, might result from the sector's transition away from the combustion engine in Europe. The government is aiming to preserve the country's attractiveness for foreign investors as its traditional (tax) incentives come under more international scrutiny. Government external borrowing partly replaced private external inflows in 2020, as narrow net external debt to current account receipts surged by 10 pps to 34%. We expect narrow net external debt to decrease over our 2021-2024 forecast horizon, to 25%.

We expect the pegged denar-euro exchange rate to continue for the foreseeable future. Foreign currency reserves increased over 2020--mainly on foreign borrowing--and into 2021. As of July 2021, they were up 2% year on year despite a monthly decline due to the eurobond repayment. The absence of large-scale portfolio flows into North Macedonia somewhat buffers against potential external risks, for example if net FDI or remittances recovery were to disappoint. Our baseline expectation is that there will be no large-scale resident conversion to foreign currencies, so the exchange rate will remain intact. This despite the high deposit growth during the pandemic, including growth in foreign currency deposits. The National Bank of the Republic of North Macedonia also recently agreed a €400 million repo line with the European Central Bank, which could be deployed in a downside scenario but has not been used so far.

We now expect inflation of 2.2% in 2021. This reflects higher energy and food prices in international markets but also domestic price pressures, as domestic demand recovers and wages continue to grow.

In our view, North Macedonia's banking system is stable, but asset quality will likely weaken because regulatory flexibility has expired for the largest parts of the banks' portfolios. However, the nonperforming loan ratio was low, at 3.4% as of second-quarter 2021. The banking sector remained profitable and highly capitalized in 2020-2021, and credit growth was sound.

One year ago, the regulator revoked a license from a small domestic bank, Eurostandard. We understand that the bank had been vulnerable and undercapitalized. Its share in total domestic credit and deposits was small at below 2% and the license withdrawal did not have any systemic repercussions. The government is not involved in its resolution, and the deposit guarantee fund will assume insured deposit payouts with no government budget involvement. However, we understand that parties adversely affected by the license withdrawal voiced concerns in the media regarding banking sector surveillance and performance. This shows that, despite their usually high capital ratios, small banks in the country could be susceptible to public speculation. While this was refuted by relevant authorities and international observers (such as the IMF), these episodes highlight the importance of maintaining trust in the banking sector and exchange rate stability to avoid sudden volatility in deposits. There were some deposit withdrawals and conversions to foreign currencies briefly in April 2020 and some withdrawals following the Eurostandard bank license revocation. However, the overall rise in the deposit base in 2020-2021 suggests that the central bank was successful in maintaining confidence.

Key Statistics

Table 1

North Macedonia Selected Indicators

Mil. MKD	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Economic indicators (%)										
Nominal GDP (bil. LC)	559	595	618	661	689	664	702	743	784	826
Nominal GDP (bil. $)	10	11	11	13	13	13	14	15	15	16
GDP per capita (000s $)	4.9	5.2	5.5	6.1	6.0	6.3	6.7	7.1	7.4	7.8

Table 1

North Macedonia Selected Indicators (cont.)

Mil. MKD	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Real GDP growth	3.9	2.8	1.1	2.9	3.2	(4.5)	3.7	3.7	3.4	3.3
Real GDP per capita growth	3.7	2.7	1.0	2.8	3.1	(4.5)	4.1	3.6	3.3	3.2
Real investment growth	8.3	12.5	(2.2)	1.7	9.5	(10.2)	8.9	7.3	4.3	3.9
Investment/GDP	30.4	32.5	32.3	32.3	34.5	29.6	31.1	32.3	32.6	32.9
Savings/GDP	28.5	29.6	31.4	32.2	31.2	26.4	28.4	30.0	30.4	30.8
Exports/GDP	48.7	50.7	55.1	60.4	62.3	58.1	62.7	63.3	64.1	65.2
Real exports growth	8.5	9.1	8.3	12.8	7.2	(10.9)	12.9	4.8	4.8	5.2
Unemployment rate	26.1	23.7	22.4	20.7	17.3	16.4	15.8	15.3	15.0	14.8
External indicators (%)										
Current account balance/GDP	(1.9)	(2.9)	(0.9)	(0.1)	(3.3)	(3.2)	(2.7)	(2.2)	(2.2)	(2.1)
Current account balance/CARs	(2.8)	(4.2)	(1.1)	(0.2)	(4.1)	(4.7)	(3.5)	(2.8)	(2.8)	(2.6)
CARs/GDP	68.8	69.9	75.1	79.5	80.4	69.6	77.5	79.0	79.9	81.0
Trade balance/GDP	(20.1)	(18.8)	(17.8)	(16.2)	(17.6)	(15.8)	(17.7)	(17.9)	(17.7)	(17.2)
Net FDI/GDP	2.3	3.3	1.8	5.6	3.2	1.8	2.6	2.8	2.8	2.9
Net portfolio equity inflow/GDP	(0.4)	(0.2)	(0.4)	(0.8)	(0.0)	(0.5)	(0.7)	(0.7)	(0.7)	(0.7)
Gross external financing needs/CARs plus usable reserves	108.3	109.9	106.4	109.4	112.1	114.5	114.2	113.4	111.8	110.6
Narrow net external debt/CARs	26.9	28.3	32.6	24.3	23.2	34.0	30.2	28.6	26.8	24.8
Narrow net external debt/CAPs	26.1	27.1	32.2	24.3	22.2	32.4	29.2	27.8	26.1	24.2
Net external liabilities/CARs	80.2	78.8	82.2	68.6	71.6	94.6	84.1	80.6	78.2	75.6
Net external liabilities/CAPs	78.0	75.7	81.3	68.5	68.8	90.4	81.2	78.4	76.1	73.7
Short-term external debt by remaining maturity/CARs	27.1	21.3	20.3	20.2	20.7	24.2	23.0	23.2	22.6	21.7
Usable reserves/CAPs (months)	2.3	1.6	1.7	1.2	1.3	1.4	1.3	1.3	1.4	1.5
Usable reserves (mil. $)	1,055	1,198	1,010	1,153	1,136	1,155	1,283	1,492	1,636	1,821
Fiscal indicators (general government; %)										
Balance/GDP	(3.4)	(2.7)	(2.8)	(1.1)	(2.2)	(8.2)	(5.7)	(3.8)	(3.4)	(3.1)
Change in net debt/GDP	5.1	4.3	3.2	1.6	3.5	7.6	6.6	5.3	4.1	2.9
Primary balance/GDP	(2.3)	(1.5)	(1.5)	0.1	(1.0)	(7.0)	(4.3)	(2.2)	(1.7)	(1.3)
Revenue/GDP	31.0	30.6	31.0	30.4	31.5	30.2	32.4	31.6	31.3	30.5
Expenditures/GDP	34.4	33.2	33.8	31.5	33.7	38.4	38.1	35.4	34.7	33.6
Interest/revenues	3.8	3.8	4.4	3.9	3.7	4.0	4.4	5.0	5.3	6.0
Debt/GDP	41.7	44.7	44.4	45.8	46.7	57.5	61.0	62.9	63.8	63.4
Debt/revenues	134.7	146.2	143.3	150.8	148.3	190.5	188.2	199.2	203.8	207.9
Net debt/GDP	36.5	38.6	40.4	39.3	41.2	50.3	54.2	56.6	57.7	57.7
Liquid assets/GDP	5.2	6.1	4.0	6.5	5.5	7.1	6.7	6.4	6.0	5.7
Monetary indicators (%)										
CPI growth	(0.3)	(0.2)	1.4	1.5	0.8	1.2	2.2	2.1	2.0	2.0
GDP deflator growth	2.0	3.5	2.8	3.9	1.1	0.9	2.0	2.0	2.0	2.0
Exchange rate, year-end (LC/$)	56.37	58.33	51.27	53.69	54.95	50.24	50.87	50.87	50.87	50.87

Table 1

North Macedonia Selected Indicators (cont.)										
Mil. MKD	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**
Banks' claims on resident non-gov't sector growth	9.6	0.2	5.4	7.3	6.4	4.8	6.0	6.0	6.0	6.0
Banks' claims on resident non-gov't sector/GDP	51.1	48.1	48.8	48.9	49.9	54.3	54.4	54.5	54.8	55.1
Foreign currency share of claims by banks on residents	44.8	43.8	41.7	40.3	41.2	41.2	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	41.2	41.6	40.9	40.0	38.4	39.7	N/A	N/A	N/A	N/A
Real effective exchange rate growth	(0.3)	1.1	(0.5)	1.4	(1.7)	1.9	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.
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 claims on 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. 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 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	4	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. Over 75% 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."

Table 2

North Macedonia Ratings Score Snapshot (cont.)		
Key rating factors	**Score**	**Explanation**
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, external political developments or because the government loses the current slim parliamentary majority 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. Additionally, there are downside risks from a hypothetical scenario of persistent deposit withdrawals and conversions to FX. This is not fully captured in the indicative rating level.
Foreign currency	BB-	
Notches of uplift	0	Default risks do not apply differently to foreign- and local-currency debt.
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: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Sovereign Ratings Score Snapshot, Aug. 3, 2021
- Sovereign Ratings List, July 26, 2021
- Sovereign Ratings History, July 26, 2021
- Sovereign Risk Indicators, July 12, 2021; a free interactive version is available at hiip://www.spratings.com/sri
- EMEA Emerging Markets Sovereign Rating Trends Midyear 2021, June 29, 2021
- Default, Transition, and Recovery: 2020 Annual Sovereign Default And Rating Transition Study, April 12, 2021
- Sovereign Debt 2021: Global Borrowing Will Stay High To Spur Economic Recovery, March 1, 2021

Ratings Detail (As Of August 23, 2021)*	
North Macedonia	
Sovereign Credit Rating	BB-/Stable/B
Transfer & Convertibility Assessment	BB
Senior Unsecured	BB-

Ratings Detail (As Of August 23, 2021)*(cont.)		
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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