S&P Global
Ratings

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Research Update:

North Macedonia 'BB-/B' Ratings Affirmed; Outlook Stable

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Overview

- We expect North Macedonia's economy to expand by 3.7% in 2022.
- We project budget deficits to narrow gradually over 2022-2025 and net government debt to stabilize at around 57% of GDP.
- We are affirming our 'BB-/B' sovereign credit ratings on North Macedonia and maintained the stable outlook.

Rating Action

On Feb. 18, 2022, S&P Global Ratings affirmed its 'BB-/B' long- and short-term foreign and local currency sovereign credit ratings on North Macedonia. The outlook is stable.

Outlook

The stable outlook reflects our view that North Macedonia's strong economic growth prospects will support the government's budgetary consolidation efforts, and allow it to broadly stabilize government debt in the medium term.

Upside scenario

We could raise the ratings if structural reform efforts continue, strengthening North Macedonia's institutional framework, and allowing the country to consolidate its budgetary position. The country's EU accession objective could continue serving as a force for bolstering the institutional framework. We could also raise the rating if fiscal consolidation efforts surpass our expectations, putting net government debt as a share of GDP on a downward trajectory.

Downside scenario

We could lower the rating if budget and current account deficits worsen beyond our expectations in the medium term, leading to a protracted buildup of government debt and external funding pressure. The ratings could also come under stress if, contrary to our expectations, domestic financial system stability was to weaken under a hypothetical scenario of sustained asset quality deterioration and persistent deposit conversion to foreign currency.

Rationale

Our ratings on North Macedonia are constrained by a weak-but-improving institutional framework, low GDP per capita, increasing levels of net government debt, high government foreign currency-denominated debt, and limited monetary flexibility due to the denar peg.

Nevertheless, our ratings on North Macedonia are supported by moderate net government and external debt levels, the strong outlook for net foreign direct investment (FDI) inflows, and the stable banking sector.

Institutional and economic profile: New governments in both North Macedonia and Bulgaria inject impetus into EU accession talks

- The economy has recovered its pre-pandemic level, and North Macedonia's economy is set to expand by 3.7% in 2022 and 3.4% on average from 2023-2025.
- We expect strong consumption and investment to propel growth.
- The new governments in North Macedonia and Bulgaria have injected a positive dynamic into North Macedonia's EU accession talks.

Despite high frequency indicators showing that manufacturing activity hasn't recovered to 2019 levels, we estimate that the pick-up in activity in other sectors has been stronger, with North Macedonia's GDP in 2021 broadly recovering after the pandemic-induced recession in 2020. We expect real GDP to expand by 3.7% in 2022, following an expansion of 4.1% in 2021. Domestic demand will remain the key growth factor, due to buoyant private consumption on accommodative monetary policy, wage growth, and a steady inflow of worker remittances. Cash remittances from North Macedonians employed abroad are an important household income determinant, accounting for one-quarter of disposable income.

Along with consumption, investment will remain an important factor in growth. As indicated by the Growth Acceleration Plan adopted in October 2021, raising public investment is one of the government's key policy priorities. Government investment will focus on a variety of sectors, including education, transport, energy, road, and health care infrastructure. Notable projects include the Corridor VIII and the North Macedonia–Greece Interconnector Gas Pipeline. However, given the track record of under-execution in past years, it will be difficult to mobilize and execute budgeted capital expenditure (roughly 5% of GDP in 2022) in full. Still, the government's efforts to improve public investment management continue and we estimate that public and private investments combined will amount to slightly above 30% of GDP over 2022-2025.

Exports have recovered solidly from the pandemic-induced contraction, thanks to strong external demand, especially from key trading partners in the EU. Nevertheless, any growth contributions by exports will be outstripped by an increase in imports due to strong domestic demand and increasing commodity prices. As a result, net exports will drag on growth in 2022. Risks to the growth outlook include further increasing commodity prices, global supply chain disruptions, monetary policy tightening, and the pandemic's evolution, including the emergence of variants amid stagnating vaccination levels. Since third-quarter 2021, the share of fully vaccinated population has remained around 40%, partly reflecting the public's reluctance to get vaccinated.

The labor market has shown signs of improvement since the pandemic's peak. A gradual economic recovery and government support measures helped the unemployment rate narrow to 15.7% in third-quarter 2021, from 16.5% in the same period a year earlier. In addition, wages increased by approximately 6% in November 2021. We expect the unemployment rate to continue decreasing as the economy recovers from the pandemic. Labor costs remain among the lowest in the region. However, the labor force has shrunk by 2.4% since fourth-quarter 2019, reflecting a trend of persistent net emigration. This shortage of skilled labor could fuel wages pressure.

The government has made efforts to attract FDI into the free economic zones, resulting in an acceleration in goods exports. Companies operating in those zones focus on the electronic and auto sectors. However, a large proportion of inputs are still imported, rather than sourced domestically, which limits the free zones' wider integration into the domestic economy.

We believe that a start of EU accession negotiations could anchor structural and institutional improvements, supporting the country's economic growth prospects. However, in 2020, Bulgaria vetoed the adoption of the EU's negotiation framework for North Macedonia due to a dispute over historical and language ties. Dimitar Kovacevski, the leader of the Social Democratic Union of Macedonia, was sworn in as North Macedonia's new Prime Minister in January 2022, winning 62 of 120 votes. A key foreign policy target of the new government is to make progress on North Macedonia's bid for EU membership. Given that there are new governments in North Macedonia and Bulgaria with a common objective of improving relations between the two countries, we believe a new positive dynamic has taken hold. This is evident with a recent visit to Skopje by Bulgarian Prime Minister Kiril Petkov, and the setup of bilateral groups focused on closer cooperation on many fronts, such as trade and investment. This could improve progress in North Macedonia's EU accession talks. Nevertheless, this would likely be a gradual process and we do not expect the country to become a member of the EU this decade.

Flexibility and performance profile: Net general government debt is set to stabilize from 2023

- Budget and current account deficits will remain elevated this year, so we project general government deficits will remain wide, at slightly above 4% of GDP in 2022, with a gradual consolidation thereafter.
- As a result, net general government debt will stabilize at 56%-57% of GDP in the medium term.
- The current account deficit will widen in 2022 on high energy prices and strong domestic demand, although net FDI will cover the major part.

We estimate the general government deficit amounted to 5.4% of GDP in 2021, lower than the 6.5% deficit projected in the 2021 budget. This was due to higher nominal GDP growth, solid revenue performance, and underuse of budgeted capital expenditure. For 2022, we estimate the general government deficit will decrease to 4.1% of GDP, compared with the government's own target of 4.3% of GDP. The difference in fiscal forecasts is explained by our expectations of continued capital expenditure underspending. Nevertheless, strong growth will support revenue, while expenditure is expected to stay broadly flat as COVID-19-related emergency fiscal measures are eased. However, the budget does allow for higher spending on wages and the health care sector, such as higher wages for certain public sector employees and the procurement of COVID-19 vaccines. Moreover, we expect capital expenditure to increase significantly, with a particular focus on investment in a range of sectors such as health care and transport infrastructure.

We expect the general government deficit to narrow to 2.3% of GDP by 2025 as authorities implement their budgetary consolidation agenda. At the same time, this fiscal effort is not immune to challenges, including the economy's high informality.

Nevertheless, revenue growth climbed significantly in 2021 on the government's efforts to strengthen North Macedonia's fiscal framework, most notably though the adoption of the tax system reform strategy in December 2020. The reform aims to improve revenue administration, broaden the tax base, and reduce tax arrears and evasion, among other objectives. A set of fiscal rules (similar to the eurozone's Maastricht criteria) and the establishment of an independent fiscal council as outlined in the Organic Budget Law is yet to be legally adopted by parliament, although we expect adoption by the middle of the year, which should anchor the budgetary consolidation path.

Our projected budgetary trajectory means that net general government debt will rise to a moderate 57% of GDP in 2023 from 55.5% in 2022 and stabilize thereafter. North Macedonia's net general government debt was approximately 40% of GDP before the pandemic. However, to counter the pandemic's economic effects, the government adopted an expansionary fiscal stance, pushing debt levels up 9 percentage points in 2020. Yet, North Macedonia benefits from strong connections with international financial institutions and access to their financing facilities, notably from strong access to capital markets. In March 2021, the country issued a €700 million Eurobond (its eighth) at a record low interest rate. In addition, North Macedonia's debt stock has an average maturity of six years, and roughly 21% of government debt is concessional. However, about 75% of government debt is denominated in foreign currency, posing a risk.

According to our estimates, North Macedonia's current account deficit narrowed marginally, to 3.2% of GDP in 2021. In 2022, we expect the deficit to widen to 3.8% of GDP on strong domestic demand and increases in commodity prices. At the same time, the external deficit will be financed through net FDI and other traditional sources of financing. Simultaneously, we expect net FDI to rebound to and average 3% of GDP over the forecast horizon, following a drop in investment caused by the pandemic in 2020. As business confidence recovers, we expect companies to increase investments in North Macedonia. But the supply chain could change, particularly in the auto sector, reflecting the sector's transition away from the combustion engine in Europe. Nevertheless, the government is aiming to preserve the country's attractiveness for foreign investors.

Beyond 2022, we expect the current account deficit to narrow again, particularly as exports recover (in line with global demand), private transfers remain steady, and energy prices gradually decline. As a result, given the historical external funding mix, we project narrow net external debt, our preferred measure of external leverage, to decrease to a modest 25% of current account receipts in 2025 from around 33.5% in 2020.

We foresee no changes to the pegged denar-euro exchange rate regime. Compared with the previous year, foreign currency reserves increased by 8.4% to €3.6 billion in 2021. The increase in reserves can be attributed to North Macedonia's Special Drawing Rights allocation of €161 million and external government borrowing. As a result, foreign currency reserves remain ample to support the denar peg. The absence of large-scale portfolio flows into the country provides buffers against potential external risks. In addition, the European Central Bank has extended the deadline for the National Bank of the Republic of Macedonia's (NBRM's) €400 million repurchase (repo) line until March 2022. Currently, the NBRM has not used the repo line, but it could if external risks materialize.

Tight labor market conditions have not driven up price pressures; instead, inflation levels have been driven by external factors, such as increases in energy and food prices. North Macedonia's 12-month average headline inflation rate accelerated to 3.2% in December 2021, from 1.2% in the same period a year earlier. We expect inflation to moderate to 2.6% in annual average terms in 2022 due to a slowdown in food prices. Inflation continues to be dictated by external factors, so we expect the NBRM to maintain an accommodative monetary policy stance in the near term.

North Macedonia's banking system remains stable and profitable. Forbearance measures expired in September. Consequently, the nonperforming loan ratio was broadly flat at 3.6% in September 2021, from 3.3% the same period a year earlier. Moreover, the capital adequacy ratio increased to 17.3% in third-quarter 2021, from 16.9% in the same period a year earlier.

Key Statistics

Table 1

North Macedonia--Selected Indicators

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Economic indicators (%)										
Nominal GDP (bil. LC)	594.79	618.11	660.88	689.42	664.01	707.58	749.37	789.71	829.64	871.84
Nominal GDP (bil. $)	10.67	11.31	12.68	12.55	12.26	13.58	14.03	14.94	15.85	16.66
GDP per capita (000s $)	5.2	5.5	6.1	6.0	5.9	6.6	6.8	7.2	7.7	8.1
Real GDP growth	2.8	1.1	2.9	3.2	(4.5)	4.1	3.7	3.4	3.3	3.3
Real GDP per capita growth	2.7	1.0	2.8	3.1	(4.5)	4.5	3.7	3.4	3.3	3.3
Real investment growth	12.5	(2.2)	1.7	9.5	(10.2)	10.4	7.5	3.9	3.6	3.6
Investment/GDP	32.5	32.3	32.3	34.5	29.6	31.3	32.5	32.8	33.1	33.4
Savings/GDP	29.6	31.4	32.2	31.2	26.2	28.1	28.7	29.4	29.6	30.5
Exports/GDP	50.7	55.1	60.4	62.3	58.1	61.0	63.5	65.4	67.3	69.2
Real exports growth	9.1	8.3	12.8	7.2	(10.9)	10.7	8.5	7.0	6.5	6.5
Unemployment rate	23.7	22.4	20.7	17.3	16.4	15.8	15.3	15.0	14.8	14.8
External indicators (%)										
Current account balance/GDP	(2.9)	(0.9)	(0.1)	(3.3)	(3.4)	(3.2)	(3.8)	(3.4)	(3.5)	(2.9)
Current account balance/CARs	(4.2)	(1.1)	(0.2)	(4.1)	(4.6)	(4.0)	(4.5)	(4.0)	(3.9)	(3.3)
CARs/GDP	69.9	75.1	79.5	80.5	74.5	80.3	84.2	86.1	88.0	90.1
Trade balance/GDP	(18.8)	(17.8)	(16.2)	(17.4)	(16.8)	(19.0)	(20.1)	(19.7)	(19.5)	(19.3)
Net FDI/GDP	3.3	1.8	5.6	3.2	1.4	2.3	3.0	3.0	3.0	3.0
Net portfolio equity inflow/GDP	(0.2)	(0.4)	(0.8)	0	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)
Gross external financing needs/CARs plus usable reserves	109.9	106.4	109.4	112.0	114.4	114.3	114.8	113.5	113.4	112.4
Narrow net external debt/CARs	28.3	32.6	24.3	23.1	33.6	31.3	30.1	28.3	26.6	25.3

Table 1

North Macedonia--Selected Indicators (cont.)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Narrow net external debt/CAPs	27.1	32.2	24.3	22.2	32.1	30.1	28.8	27.2	25.6	24.5
Net external liabilities/CARs	78.8	82.2	68.6	71.6	92.8	82.2	79.6	77.0	74.8	72.6
Net external liabilities/CAPs	75.7	81.3	68.5	68.8	88.8	79.0	76.2	74.0	72.0	70.3
Short-term external debt by remaining maturity/CARs	21.3	20.3	20.2	20.7	24.1	22.4	22.5	21.1	20.3	19.4
Usable reserves/CAPs (months)	1.6	1.7	1.2	1.3	1.4	1.2	1.2	1.2	1.1	1.1
Usable reserves (mil. $)	1,198	1,010	1,153	1,136	1,155	1,242	1,310	1,332	1,374	1,446
Fiscal indicators (general government; %)										
Balance/GDP	(2.7)	(2.8)	(1.1)	(2.2)	(8.2)	(5.4)	(4.1)	(3.2)	(2.8)	(2.3)
Change in net debt/GDP	4.3	3.2	1.6	3.5	7.6	5.6	5.6	3.9	2.6	2.1
Primary balance/GDP	(1.5)	(1.5)	0.1	(1.0)	(7.0)	(4.1)	(2.6)	(1.6)	(1.1)	(0.6)
Revenue/GDP	30.6	31.0	30.4	31.5	30.2	32.4	31.6	31.3	30.5	30.5
Expenditures/GDP	33.2	33.8	31.5	33.7	38.4	37.8	35.7	34.5	33.3	32.8
Interest/revenues	3.8	4.4	3.9	3.7	4.0	3.9	4.8	5.2	5.7	5.7
Debt/GDP	44.7	44.4	45.8	46.7	57.5	59.5	61.8	62.5	62.1	61.2
Debt/revenues	146.2	143.3	150.8	148.3	190.5	183.7	195.5	199.8	203.7	200.7
Net debt/GDP	38.6	40.4	39.3	41.2	50.3	52.8	55.5	56.5	56.4	55.8
Liquid assets/GDP	6.1	4.0	6.5	5.5	7.1	6.7	6.3	6.0	5.7	5.4
Monetary indicators (%)										
CPI growth	(0.2)	1.4	1.5	0.8	1.2	3.2	2.6	2.0	1.8	1.5
GDP deflator growth	3.5	2.8	3.9	1.1	0.9	2.4	2.1	1.9	1.7	1.7
Exchange rate, year-end (LC/$)	58.33	51.27	53.69	54.95	50.24	54.37	53.34	52.61	52.16	52.16
Banks' claims on resident non-gov't sector growth	0.2	5.4	7.3	6.4	4.8	8.0	6.0	6.0	6.0	6.0
Banks' claims on resident non-gov't sector/GDP	48.1	48.8	48.9	49.9	54.3	55.0	55.1	55.4	55.9	56.4
Foreign currency share of claims by banks on residents	43.8	41.7	40.3	41.2	41.2	40.4	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	41.6	40.9	40.0	38.4	39.7	42.8	N/A	N/A	N/A	N/A

Table 1

North Macedonia--Selected Indicators (cont.)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Real effective exchange rate growth	1.1	(0.5)	1.4	(1.7)	1.9	N/A	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)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.
		The 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.
Final rating		
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

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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 List, Feb. 7, 2022
- Sovereign Ratings History, Feb. 7, 2022
- Sovereign Ratings Score Snapshot, Feb. 4, 2022
- Global Sovereign Rating Trends 2022: Despite Stabilization, The Pandemic Threatens The Recovery, Jan. 27, 2022
- Sovereign Risk Indicators, Dec. 13, 2021. A free interactive version is available at hiip://www.spratings.com/sri
- 2020 Annual Sovereign Default And Rating Transition Study, April 12, 2021

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed	
North Macedonia	
Sovereign Credit Rating	BB-/Stable/B
Transfer & Convertibility Assessment	BB
Senior Unsecured	BB-