S&P Global
Ratings

RatingsDirect®

North Macedonia

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This report does not constitute a rating action.

Credit Highlights

Overview

Institutional and economic profile	Flexibility and performance profile
The economic effects of the Russia-Ukraine war appear manageable, and growth should recover.	Despite increasing over the past few years, public debt remains moderate and is set to stabilize.
-- S&P Global Ratings expects GDP growth to decelerate to 2.1% in 2023, with consumption and investment the underlying drivers.	-- The fiscal deficit will remain elevated in 2023 at roughly 4.1% of GDP, followed by gradual fiscal consolidation over the next four years.
--North Macedonia's trade and financial links with Russia and Ukraine remain limited.	-- We anticipate the current account deficit will narrow over the next few years as commodity prices decrease.
--EU accession talks are underway, but the necessary constitutional amendments remain a hurdle.	-- International reserves have recovered after hitting a recent low in June 2022.

The economic effects of the Russia-Ukraine war appear contained for now. Weaker external demand from the EU (due to the indirect effects of the conflict) and weaker household demand will keep North Macedonia's GDP growth suppressed at 2.1% in 2023. Subsequently, we expect growth to revert to its trend in the medium term.

Sizable energy subsidies will keep the fiscal deficit elevated at 4.1% of GDP in 2023, down from 4.3% in 2022. We expect fiscal consolidation to continue as energy subsidies are phased out. As a result, net general government debt will remain on a stable trajectory.

EU accession talks are in progress, but issues remain. The second intergovernmental conference (IGC) will only be held once North Macedonia's constitution is changed in accordance with the France-backed proposal. We believe the second IGC will not happen in the near term owing to political polarization, the government’s slim majority, and the high number of votes required for constitutional amendments to pass.

Outlook

The stable outlook reflects our view that multiple risks arising from the Russia-Ukraine conflict over the next year are offset by North Macedonia's proactive policymaking as well as its moderate government debt levels and contained interest costs. We project general government interest payments will amount to about 6% of government revenue over the next four years, which is comparatively modest in a global context.

Downside scenario

We could lower the ratings if North Macedonia's balance-of-payments performance proved weaker than we expect, leading to a higher depletion of international reserves and possibly presenting risks to financial stability. This scenario could entail the additional risk that domestic residents increasingly convert deposits from local into foreign currency, but this is not our baseline scenario. The ratings could also come under pressure if fiscal deficits worsened beyond our expectations in the medium term, leading to a protracted build-up of government leverage in contrast to our current projection of net general government debt stabilizing at close to 53% of GDP through 2026.

Upside scenario

We could raise the ratings if structural reform implementation strengthened North Macedonia's institutional settings while its fiscal performance improved, with net general government debt trending down, alongside robust GDP growth.

Rationale

Institutional and economic profile: Formal EU accession talks are in progress, but the short-term economic outlook remains somewhat weak

We expect real GDP growth to remain somewhat weak in 2023, at roughly 2.1%, but up from an estimated 1.5% in 2022 due to lower external demand primarily from the EU (exasperated by the indirect effects of the Russia-Ukraine conflict). Weaker domestic household consumption on the back of tighter credit conditions and high inflation will contribute to weaker growth this year, but remittances from Macedonians working abroad will help household consumption remain an important contributor to growth. Along with consumption, investment will also be a key contributor to growth, particularly from government investments such as the Corridor 8 and 10d highway project, which is worth a total of €1.3 billion and works have already started. Beyond 2023, we expect growth to recover to roughly 3% per year as the indirect effects of the Russia-Ukraine conflict gradually dissipate.

North Macedonia's trade and financial links with Russia and Ukraine remain limited despite the country having some energy exposure to Russia. Most natural gas imports come from Russia, but this only accounts for 10% of North Macedonia's total energy mix. Moreover, less than 1% of oil imports originate from Russia. Despite Russia halting gas supplies to Bulgaria, North Macedonia continues to receive gas from Russia via pipelines in Bulgaria.

The ruling Social Democratic Union of Macedonia (SDSM)-led coalition has governed the country since parliamentary elections in July 2020. One of the main priorities of the current administration is to continue the path to EU membership. Nevertheless, long-standing political polarization remains an issue, particularly between the SDSM and opposition party Internal Macedonian Revolutionary Organization – Democratic Party for Macedonian National Unity (VMRO-DPMNE). This political polarization has sometimes caused obstructions in parliament, for example, leading to delays in legislation being approved, and is not positive factor for the country's institutional setup. North Macedonia's institutional framework also suffers from other shortcomings including corruption, but progress to combat the problem has been made in recent years.

Accession talks between the EU and North Macedonia started in July 2022. Progress continues to depend on parliament's approval of a France-backed proposal formed to encourage Bulgaria to withdraw its veto on North Macedonia's EU membership bid. Under the proposal, North Macedonia must amend its constitution to acknowledge a Bulgarian minority, among other measures. As a result, the first of two intergovernmental conferences (IGC) between North Macedonia and the EU were held. The second IGC will only occur once North Macedonia's constitution is changed in accordance with the France-backed proposal. Under Macedonian law, constitutional amendments require 80 out of 120 votes in favor for any proposal to pass. Given the government's slim majority, continued political polarization, and the number of votes required, we don't expect the second IGC to be held soon. Bulgaria could also block North Macedonia's bid for EU membership again, even if this is achieved. Nevertheless, we still consider the bid to serve as an anchor for structural and institutional developments over the longer term, supporting the country's economic prospects.

Flexibility and performance profile: Fiscal and external pressures will continue into 2023

North Macedonia's budget deficit was at 4.3% of GDP in 2022, lower than the planned 5.3% approved in the 2022 supplementary budget. Fiscal performance was better than expected because of lower capital and general expenditure than planned. On the other hand, revenue collection did not disappoint thanks to high inflation. Notably, compared to previous years, which encompassed under-budgeted capital expenditure (capex), execution increased to 88% in 2022, higher than the 78% recorded in 2021, although much higher input costs could be a driving factor for the increase.

Given the government's underutilization of budget funds in recent years, we expect a budget deficit of 4.1% of GDP in 2023 against the government's target of 4.6%. The authorities aim to boost revenue by streamlining preferential treatments on corporate and personal income tax, and value-added tax. In addition, the EU will provide €80 million of budget support in the form of a grant. On the expenditure side, energy subsidies account for roughly 2% of spending (consumers are currently protected from large tariff adjustments). In addition, the authorities are targeting a reduction in operating costs through a decrease in expenses such as electricity consumption, travel, and the hiring of external consultants, among others. In line with previous years, the budget deficit will be financed with a mixture of domestic and foreign borrowing. We expect the authorities to return to the Eurobond market this year with roughly €500 million of issuances to refinance a €450 million Eurobond that will mature in 2023. The authorities also received approval from the IMF for a two-year €530 million precautionary liquidity line (PLL) in November 2022.

Looking ahead, we expect the general government deficit to average approximately 3.2% through to 2025. The government's fiscal consolidation efforts will continue to face challenges including the economy's large informal sector and the indirect effects of the Russia-Ukraine conflict, although to a lesser extent than before. Therefore, we project net general government debt will rise from 52.9% of GDP in 2023 and stabilize by 2025.

Notably, about 75% of government debt is denominated in foreign currency and this could create downside risks, particularly in a scenario of the pegged exchange rate regime coming under pressure. Nevertheless, this is not our baseline scenario. Strict adherence to the recently adopted Organic Budget Law, which outlines a set of fiscal rules (similar to the eurozone's Maastricht criteria) and the establishment of an independent fiscal council should help North Macedonia's fiscal consolidation efforts. We also note that despite tightening global financing conditions, North Macedonia's cost of servicing government debt remains contained and we expect it will average under 6% of government revenue over the next four years, which is significantly lower than most emerging markets.

North Macedonia's exports to Germany accounted for 45% of total exports from January through October in 2022. It is also a net energy and food importer. Given our anticipation of an economic slowdown in Germany and elevated hydrocarbon prices this year, we expect North Macedonia's current account deficit remain wide at roughly 5.5% of GDP in 2023. We then expect the current account deficit to narrow gradually, averaging over 3% of GDP until 2026. The 2023 current account deficit will most likely be financed via a combination of channels that include net foreign direct investment (FDI) inflows and external government borrowing (via Eurobonds, IMF program disbursements, and international financial institution loans).

In November 2022, the IMF approved a two-year €530 million PLL line requested earlier in the year. The authorities plan to draw €265 million of the PLL funds and treat the remainder as precautionary. Given tightening financial conditions, the program will mainly help it meet forthcoming external and fiscal financing needs. Priorities under the PLL program include fiscal consolidation, reducing inflation, and protecting financial stability. The authorities have also requested macro-financial assistance from the EU.

We expect net FDI to rebound and average roughly 3% of GDP through to 2026. But changes in the supply chain represent a risk, particularly in the auto sector as it transitions away from traditional combustion engines, at least in Europe. Nevertheless, the government is aiming to preserve the country's FDI attractiveness. For instance, it recently announced the opening of its first high-tech economic zone--Skopje III--which aims to be a national hub for new technologies and clean manufacturing. The zone offers incentives similar to other free economic zones, including a 10-year holiday on corporate and personal income tax. Currently, companies operating in North Macedonia's free economic zones are focused on the electronic and auto sectors, and a large proportion of inputs are still imported rather than sourced domestically, which limits the free zones' wider integration into the domestic economy.

We do not expect any changes to the pegged denar-euro exchange rate regime. However, the central bank's foreign reserves came under pressure from January to June 2022 due to a higher energy import bill and decreases in the values of security holdings. Nevertheless, reserves steadily increased to €3.9 billion in December from €3.2 billion in June thanks to external government borrowing and central bank interventions. Given energy prices have moderated over recent months, we don't expect significant pressures on the central bank's foreign reserves to resurface this year.

In line with global trends, headline inflation in North Macedonia has increased significantly over the past 12 months, largely due to higher energy and food prices, to 18.7% in December 2022 from 6.7% in January 2022, reaching its highest levels since 1995. Similarly, due to second-round effects, core inflation increased to a new peak of 11.1% in December 2022. Nevertheless, price pressures have started to ease, headline inflation started to decelerate from November 2022, and we expect this trend to continue. We forecast headline inflation to average 8% in 2023. Furthermore, in line with the European Central Bank's monetary policy tightening, the National Bank of the Republic of North Macedonia (NBRNM) hiked its policy rate by a cumulative 350 basis points in 2022.

North Macedonia's financial sector linkages with Russia remain limited, as a result, the authorities did not have to intervene to manage the fallout of sanctions on Russian bank subsidiaries. This set North Macedonia apart from countries like Slovenia, Croatia, and Bosnia and Herzegovina. Pressures within the banking system emerged nonetheless, with a short-lived episode of deposit withdrawals in March 2022. That said, the euroization of deposits has edged up with the share of deposits in foreign currencies rising to roughly 44.9% in November 2022 from 42.8% in December 2021. In response, the NBRM reduced the reserve requirements (RRs) in denar to 5% and increased RRs in foreign currency to 19%. Moreover, a counter cyclical buffer of 0.5% comes into effect in August 2023, and another 0.25% in January 2024. We do not expect significant additional deposit withdrawals or their conversion to foreign currency in our current base case. The nonperforming loans ratio remains low at 3.2% of total loans, and the capital adequacy ratio is stable at 17.7%. In turn, the materialization of contingent liabilities for the government from the financial sector remains unlikely in the near term.

North Macedonia--Selected Indicators

	2017	2018	2019	2020	2021	2022	2023bc	2024bc	2025bc	2026bc
Economic indicators (%)										
Nominal GDP (bil. MKD)	618.1	660.9	692.7	669.3	720.4	804.3	867.2	918.3	973.2	1,031.5
Nominal GDP (bil. $)	11.3	12.7	12.6	12.4	13.8	13.8	14.6	16.5	18.1	19.2
GDP per capita (000s $)	5.5	6.1	6.1	6.0	6.7	6.7	7.1	8.0	8.8	9.3
Real GDP growth	1.1	2.9	3.9	(4.7)	3.9	1.5	2.1	2.8	3.1	3.1
Real GDP per capita growth	1.0	2.8	3.8	(4.7)	4.3	1.7	2.3	2.9	3.2	3.2
Real investment growth	(2.2)	1.7	9.5	(15.1)	0.9	7.0	5.0	3.1	3.2	3.2
Investment/GDP	32.3	32.3	34.3	29.9	32.3	33.5	33.9	33.7	33.4	33.2
Savings/GDP	31.7	32.5	31.3	27.0	29.3	26.0	28.4	29.8	30.1	30.9
Exports/GDP	55.2	60.4	62.4	57.8	66.2	74.4	81.1	83.2	87.0	91.0
Real exports growth	8.4	12.8	8.9	(10.9)	11.7	9.6	7.8	6.8	6.8	6.8
Unemployment rate	22.4	20.7	17.3	16.4	15.7	14.5	14.0	13.6	13.2	13.2
External indicators (%)										
Current account balance/GDP	(0.6)	0.1	(3.0)	(2.9)	(3.0)	(7.5)	(5.5)	(3.9)	(3.3)	(2.3)

North Macedonia--Selected Indicators

Current account balance/CARs	(0.8)	0.2	(3.7)	(3.9)	(3.5)	(8.1)	(5.4)	(3.7)	(3.1)	(2.1)
CARs/GDP	75.4	79.8	80.4	74.3	85.9	92.4	102.1	104.4	107.3	110.2
Trade balance/GDP	(17.8)	(16.2)	(17.3)	(16.7)	(20.2)	(23.1)	(24.0)	(23.6)	(23.1)	(22.5)
Net FDI/GDP	1.8	5.6	3.2	1.4	3.3	4.3	3.0	3.0	3.0	3.0
Net portfolio equity inflow/GDP	(0.4)	(0.8)	(0.0)	(0.5)	(0.4)	(0.3)	(0.3)	(0.3)	(0.3)	(0.3)
Gross external financing needs/CARs plus usable reserves	106.0	109.1	111.7	113.8	113.1	116.9	114.0	112.7	112.2	111.0
Narrow net external debt/CARs	32.5	24.3	23.0	33.4	26.4	32.9	32.5	31.0	29.6	28.9
Narrow net external debt/CAPs	32.3	24.3	22.2	32.1	25.5	30.5	30.9	29.9	28.7	28.3
Net external liabilities/CARs	81.9	68.4	71.3	92.2	69.1	72.2	67.1	61.6	57.5	54.6
Net external liabilities/CAPs	81.3	68.5	68.7	88.8	66.8	66.8	63.7	59.4	55.8	53.5
Short-term external debt by remaining maturity/CARs	20.2	20.2	20.7	24.0	20.6	20.5	17.1	16.2	16.1	16.1
Usable reserves/CAPs (months)	1.7	1.2	1.3	1.4	1.1	1.1	0.9	0.7	0.7	0.8
Usable reserves (Mil. $)	1,008.6	1,152.5	1,137.3	1,153.1	1,267.0	1,105.4	1,105.9	1,201.8	1,373.5	1,586.3
Fiscal indicators (general government %)										
Balance/GDP	(2.8)	(1.1)	(2.1)	(8.2)	(5.4)	(4.3)	(4.1)	(3.4)	(3.0)	(2.4)
Change in net debt/GDP	3.2	1.6	3.5	7.5	5.4	5.6	4.7	3.2	2.8	2.2
Primary balance/GDP	(1.5)	0.1	(1.0)	(7.0)	(4.2)	(2.7)	(2.2)	(1.6)	(1.4)	(0.8)
Revenue/GDP	31.0	30.4	31.4	29.9	32.4	31.0	31.0	30.7	30.7	30.7
Expenditures/GDP	33.8	31.5	33.5	38.1	37.8	35.3	35.1	34.1	33.7	33.1
Interest/revenues	4.4	3.9	3.8	4.0	3.9	5.1	6.1	5.9	5.4	5.3
Debt/GDP	44.4	45.8	46.5	57.0	58.5	58.0	58.5	58.4	57.9	56.9
Debt/revenues	143.3	150.8	148.3	190.5	180.4	187.1	188.8	190.4	188.7	185.3
Net debt/GDP	40.4	39.3	41.0	50.0	51.8	52.0	52.9	53.2	53.0	52.2
Liquid assets/GDP	4.0	6.5	5.5	7.1	6.7	6.0	5.6	5.3	5.0	4.7
Monetary indicators (%)										
CPI growth	1.4	1.5	0.8	1.2	3.2	14.2	7.8	3.5	2.6	2.6
GDP deflator growth	2.8	3.9	0.9	1.4	3.6	10.0	5.6	3.0	2.8	2.8
Exchange rate, year-end (MKD/$)	51.3	53.7	55.0	50.2	54.4	57.7	57.5	55.0	53.5	53.5
Banks' claims on resident non-gov't sector growth	5.4	7.3	6.4	4.8	8.3	6.0	6.0	6.0	6.0	6.0
Banks' claims on resident non-gov't sector/GDP	48.8	49.0	49.7	53.9	54.2	51.4	50.6	50.6	50.6	50.6
Foreign currency share of claims by banks on residents	41.7	40.3	41.2	41.2	40.3	43.5	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	40.9	40.0	38.4	39.7	42.8	44.4	N/A	N/A	N/A	N/A
Real effective exchange rate growth	(0.5)	1.4	(1.7)	1.9	1.1	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).

North Macedonia--Selected Indicators

Adjustments: We adjust usable reserves by subtracting monetary base and required bank reserves on resident foreign-currency deposits from the reported international reserves. 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. MKD--Macedonian denar. 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

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/(current account receipts (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 gross government debt is denominated in foreign currency.
Monetary assessment	4	The North Macedonian denar is pegged to the euro. Furthermore, the National Bank of the Republic of North Macedonia benefits from a degree of operational independence; it uses market-based monetary instruments and has some ability to act as a lender of last resort for the financial system. Annual consumer price index is generally 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, 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 foreign direct investments inflows. It could also negatively impact the comparatively modest per capita income levels. Most importantly, we do not believe the indicative rating full captures the potential economic and political downside risks arising from the Russia-Ukraine conflict.
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, Jan. 4, 2023
- Sovereign Ratings History, Jan. 4, 2023
- Sovereign Risk Indicators, Dec. 12, 2022. Interactive version available at http://www.spratings.com/sri
- Economic Outlook Eurozone Q1 2023: Reality Check, Nov. 28, 2022
- Default, Transition, and Recovery: 2021 Annual Global Sovereign Default And Rating Transition Study, May 4, 2022

Ratings Detail (as of January 27, 2023)*

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.