Republic of North Macedonia
Ministry of Finance

ECONOMIC REFORM PROGRAMME
2025-2027

January 2025

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ABBREVIATIONS

AES	Automated Export System
CF	Christiano-Fitzgerald filter
CPI	Consumer price index
DSTI	Debt service to income ratio
DTI	Debt to income
EIB	European Investment Bank
ERP	Economic Reform Programme
FDI	Foreign Direct Investment
GDP	Gross domestic product
GVA	Gross Value Added
HICP	Harmonised Index of Consumer Prices
HP	Hodrick-Prescott filter
HPI	House Price Index
ICS	Import Control System
ICT	information and communication technology
ICP	Internal capital process
IIP	International investment position
IMF	International Monetary Fund
IPA	Instrument for Pre-Accession Assistance
IRENA	International Renewable Energy Agency
LGU	Local Government units
LTV	Loan to value
MAKStat	State Statistical Ofiice Database
MoF	Ministry of Finance
MSIP	Municipal Services Improvement Project
NBRNM	National Bank of the Republic of North Macedonia
NCTS	New Computerized Transit System
NECP	National Energy and Climate Plan
OECD	Organisation for Economic Cooperation and Development
PFA	Production Function Approach
PPP	Public-Private Partnership
RVETC	Regional Vocational Education and Training Centres
REER	real efective exchange rate
RES	renewable energy sources
SEPA	Single Euro Payments Area
SME	small and medium enterprises
SSO	State Statistical Office
TFP	total factor productivity
UNECE	United Nations Economic Commission for Europe
VAT	value added tax
VET	vocational education and training
VNFIL	Validation of Non – Formal and Informal Learning
WBIF	Western Balkan Investment Framework

1. Overall policy framework and objectives

Economic Reform Programme (ERP) is part of the European Semester Light procees for candidate countries, inspired by the European Semester for EU Member States. The process, introduced with the Enlargement Strategy in 2013, implies improvement of both the economic governance and the coordination of economic policies in order to ensure long-term economic growth and competitiveness in accordance with the requirements of the Copenhagen criteria for EU membership. ERP is the fundamental document for the Economic and Financial Dialogue between the Western Balkan countries and the EU, at which Joint Conclusions are adopted, with recommendations for priority reforms pertaining to fiscal and structural policies, which are to be incorporated in the national budgets, the implementation of which is monitored and assessed on annual basis.

According to the EU Guidance Note for the 2025 - 2027 Economic Reform Programme (June 2024) the Western Balkan countires shall not prepare the structural reform section of the ERP, considering that they have prepared a separate document Reform Agenda (RA) 2024-2027, setting out reforms and concrete steps for their achievement under the respective Reform and Growth Facility for the Western Balkans. As per the Guidance Note for ERP 2025-2027, Western Balkan countries are to give a brief overview in Chapter 5A of the reforms selected from the RA in terms of their impact on the economy.

Taking into account the new EU Guidance, 2025-2027 Economic Reform Programme gives an overview of the medium-term macro-economic and fiscal framework and monetary policy, level of implementation of the Joint Conclusions with recommendations for the fiscal and the monetary policies of the Economic and Financial Dialogue with the EU held in May 2024, as well as the potential impact of the reform measures selected within the Reform Agenda on the economy.

Facing slowdown economic growth following the post-pandemic recovery and limited fiscal room, in the 2024 - 2028 Fiscal Policy Statement, the new Government put the focus on tackling the challenge of fiscal consolidation in line with the fiscal rules, taking account of not jeopardising the investments and the policies necessary to encourage and accelerate the growth and significantly improve the standard of living. Hence, medium-term fiscal policy envisages gradual fiscal consolidation, whereby, as per the fiscal rules, budget deficit of 3% is expected in 2027, dropping further to 2.8% in 2029. To that end, tax system digitalisation aimed at reducing the informal economy and improving the revenue collection are expected to considerably contribute to the fiscal consolidation. Taking into account that growth in the coming period is based on gross investments, particular attention will be paid to improving the public investment management, all to the end of their implementation within the envisaged deadline. Considering that quality infrastructure enables the business to be competitive and to develop, to attract FDIs, and also improves the quality of life of the citizens, substantial capital investments are envisaged, with their average growth expected to account for around 8%. Moreover, fiscal policy envisages access to affordable financial resources for the private sector for investments which are to increase its productivity, with accelerated digitalisation of public services and coping with corruption expected to have a positive impact on the business environment. As regards fiscal consolidation, budget discipline, transparency and accountability will be strengthened, all to the end of significantly improving effectiveness and efficiency in spending budget funds. Given the fiscal room and the need to repay debt falling due, as well as the need for accelerated economic growth, public debt management policy will be aimed at ensuring the funds necessary for financing the deficit, thereby taking account of public debt sustainability.

With respect to price pressures on the economy, inflation is in line with the expectations and it is envisaged to decline and remain at 2%, amid stabilisation of prices of basic food products and energy products on the international market, slowdown of foreign effective inflation, as well as more moderate pressure from the core inflation. Current account deficit is envisaged to gradually narrow to around 2% of GDP in the coming medium term, as a result of the expected narrowing of the trade deficit. Amid significant slowdown of the pace of the domestic inflation, favourable foreign exchange market, as well as the monitoring of the monetary policy changes by ECB, starting September 2024, National Bank has commenced to prudently normalise the monetary policy. In September 2024, policy rate was reduced by 0.25 p.p., reaching 6.05%, while continuous favourable trends made room for additional reduction to 5.8% in October and 5.55% in December.

Chapter 5A, as per the new EU Guidance for 2025 - 2027 ERP, should present a summary overview of the impact of the measures selected from the Reform Agenda on the economy. With expert support within the regional EU project “Structural Reforms Better Integrated within Fiscal Frameworks - FISR2”, implemented by CEF, tool for selection of measures with a high potential impact on the economy was prepared. Hence, Chapter 5A presents a quantitative assessment of the measures pertaining to renewables and energy efficiency, VET and adult education, as well as digital services.

The Government adopted the Economic Reform Programme 2025 - 2027 at a session held on the 14th of January, 2025.

2. Implementation of the policy guidance

Joint conclusions - Policy guidance with recommendations	Activity and stage of implementation
Policy Guidance 1:	
P1: Implement the 2024 budget as adopted and ensure the fiscal target is met, in particular by controlling wage spending and reducing energy subsidies (as foreseen under the current IMF programme); adopt the budget for 2025 in a timely manner and in line with the fiscal rules.	- The main priority of the new Government was to deliver the revised budget as soon as possible, to ensure the normal functioning of institutions. In August 2024, the Assembly of the Republic of North Macedonia approved the Supplementary Budget for 2024. The amendments and additions to the Budget for 2024 are aimed at revising the initial fiscal projections in accordance with macroeconomic developments in the first half of the year, restructuring budgetary expenditures to service the highest-priority obligations, and optimizing the sources for financing the budget deficit. Based on the revised revenue and expenditure projections of the Budget, the initially planned deficit of 3.4% of the projected GDP has been revised to a higher level, set at 4.7% of the projected GDP. The deviation from the fiscal rule is primarily due to the need to secure necessary funds for the uninterrupted functioning of institutions and servicing of obligations. - With the Revised Budget, the salary item was increased by approximately 4.2 billion denars, due to obligations arising from the signed collective agreements and legal solutions adopted after the approval of the Republic of North Macedonia’s 2024 Budget. - Subsidies for energy are neither foreseen nor projected in the Budget for 2024 and the Budget for 2025. - At the beginning of December 2024, the Budget for 2025 was adopted, which is based on the Fiscal Policy Statement for the period 2024 - 2028 and the adopted Fiscal Strategy 2025-2029. The budget deficit is projected at an absolute amount of 41,350 million denars, or at a level of 4% of the planned GDP. The deviation from the fiscal rule for the budget deficit is due to the need to secure the necessary financial resources for

	obligations that cannot be resolved with a one-year Budget, as their nature is not short-term, but generates costs over a multi-year period, as well as for significant investment in road infrastructure and local infrastructure projects.
P2: Strengthen the administrative capacity for the regular preparation and publication of the tax expenditure report and explore all options to further broaden the tax base.	Within the Public Finance Management Reform Program, Pillar 1 / Priority 1, the following activities are planned for 2025: - Conducting training for staff to build expertise in tax expenditure analysis and methodologies for creating reports and publishing them. - Develop and implement a comprehensive tax expenditure reporting plan, focusing on establishing a robust framework for data collection and processing.
P3: Introduce an integrated approach for reducing the build-up of arrears of public sector entities, through putting in place an Integrated Financial Management Information System and by setting up an effective system for monitoring fiscal risks in the Ministry of Finance, including the fiscal risks stemming from SOEs and arrears**.**	- Activities for developing and establishing the Integrated Financial Management Information System (IFMIS) are ongoing. - In January 2024, a working group was established to monitor all fiscal risks, including the SOEs. With the support of the IMF, a special tool was developed to monitor these risks (Health Check Tool-HCT), to address them in a timely manner and strengthen the country's fiscal transparency. Additionally, for the first time, this process was implemented as a part of the Fiscal Strategy 2025-2029 (Fiscal Risks Chapter).
Policy Guidance 2:	
P4: Ensure timely implementation of the new Organic Budget Law (OBL) in its entirety by 2025, by adopting the necessary by-laws, in particular on budget classification and on the statement on fiscal policy; and by updating the manual on macro-fiscal projections.	In order to ensure the compliance of the IFMIS system, which is closely linked to several by-laws, it was necessary to extend the implementation deadline of the Budget Law for one year. The Law on Amendments and Additions to the Budget Law was adopted on December 27, 2024 ("Official Gazette of the Republic of North Macedonia" No. 272/24). In the third quarter of 2024, two by-laws were adopted: 1. Fiscal Policy Statement and 2. Fiscal Strategy - preparation, timeline and content of the document. On December 30, 2024, in accordance with the Budget Law, 17 bylaws were adopted ("Official Gazette of the Republic of North Macedonia" No. 277/24): 1. Rulebook on the form, content, establishment, and maintenance of the Register of Public Entities, 2. Rulebook on organizational classification, 3. Rulebook on economic classification, 4. Rulebook on program classification,

	5. Rulebook on functional classification, 6. Rulebook on budget classification by sources of financing, 7. Rulebook on the form and content of the template for assessment of the medium-term fiscal implications, 8. Guidelines for the preparation of macroeconomic and fiscal projections and the coordination process between organizational units and institutions involved in macroeconomic and fiscal planning, 9. Guidelines for planning of the budget liquidity, 10. Rulebook on the method for entering commitments in the budget for the current year, 10.1. Rulebook on the method for entering commitments in the budgets for the following years, and 10.2. Rulebook on the manner of the availability of spending rights in the budget prior to the commencement of the public procurement procedure, 11. Rulebook on the method of opening and maintaining foreign currency accounts, 12. Guidelines for managing liquidity in the system of a single treasury account, 13. Rulebook on the method and deadlines for submitting information provided by municipalities, other budget users, and other public entities managed by state or municipal financial resources, legal entities in which the state or municipalities have direct or indirect capital investments, and other legal entities, for the needs of the registry of shares, stakes, and participation in the capital of state and municipal legal entities, 14. Rulebook on the method of issuing approval for proposals to conclude financial leasing contracts by budget users of the state or budget of the municipality, 15. Form and content of the misdemeanor payment order. Additionally, the publication of additional two bylaws is expected, which have already been harmonized with the Legislation Secretariat: 1. Form of the structure and the content of the Gender Budget Statement, and 2. Decree on public investment management - The Fiscal Policy Statement, adopted in September 2024, establishes the basic principles and objectives of the fiscal policy that will be implemented during the mandate of the Government of the Republic of North Macedonia in the period 2024-2028, which are contained in the Fiscal Strategy, and will be implemented through macroeconomic policy, tax policy, budget policy and public debt policy.
P5: To improve public investment management,	In order to regulate the procedure for determining medium-term priorities and selecting new initiatives in the form of public investment projects, the

adopt a methodology/guidelines for appraisal of projects, in line with the recommendations of the IMF and the World Bank, and ensure sufficient training of staff in the new PIM department of the Ministry of Finance.	Ministry of Finance has prepared a Draft Decree on Public Investment Management, which, among other things, prescribes a methodology, contents, procedure, and criteria for project evaluation. It was conditionally adopted by the Government in July 2024. Namely, at the request of the Legislation Secretariat, the publication in the Official Gazette is conditional on the amendments to the organic Budget Law, i.e. it should be clearly stipulated in Article 20 that the Government should adopt a Decree as a by-law instead of a methodology, which, on the other hand, should be part of the Decree. The amendments to the OBL have been adopted and the Decree is in government procedure. The first training of officials from relevant public institutions on the basics of public investment management was conducted in May 2024, with technical assistance from the World Bank.
P6: To enhance private sector financing of public infrastructure projects based on a suitable regulatory framework, adopt the Law on Public Private Partnership.	A new Draft Law on Public Private Partnership has been prepared. With the Law on Amendments to the Law on Concessions and Public Private Partnership (Official Gazette No. 147 of 15.07.2024), the previously prescribed competence of the Ministry of Economy in the field of PPP and concessions has been transferred to the Ministry of Energy, Mining and Mineral Resources as the competent authority for this area.
Policy Guidance 3:	
P7: Ensure a sufficiently tight monetary policy stance as long as necessary to anchor inflation expectations at levels consistent with price stability and support the peg, underpinned by a thorough assessment of potential second-round effects.	Amid slowdown in inflation in line with the expectations and favorable foreign exchange market developments, in September and October 2024, the policy rate was reduced by 0.25 percentage points to 5.8%. In this period, interest rates on overnight and seven-day deposit facilities remained unchanged. Regarding the macroprudential policy, a decision to extend the countercyclical capital rate of 1.75% in the fourth quarter of 2025 was adopted in late September. Such policy setup is supportive to the overall macro financial stability in the economy. The National Bank continues to regularly monitor developments and regularly reassess the monetary policy setup according to a pre-determined and published calendar, thus maintaining the need for vigilance, taking into account the still existing risks from the external and domestic environment.
P8: Safeguard the independence of the central bank in its key statutory tasks, including in staffing and wage issues, by excluding the national bank from the scope of all related laws on administrative servants and public sector	The amendments to the Law on the National Bank, which provide that the National Bank employees are not administrative servants, were adopted in April 2024.

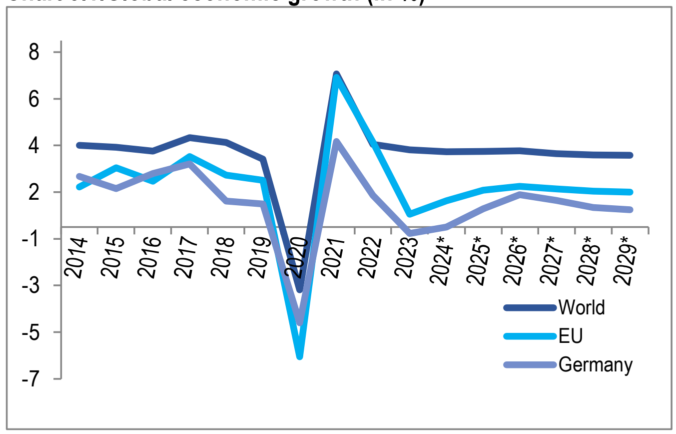
employees.	
P9: Further enhance risk-based supervision in line with best international and European practices, including by operationalising the Bank Resolution Law by amending by-laws and building capacity ahead of implementation, upgrading the deposit insurance law, further implementing measures to promote the role of the domestic currency and improving data collection, notably on real estate, to enable a comprehensive assessment of financial sector risks.	- In cooperation with the IMF, the Supervision Sector is carrying out a two-year pilot project to include the results of the banks' stress tests conducted using the bottom-up approach when determining the minimum capital requirement. Also, this project will improve the methodology for assessment of ICP (internal capital process) of the banks. Within the medium-term plan of the National Bank activities, the Supervision Sector is also taking activities to improve the supervisory risk assessment methodology and incorporate climate risks into such methodology. At the same time, activities are taken to improve the by-laws which prescribe the requirements for the banks' information system security according to EU standards; - On 1 January 2024, the new Decision on the methodology for credit risk management started to be applied, which introduces a new definition of non-performing loans, which is fully harmonized with the definition applied in the EU; - The development of the entire by-laws arising from the Law on Bank Resolution is under way, which, in accordance with the Law, should be adopted by the National Bank Council not later than April 2025; - From 1 August 2023, a countercyclical capital buffer rate for the exposures to clients from the Republic of North Macedonia of 0.5% started to be applied, which from 1 January 2024 to 30 June 2024 equals 0.75%, from 1 July to 30 October the rate equals 1%, 1.25% from 1 November 2024, 1.5% from 1 January 2025 and 1.75% from 1 August 2025; - The National Bank regularly monitors the banking sector developments and risks and is ready to use all the necessary instruments and measures that will contribute to maintaining financial stability; - Within the IPA project for HICP and HPI, in its final report, the SSO has submitted to Eurostat updated calculations for the experimental Real Estate Index for the period 2016-2022. Efforts are made to validate the administrative data from the Cadaster for 2023 and upon obtaining the data for the entire 2024 and their validation, the indices for these two years will be calculated.

3. Macroeconomic Framework

3.1 Recent Economic Developments

International Economic Environment[1]**.** Throughout 2024, global economy showed resilience, underpinned by the strong private consumption in the major economies, with a stable growth, while inflation declined. Disinflation makes room for gradual easing of the monetary policy, a process already commenced also in the advanced economies. The process of disinflation is not proceeding at the same pace in all countries, primarily due to inflation in the service sector, which is slowing the pace of reduction in overall inflation. Still, despite the turbulent period, the world avoided a recession, the banking system proved largely resilient, and the major emerging market economies did not suffer substantial shocks, although the pace of economic expansion is low by historic standards.

Chart 3.1.Global economic growth (in %)



Source: International Monetary Fund, October 2024 (forecast)

According to IMF October 2024 forecasts, global growth is expected to hold steady at 3.2% in 2024 and 2025, remaining unchanged from those in both April and July 2024 WEO. Growth in the advanced economies is projected at 1.8% in 2024 and 2025 and remains almost unchanged. However, if analysing the countries separately, notable revisions have taken place, with upgrades to the forecast for the United States offsetting downgrades to those for the largest European countries. Growth in the developing economies is expected to be 4.2% in 2024 and 2025, amid disruptions to production and shipping of commodities (especially oil), conflicts and extreme weather events. Economic growth in the EU is expected in 2024, being projected at 1.1%, before rising to 1.6% in 2025. Germany, as a country to which the domestic companies export the most, is facing stagnation in 2024, with zero growth being projected, due to the high uncertainty affecting the consumption and the investments and the deteriorated trade outlook, while in 2025, GDP growth is expected to gradually pick up to 0.8%. Over the medium term, global growth in the period 2025 - 2029 is projected at 3.1%, while average economic growth in the EU during the respective period is projected at 1.6%. If the forecast for global growth five years from now is analysed, it is considerably lower compared to the pre-pandemic period. Such low growth is a result of persistent structural headwinds, such as population aging and weak productivity, which are holding back potential growth in many economies (Chart 3.1).

Global inflation is expected to fall from an annual average 6.7% in 2023 to 5.8% in 2024 and 4.3% in 2025. Thereby, advanced economies are expected to return to their inflation targets sooner than emerging market and developing economies. However, as global disinflation continues to progress, certain challenges are still possible. Although goods prices have stabilised, services price inflation remains elevated in many regions.

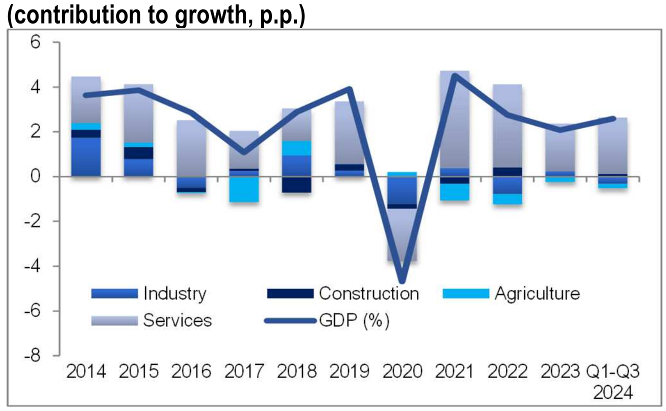
Gross Domestic Product. Economic activity in Q3 2024 accelerated, registering real growth of 3.0%, following the growth of 1.9% in Q1 and 2.8% in Q2, accounting for economic growth of 2.6% in the first nine months of the year.

Analyzed by sectors, main driving force of growth in the first three quarters of 2024 was the services sector, supported by construction activity. Activity in the services sector picked up by 4.3%, with the activities Trade,

[1] International Monetary Fund "World Economic Outlook", October 2024.

transport and hospitality industry contributing the most to the growth (6.9% growth). Professional, scientific and technical activity and Arts, entertainment and recreation also registered significant growth of 9.2% and 7.7% respectively. Construction activity surged by 2.4% in real terms. Decline was registered in the industrial and the agriculture sectors of 1.9% and 3.0% respectively.

Chart 3.2. Economic growth structure by production approach (contribution to growth, p.p.)

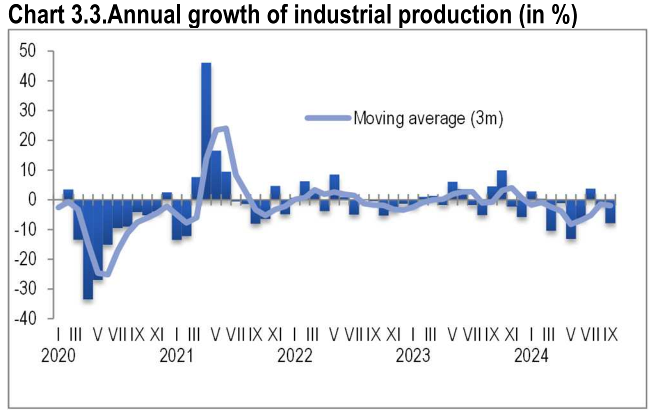


Source: SSO and MoF calculations

Analysed according to the expenditure side, growth of economic activity in this period was a result of the stronger domestic demand, amid increased consumption and scaled-up gross investments, while the contribution of net export thereto was negative. Consumption surged by 3.1% in real terms in the first nine months. Thereby, private consumption surged by 1.6%, mostly as a result of the growth of the household disposable income amid increase of employment, wages and pensions in the economy, also underpinned by the crediting to households. Public consumption grew by 10.0% in real terms. Gross investments surged by 1.2% in real terms, mainly as a result of the increased investments in fixed assets (nominal growth of import of capital goods by 16.9% and machinery and equipment by 10.7%) and decreased inventories (nominal decline of import of intermediary goods by 6.8%) (Chart 3.4). Decreased external demand also resulted in drop of foreign trade, whereby both export and import of goods and services decreased simultaneously by 3.0% and 1.4% respectively in real terms in the period January - September 2024. This was also contributed to by the further stabilization of trade among some companies in the automotive sector, following the high levels reached in the previous period.

According to high-frequency data, industrial production recorded slower downward pace, whereby it registered 2.1% decline, following 3.1% and 7.1% drop in Q1 and Q2 respectively. Still, on cumulative basis, industrial production decreased by 4.2% in the first nine months of 2024, amid declined activity registered at all sectors, with electricity supply sector having the highest negative contribution thereto. Continuous decline in the production was registered at this sector in the first nine months of 2024, while in 2023 high annual growth rates were recorded as a result of the measures aimed at supporting full utilisation of the domestic electricity generation capacities. In the period January – September 2024, retail trade recorded growth of 2.4% in real terms. Value of performed construction works in the period January - September 2024 experienced an annual growth of 15.8% in real terms, amid increased activity at buildings and specialised construction works, and declined activity at civil engineering structures. Export of goods declined by 6.1%, with import of goods registering an increase of 0.5%. Export decline was mainly due to reduced export of chemical materials and products, road vehicles, iron and steel, electricity and wearing apparel, while import

Chart 3.3.Annual growth of industrial production (in %)

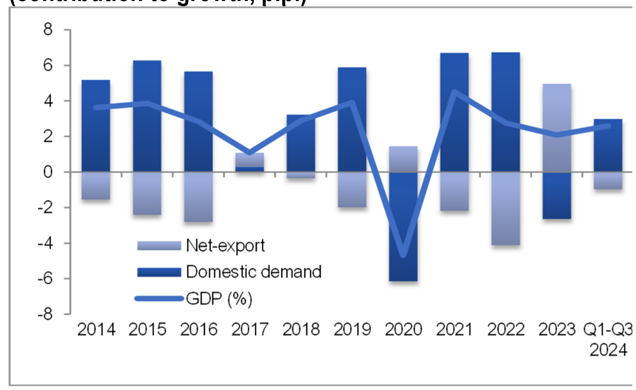


Source: SSO

decrease was mostly a result of declined import of non-ferrous metals industrial and natural gas, non-organic chemical products and oil.

2024 Estimate. In 2024, GDP is expected to grow by 2.1% in real terms, mainly supported by stronger domestic demand, i.e. increased private consumption and scaled-up gross investments, with net export expected to have a negative contribution thereto, amid weak international environment, above all at the key trading partners.

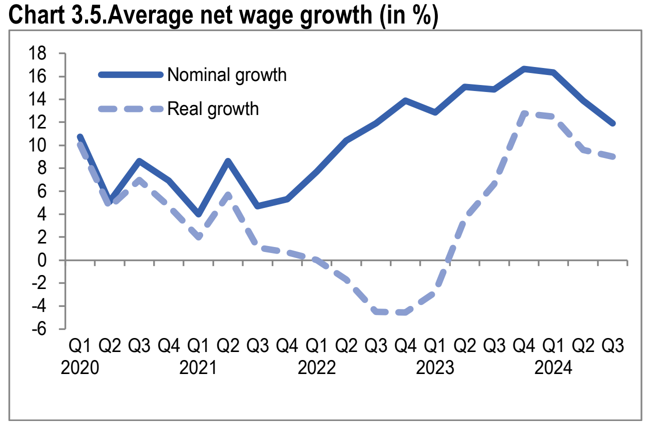
Chart 3.4. Economic growth by expenditure approach (contribution to growth, p.p.)



Labour market. Positive trend on the labour market continued in 2024 as well, amid unemployment reduction and employment growth. As per the most recent data of the State Statistical Office, unemployment rate in Q3 2024 accounted for 12.3% at the category aged 15 to 74, decreasing by 0.5 p.p. compared to the Q3 2023. Unemployment rate at the category aged 15 to 64 accounted for 12.5%, while accounting for 23.6% at the youth population (aged 15-29 years) and, compared to Q2 2024, it decreased by 0.4 p.p. each. Unemployed persons aged 15 to 74 totalled 98,322 in Q3 2024, declining by 3.7% (3,812 persons) on annual basis.

In Q3 2024, employment rate at the category aged 15 to 89 accounted for 46.1%, while accounting for 58.2% at the category aged 15 to 64. Compared to Q3 2023, employment rate as regards the above-mentioned categories increased by 0.4 p.p. and 1.1 p.p. respectively. Thereby, employed persons at the category aged 15 to 89 totalled 698,411 persons in Q3, increasing by 0.8% (5,643 persons) on annual basis. As for persons aged 15 to 29, employment rate accounted for 37.1%, being higher by 4.1 p.p. compared to Q3 2023.

Chart 3.5.Average net wage growth (in %)



In terms of activity, active population aged 15 to 89 totalled 796,733 people, accounting for 52.6% of the total working-age population. As regards the category aged 15 to 64, activity rate accounted for 66.5%, while at the youth population aged 15 to 29 years, it accounted for 48.5%.

Average net wage increased by 9.8% in September 2024 compared to the same period last year, being higher by 7.0% in real terms. In September, increase of net wage was registered in all sectors, the highest being observed in the administrative services, manufacturing and arts, entertainment and recreation.

External Sector. In the first three quarters of 2024, the balance of payments' **current account** registered a minor deficit of only 0.2% of GDP (moderate surplus of 1.2% of GDP in the same period last year). Analyzed by components, this widening is due to the moderately increased trade deficit, lower net inflows in the secondary income, as well as slightly widened primary income deficit, as opposed to the higher surplus in services compared to the same period last year. Regarding secondary income, the net inflows based on purchased cash foreign currency on the currency exchange market (used as an indicator of the cash private transfers) were lower by 6.3% compared to the same period last year.

Table 3.1. Balance of Payments

(% of GDP)	2020	2021	2022	2023	I-IX.2024
Current account deficit	-2.9	-2.8	-6.1	0.4	-0.2
Goods, net	-16.6	-19.7	-26.7	-19.3	-15.1
Services, net	3.9	4.2	5.7	5.4	6.3
Primary income, net	-3.8	-4.4	-4.4	-5.4	-4.1
Secondary income, net	13.6	17.1	19.2	19.7	12.6
Financial account, net (without foreign reserves)	3.8	4.7	7.9	3.7	2.1
FDI, net	1.4	3.3	5.0	3.6	4.9
Portfolio investments, net	2.6	1.0	0.4	-0.2	-1.5

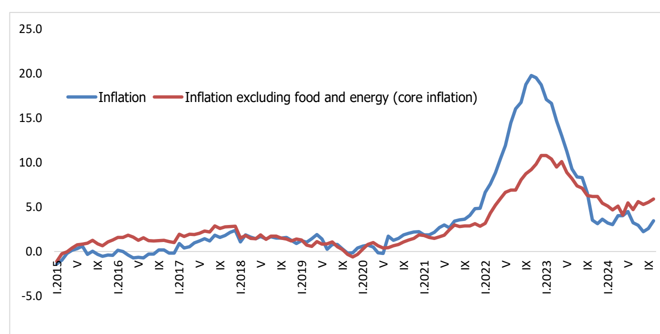
Source: NBRNM, SSO; NBRNM forecast for GDP in 2024.

Regarding the **financial account**, in the first three quarters of 2024 net inflows were registered, which originated mainly from the foreign direct investments (FDI) and government borrowings from abroad. The FDI, net, equaled Euro 715 million, or 4.9% of the GDP, which is significantly more compared to the same period last year (2% of the GDP). These inflows were registered as a result of positive developments in the equity and reinvested earnings and simultaneously, net inflow based on intercompany lending.

At the end of September 2024, the gross foreign reserves amounted to Euro 4,407 million, which is by 2.9% less compared to the end of 2023[2]. Cumulatively, this change in foreign reserves is mainly due to the outflow based on government transactions, which, in most part, was offset through the net purchase on foreign exchange market by the National Bank. Foreign reserves are maintained at an adequate level, providing 4.3-month coverage, on average, of the next year import of goods and services.

Inflation. In line with the global market developments and the measures taken, the average annual inflation rate of 14.2% in 2022 decreased to 9.4% in 2023. In the first nine months of 2024, the average annual inflation rate kept declining and fell to 3.3%, given lower contribution of all three components (food prices, energy and core inflation). In September, a measure to limit the gross profit margin of some basic food products in wholesale and retail trade, valid until the end of October, was adopted, while at the end of September implementation of the Law on Prohibition of Unfair Trade Practices began, which is expected to have an additional impact on price reduction in the future. In the period January – September, the core inflation (excluding food and energy) decelerated, as well and equaled 5.1%, on average (according to the NBRNM calculation). The main contribution to the average core inflation arises from the higher prices in "restaurants and hotels" category, given additional contribution also of almost all other items within the index, as well as the effects of the one-time non-market price changes (higher excises on tobacco). Within the National Bank's Inflation Expectations Survey, conducted in September 2024, the surveyed economic analysts expect that inflation deceleration will continue in the next two years, considering expectations for more moderate price pressures due to the gradual

Chart 3.6. Inflation (annual changes, in %)



Source: SSO, NBRNM calculations.

[2] At the end of October 2024, compared to the end of 2023, gross foreign reserves were 9.6% higher, with an inflow in October based on the loan from the Hungarian government.

stabilization of food and energy prices, measures taken by policymakers, as well as the slowdown in foreign inflation**.**

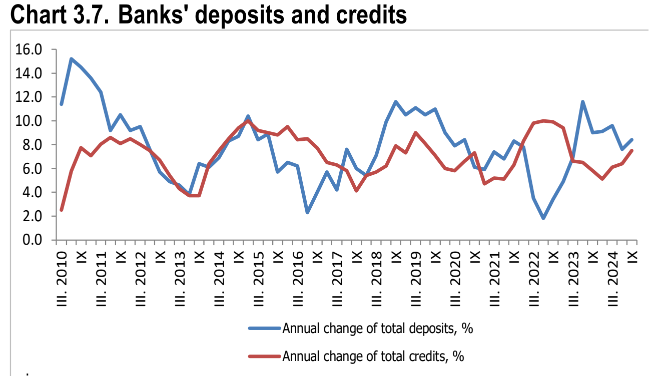
Monetary Developments and Exchange Rate. In conditions of a disrupted global environment and rising world prices of basic products that led to inflation acceleration, since April 2022, the National Bank has begun to increase the policy rate gradually, which continued throughout 2023, reaching 6.3% in September 2023. As of August 2024, the level of the policy rate has been retained unchanged, amid a gradual inflation and inflation expectations slowdown, as well as solid developments in the foreign exchange market. At the same time, the inflation gap relative to the euro area also narrowed. Monetary tightening was accompanied by changes in reserve requirements aimed at denarization support, adopting also several macroprudential measures that contributed towards further strengthening of the banks' capital base and their resilience to shocks. In September 2024, the National Bank reduced the policy rate from 6.3% to 6.05%, in line with the registered slowdown in inflation and inflationary trends and favorable developments in the foreign exchange market.[3] In doing so, changes in the ECB's monetary policy setup were also taken into account, which in September reduced the policy rate for the second time this year.

In August 2020, the ECB announced that for the first time it extended to the National Bank of the Republic of North Macedonia a euro repo line, with a possibility of utilization, initially until June 2021, then prolonged until March 2022, but taking into account the global effects of the Russian-Ukrainian crisis, the utilization was again prolonged for several times, with the latest prolongation until January 2025. The repo line is intended for providing additional foreign currency liquidity in the banking system, if necessary, and a significant support while dealing with the pandemic-related crisis and the consequences of the Russian-Ukrainian conflict (no funds from this line have been used so far).

The monetary aggregates growth has been maintained, with the broad money M4 registering an annual increase of 8.6% at the end of September 2024 (increase of 8.7% at the end of 2023). Simultaneously, in September 2024, total private sector deposits were higher by 8.8% on an annual basis (compared to 8.7% at the end of 2023). Analyzing by sector, the growth of household deposits accelerated and in September 2024 reached 11.2% (at the end of 2023 they increased by 7.9%), while the growth of corporate deposits decelerated to 4.7% (by 13.2% at the end of 2023). At the end of September, approximately 70% of the annual growth of total deposits resulted from the growth of household deposits. Analyzed by structure, the annual growth of total deposits stems from the growth of long-term deposits and transaction deposits (with an almost equal contribution), while short-term deposits recorded a slight decline.

Regarding currency, the growth of denar deposits (including transaction deposits) accelerated and at the end of September 2024 amounted to 13.1% annually, while the growth of foreign currency deposits (including deposits with a currency clause) continued to slow down and in September equaled 3.6%, indicating further normalization of currency preferences among economic agents (after the period of the global energy crisis). The share of deposits with currency component (foreign currency and foreign currency clause) in total deposits at the end of the third quarter of 2024 was 42.5%, which is lower compared to the end of

Chart 3.7. Banks' deposits and credits



Source: NBRNM.

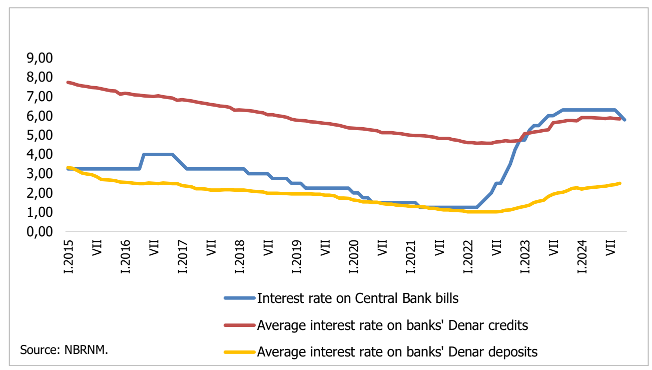
[3] In October, the policy rate of the National Bank reduced additionally to 5.8%.

2023 (43.1%), as well as relative to the period of energy crisis in mid-2022 (46%).

In 2024, amid further economic upturn and solid deposite base, the bank lending to private sector moderately accelerated. In September 2024, the annual credit growth equaled 7.5% (as opposed to 5.1% at the end of 2023). Larger acceleration was registered in corporate loans, given simultaneous acceleration in household loans, with the corporate loans registering annual growth of 7.5%, while the household loans were higher by 7.7%, annually. In September, about 54% of the annual growth of total loans resulted from the growth of corporate loans. According to the Lending Survey, despite small changes in the first quarter, in the second and third quarter of 2024, banks experienced a moderate net easing of lending standards for enterprises and households, while at the same time, the demand for loans in these two sectors increased.

The interest rates of the banking sector have risen moderately since mid-2022, in conditions of inflationary pressures and gradual monetary policy tightening. At the end of 2023, the interest rates on the foreign currency loans started to decline gradually, while the denar loans registered a decrease in September 2024. The deposit interest rate kept increasing. The average weighted interest rates on denar loans and denar deposits equaled 5.8% and 2.5% in September 2024 and compared to December 2023 they were higher by 0.1 and 0.2 percentage points, respectively. Interest rate spread between denar lending and denar deposit interest rate decreased by 0.2 percentage points compared to the end of 2023 and equaled 3.3 percentage points. In September 2024, the average interest rates on foreign currency loans equaled 4.8%, which is by 0.3 percentage points less compared to the end of the preceding year, while the average interest rates on foreign currency deposits were 1.6% or 0.2 p.p. more compared to the end of the last year, thus the interest rate spread narrowed by 0.5 percentage points compared to December 2023, and reached 3.2 percentage points. The interest rate differential between total denar and foreign currency deposit interest rates remained unchanged and equaled 0.9 percentage points in September 2024. The interest rates on the newly received denar and foreign currency deposits in banks in the first nine months increased by 0.2 percentage points compared to the end of the previous year, whereby the interest rate differential in the newly received denar and foreign currency deposits remained unchanged and equaled 0.8 percentage points.

Chart 3.8.Interest rates (in %, on annual basis)



Source: NBRNM.

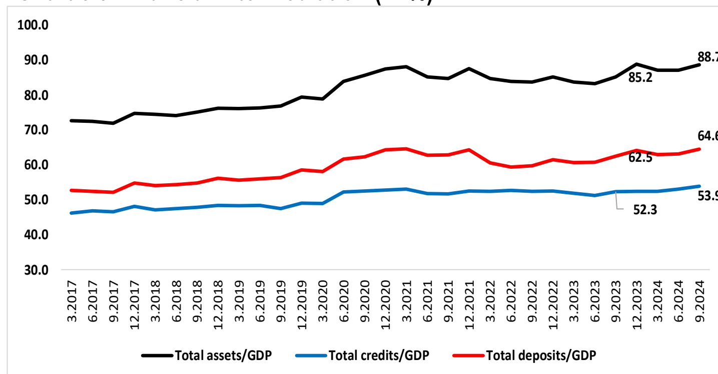
The **financial system** has a simple structure, low inter-institutional connection and small exposure to the transmission risk, as well as absence of more complex financial instruments and services. Combined products are less, although their share increased. Throughout 2023, the financial institutions operating environment gradually stabilized, although risks and uncertainties, mainly associated with the external environment and the impact of the geopolitical turmoil, were still present.

Banking System. The banking sector is the main segment of the financial system, where the savings of the non-financial sector and the liquidity of other financial institutions being concentrated in, and therefore, crucial for the financial stability of the country. The share of the banks in the financial system, as measured by the amount of assets, has been gradually declining over the years, and as of 31.12.2023 it equaled 77.7%[4]. As of

[4] Source: Financial Stability Report for the Republic of North Macedonia in 2023, National Bank of the Republic of North Macedonia.

30.9.2024, there are thirteen banks in the Republic of North Macedonia. Nine of them are banks in predominant foreign ownership, five of which are subsidiaries of foreign banks. Foreign banks (mainly from the EU countries) dominate almost all the important positions of the banking system's balance sheets. The concentration in the banking system, measured by the Herfindahl index is within acceptable values of this index.

Chart 3.9.Financial intermediation (in %)



Source: NBRNM. Note: The data for September 2024 are calculated based on the latest available GDP data for the second quarter of 2024.

In the third quarter of 2024, banks operated in a more favorable macro environment with a significant slowdown in domestic inflation, a favorable foreign exchange market, and still present risks mainly related to current geopolitical tensions. The National Bank began with prudent normalization of the monetary policy. Regarding the macroprudential policy, in late September a decision on extending the countercyclical capital buffer rate of 1.75% in the fourth quarter of 2025 was adopted. Such policy setup underpinned the overall macrofinancial stability in the economy. The balance sheet (assets) of the banking system increased in the third quarter of the year (by 1.8%), and the annual growth rate accelerated to 8.7%. The risk exposure indicators of the banking sector were stable, while the stress tests indicate a solid capacity to deal with assumed shocks. However, the environment remains vague, with the risks to the world and domestic economy still persisting. Hence, there is a need for further prudent risk monitoring and policy conduct in order to preserve the banking sector stability in the following period.

In the third quarter of 2024, **the deposits and loan performance** was favorable. The growth in the bank deposits remained solid, thus enabling maintenance of the credit growth. As of 30.9.2024, the shares of total assets of the banking system, loans and deposits in GDP equaled 88.7%, 53.9% and 64.6%[5], respectively.

Credit risk is the most prevalent risk in the bank operations, but the exposure to this risk is moderate. In the third quarter of 2024, non-performing loans to non-financial entities decreased (by 1.1%), contrary to the increase in the previous two quarters.[6] Their decrease resulted entirely from corporate loans (a decline of 6.1%, analyzed by individual clients, slightly over half of the quarterly decline in non-performing loans results from collection), given a slower quarterly growth in non-performing loans of households (since the beginning of 2024, there has been an increase in households' non-performing loans, which is mainly an effect of the different methodological approach in determining the non-performing status due to the regulatory changes that were in effect from 1 January, 2024). Thus, on 30 September 2024, the rate of non-performing loans in the enterprise portfolio was reduced to a new historical minimum (3.5%), and in households, it equaled 2.6%. The coverage of non-performing loans with impairment for anticipated credit losses is traditionally solid, while the non-provisioned part of the non-performing loans accounts for only 4.9% of banking system's own funds, which limits the potential risks to the banking system solvency amid assumed complete default of non-performing loans. The results of the credit risk stress-test simulations confirms the banking sector resilience to assumed extreme deteriorations of the credit portfolio risk. Prolonged and restructured loans, which are mainly part of the corporate credit

[5] The data pertaining to September 2024 are calculated using the latest available GDP data for the second quarter of 2024.

[6] As of 1 January 2024, the new Decision on the methodology for credit risk management has been in effect, which introduced certain methodological changes, which have effects on the amount of non-performing loans and on some of the credit risk exposure indicators, which was particularly pronounced in the first quarter of the year as an initial effect of the new regulation. The Decision is available at the following link: https://www.nbrm.mk/content/Regulativa/Odluka_metodologija_%20za_krediten_rizik_nova.pdf

portfolio, for now, are not a source of risk for larger deterioration in the credit portfolio quality of the domestic banking system, due to their relatively low share in total loans (3.9% and 1.6%, respectively as of 30.9.2024). Given the still present environment-related risks, the banks need to remain cautious in credit risk management.

The banks' exposure to interest rate risk in the banking book is twice lower than the prescribed limit (20%) and as of 30.9.2024 it equals 11.4% of own funds. On the other hand, exposure to indirect interest rate risk remains present due to the significant presence of loans with variable and adjustable interest rates in the banks' loan portfolio, which is particularly significant if interest rates rise.

The banking system's exposure to currency risk is not high and in the third quarter of 2024 the open foreign currency position equaled 7.3% of own funds (significantly below the regulatory limit of 30%). Indirect exposure to currency risk has decreased, given a reduced share of loans with foreign currency component in total loans to the non-financial sector (resulting mainly from the lower share of corporate loans with a currency component). However, there is still a significant share of loans with foreign currency component, but the risk of indirect currency risk materialization was mitigated due to the implementation of the exchange rate targeting strategy.

Profitability. Banking system is profitable. The profit of the banking system for the first nine months of 2024 increased by 22.9% (the increase registered in the same period of the previous year equaled 50.5%). The higher net interest income contributed the most to the profit growth (the net interest income increased by 14.7%), while the contribution of net income from fees and commissions (with a growth of 8.1%) was also positive, but far smaller. The rates of return on average assets and the rates on return on average equity equaled 2.6% and 20.2%, respectively (2.1% and 17.1%, respectively last year). The operational efficiency indicators improved despite the increase in the operating costs. The net interest margine expanded further, reaching the level of 4.3% (September 2024).

Liquidity risk. The banking system traditionally maintains a high volume of liquid assets, which enabled high resilience to shocks, as well as satisfactory capacity for timely and regular servicing of liabilities. In the third quarter of 2024, the increase in liquid assets of the banking system contributed for improved liquidity indicators, which remained stable and within satisfactory levels. Thus, as of 30.9.2024, the liquid assets account for 30.9% of the total bank's assets, while the coverage of short-term liabilities and household deposits with liquid assets amounts to 54% and 61.3%, respectively. The Liquidity Coverage Ratio of the banking system equals 289.7%, which is significantly higher than the regulatory minimum (100%), thus confirming that there is sufficient liquidity available to the banking system. The stress test results indicate satisfactory resilience of the banking system to the assumed extreme, individual and combined liquidity outflows.

Table 3.2 Main banking system indicators (in %)

	2017	2018	2019	2020	2021	2022	2023	9.2024
Capital adequacy								
Capital adequacy ratio	15.7	16.5	16.3	16.7	17.3	17.7	18.1	19.0
Assets quality								
Non-peforming loans /total loans (non-financial sector)	6.3	5.2	4.8	3.4	3.2	2.9	2.8	3.0
Total loans impairments /non-performing loans (non-financial sector)	110.7	118.9	109.6	141.1	134.1	148.8	150.4	132.3
Profitability								
ROAA	1.4	1.7	1.3	1.3	1.5	1.5	2.0	2.6
ROAE	13.5	16.0	11.7	11.3	12.9	12.2	16.1	20.2
Operational costs/total regular revenues	48.7	46.2	50.1	48.2	47.4	47.8	43.4	41.3
Liquidity								
Liquid assets/Total assets	29.8	30.6	31.9	32.5	32.4	30.0	31.8	30.9
Liquid assets/Short-term liabilities	51.7	53.2	54.8	53.8	52.3	47.7	52.3	54.0
Market risk								
Net foreign exchange position/own funds	6.2	3.8	6.0	10.1	2.1	6.7	10.7	7.6

Source: National Bank of the Republic of North Macedonia

Insolvency Risk. The banking system has high-quality capital positions, which enable satisfactory resilience to possible stress situations. The banking system is well capitalized and the solvency registers an improvement in the first three quarters of 2024, which is mostly due to the retained bank earnings from last year. The capital adequacy ratio equaled 19%, which is the highest value since 2006. About one tenth of own funds remains free after being used for meeting the regulatory and supervisory requirements in relation to the banks' capital levels. This surplus, together with the capital buffers are especially important in conditions of crisis episodes, when they can be used to deal with challenges of different nature and intensity.

Stress testing. The resilience of the banking sector to shocks is also confirmed by the conducted stress-tests, which show good capacity of banks to absorb credit losses, even in case of extreme and slightly plausible shocks, which would mean more pronounced materialization of the credit risk. The results of the conducted stress testing in the third quarter of 2024 indicate that the capital adequacy ratio of the banking system does not go below 8% in individual hypothetical simulations. The hypothetical shocks on the part of the credit risk have the greatest impact on the stability of the banking system, and the results of the stress-test simulations for materialization of the credit risk indicate that it takes 19.6% of the regular credit exposure to the non-financial sector to receive a non-performing status, for the capital adequacy of the banking system to reduce to 8%. This result is better than that registered in the preceding quarter, as well as than the one registered in the same quarter of the previous year.

Macroprudential framework. After the enforcement of the new Law on Financial Stability in August 2022, the Financial Stability Committee and the two subcommittees acting as auxiliary bodies of the Committee (Subcommittee for Monitoring Systemic Risks and Proposing Macro Prudential Measures and Subcommittee for Financial Crisis Management) have been holding regular meetings, which discuss matters within the competence of these bodies in accordance with the Law.

Based on this Law, as well as according to the Banking Law, the National Bank has undertaken several macro prudential measures so far:

- capital conservation buffer, set at 2.5% of the risk-weighted assets, effective since 2017 and applicable to all banks;
- capital buffer for systemically important banks - according to the latest calculations based on the data for 2023, 7 systemically important banks have been determined, which until 31 March 2025, should achieve and maintain a rate of the capital buffer for systemic importance that ranges between 1% and 2.5% of risk-weighted assets;
- A countercyclical capital buffer of 0.5% applicable from 1 August 2023, aimed to respond to the estimated gradual accumulation of cyclical systemic risks related to the environment, housing loans and real estate prices. Consequently, the level of this countercyclical capital buffer has been elevated in several occasions, and at the end of September, a decision on extending the implementation of the countercyclical capital buffer of 1.75% also in the fourth quarter of 2025 was made;
- the systemic risk buffer equals 0%, and the National Bank continuously monitors the movements and evaluates the need for introducing this buffer;
- macro prudential measures for the credit demand quality have been introduced since 1 July 2023, as follows:
    - DSTI (debt service to income ratio) at the level of 55% for newly approved denar loans to individuals and 50% for newly extended loans with a foreign currency component to individuals,
    - LTV (loan to value) ratio at the level of 85%,

- Limiting the maturity of housing loans and other mortgage loans to 30 and 20 years, respectively,
- Defining the DTI (debt to income) indicator, the amount of which has not been prescribed for now,
- 10% permissible exception from the prescribed value and these indicators.

Performance of the non-financial sector. The non-financial sector is vulnerable to the risks from the environment and the shocks that could adversely affect the household income and the activities of the corporate sector. Such a risk has been currently mitigated by the good financial position of both households and corporate sector, but the debt should be managed carefully and prudently, in order to ensure its sustainability also in the following period.

In 2023 the risks to financial stability related to **household sector** remained moderate. Solvency and liquidity ratios of the household sector remain within the level that has been characteristic for the several previous years, indicating limited sensitivity to shocks and the relatively limited systemic vulnerability of this sector. Disposable income, which is the basis for the sustainability of the household debt as a whole, as well as for generating savings, taking financial risks through investments and subsequent increase in the financial funds, although at slower pace, continued to grow in 2023, as well. The household debt kept increasing, although the household debt ratio remained stable at the level of about 30% of the GDP. However, the enduring uncertainty in conditions of price pressures despite inflation stabilization trends, create risks for the income and the future creditworthiness of the households, to which the lower income segments are particularly sensitive. In that regard, the National Bank undertook macroprudential measures pertaining to the quality of the individuals' credit demand (from mid-2023), which affect the individuals' credit demand quality, in order to prevent excessive indebtedness of individuals during the period of rising prices and interest rates, and consequently, to maintain the banking stability. The bank data show that the level of the applied amount of DSTI and LTV indicators is relatively prudent and as of 30.9.2024 they are 34% (prescribed limit of 55% for denar and 50% for loans with currency clause) and 62% (prescribed limit of 85%), on average, respectively.

Through 2023, the profitability of the **corporate sector** continued to increase, although at a slower pace compared to the previous year, and the debt ratio measured by the debt-to-GDP ratio is slightly higher compared to the previous year. Non-residents are still the main creditor of the domestic corporate sector, with the indebtedness towards domestic banks recording slower growth, in conditions of reduced supply and demand for loans and tight financial conditions. The risks for the corporate sector operating are still associated with the possible deterioration of the geopolitical and economic context, which can disrupt the financial position of the companies, and the risks are especially high for the most financially vulnerable and highly indebted entities. Hence, vigilance and prudent debt management, accompanied by sustainable measures and policies that will improve productivity and competitiveness in operations, as well as in the context of climate-related risk, should be considered as important factors for the sustainability of the corporate sector on the medium and long run.

The structure of household debt, and especially corporate debt, exposes them to interest rate risk (47% and 24% of corporate and household debt has variable interest rates), which is accentuated if there are conditions for rising interest rates, as well as to currency risk (74.7% and 45% of corporate and household debt is denominated in foreign currency), which is, however, limited due to the exchange rate targeting strategy.

Submission of an application for joining SEPA. The National Bank, in its capacity as regulatory and supervisory institution for payment service providers in the country, on 10 July 2024, submitted formal application for the country's accession to the Single Euro Payments Area (SEPA), which is a historic step forward for the further development and integration of the domestic financial system into the European economy. The country's membership in SEPA will bring numerous benefits for the citizens, companies and overall economy, by enabling faster, more efficient and cheaper euro payments to and from SEPA member countries, simplified procedures, greater transparency and enhanced consumer protection.

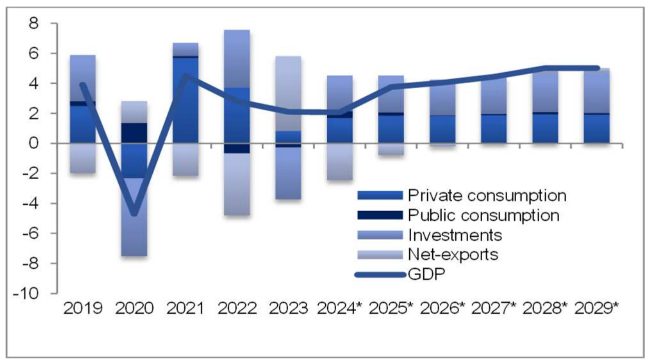
The benefits of joining SEPA are very significant for citizens and companies, considering that the majority of cross-border payments are made in euros. In 2023, 87% of total outflow payments, i.e. 77% of total inflow cross-border payments at domestic banks were made in euros, hence the efficiency of payments in SEPA will also contribute to reducing the use of cash, prioritizing the use of digital payment methods and encouraging the transition to a modern digital society. For businesses, joining SEPA will provide easier access to the EU market, facilitating cross-border trade in goods and services.

3.2 Medium-Term Macroeconomic Scenario

Gross Domestic Product. As per the baseline macroecnomic scenario, economic growth is projected at 4.5% in the period 2025 - 2059. It will be driven by domestic demand, i.e. gross investments and private consumption.

2025 - 2029 medium-term macroeconomic scenario includes the assumptions, the projects and the measures incorporated in the Work Programme of the Government of the Republic of North Macedonia. As opposed to the growth model of the previous Government resting on consumption, main goal of this Government is to generate economic growth via investments, boosted competitiveness of the domestic economy and export growth. Increased share of capital expenditures, increased financial support for the investment activity of domestic production companies, expansion of existing and attracting new foreign companies are expected to contribute to attaining higher economic growth, i.e. gradually reaching GDP growth of 5%. Strategic investments in infrastructure and energy, support to innovations, competitiveness and productivity of companies, accompanied by measures aimed at digitalisation and innovations in IT, will contribute to increasing the total productivity in the economy and creating conditions for sustainable economic growth. Thereby, one of the main assumptions for generating accelerated growth is for the global trends to get back to normal, inflationary pressures to stabilise and economic activity at our major trading partners to strengthen, thus contributing to increased external demand and more favourable investment climate.

Chart 3.10.Expenditure structure of GDP growth (contribution to GDP, p.p.)



Source: MoF calculations based on SSO data (* - forecast)

EU's Growth Plan for the Western Balkans is expected to underpin the economic growth. As per the third pillar under the respective Plan, 2024 - 2027 Reform Agenda has been prepared, incorporating reform measures in five priority areas, the implementation of which provides for budget support in the amount of around EUR 750 million. Investments under the Reform Agenda refer to transport and energy infrastructure, education, digitalisation.

Gross investments are expected to play major role in boosting the economic activity, and its gradual intensification in the medium run. In the period 2025 - 2029, investments are expected to grow at an average rate of 7.6%. Scaled-up capital investments as foreseen under the Budget will be the driver of gross investments, in particular investments in efficient infrastructure which will boost both the competitiveness and the development of the business entities, as well as attract new foreign investments. Launching the construction of Corridors 8 and 10d, as per the steps undertaken for cost optimisation, the dynamics and the conditions, the construction and reconstruction of numerous highways, express, national, regional and local roads, railway transport, investments in energy, agriculture, education, health, as well as digitalisation and environment are expected to substantially contribute thereto. Moreover, to the end of a more balanced regional development, municipalities will have access to substantial financial resources under favourable terms and conditions intended for investment projects, which are to improve the living conditions of the citizens. Scaling up domestic private investments will be encouraged via the predictable tax environment, by extending affordable financial resources for investments to the production capacities, digitalising public services and reducing bureaucracy, supporting export-oriented capacities, rationalising and digitalising border procedures, enhanced access to affordable financial resources for the SMEs through the Development Bank intended for investments and green transition. High growth of gross investments will be also underpinned by the increased inflow of FDIs, by redesigning the financial support system, mapping the industries focused on advanced technologies with higher added value.

Following the decline in the past period, export activity is expected to recover in 2025, with a projected growth of 4.2%, amid overcoming temporary limiting factors and gradual stabilisation of the international environment, increase of the external demand and also a favorable price situation in metal prices, which will have a positive impact on the traditional export sector. Support to domestic companies by amending the Law on Financial Support to Investments to the end of boosting competitiveness and productivity for production of higher added value products, expanding the capacities of the existing and attracting new foreign companies, is expected to strengthen the export potential of the country over the medium term, hence, its average growth in the period 2026 - 2029 is projected at 6.0% annually.

Scaled-up investments and domestic demand will contribute to increased import, which is expected to be 4.8% on average annually in the period 2025 - 2029. Thereby, during the forecasting period, starting 2027, contribution of net export is expected to moderately shift to the positive zone as a result of the stronger growth of the export.

Private consumption, projected to increase by 2.7% in real terms in 2025, is expected to significantly contribute to the economic growth, growing by 2.9% on average annually in the period 2026 - 2029. Such growth of private consumption will be underpinned by the increased number of employees, net wage rise, supported by productivity growth, as well as pension increase, by their linear increase on two occasions in September 2024 and March 2025 - total of Denar 5,000 per pensioner, which will contribute to increasing the purchasing power of people with lower pensions. Credit support to households is expected to continue in the coming period as well, maintaining solid level of private transfers, which are an additional source of household disposable income.

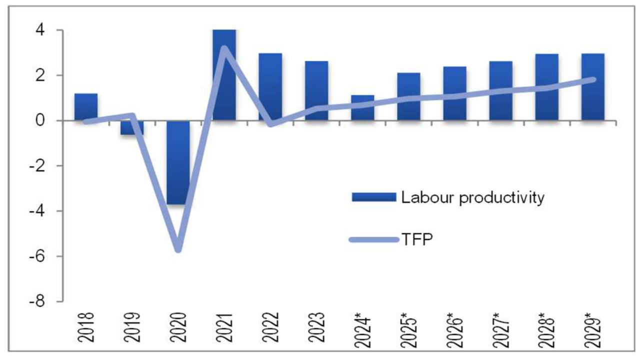
Public consumption in 2025 is projected to grow to 1.5%, mainly as a result of the effects from the increased wages in certain sectors of the public administration (education and health sectors above all), while growth in the period 2026 - 2029 is expected to be much moderate, accounting for 0.8% on average annually. Moderate growth of public consumption is in line with the expected efforts for reducing non-productive budget expenditures, strengthened public finance management and implementing the fiscal consolidation process.

Labour Market. Although demographic changes, such as population aging and migration, cause shrinking of the working-age population, employment rate is expected to surge, considering that almost half of the working-age population is inactive. By better targeting of the social assistance and the measures for activating the unemployed - beneficiaries of social assistance, further improvement of the labour market conditions are expected in the coming period through the active employment measures and programmes. Substantial amount of funds are envisaged for the Employment Agency’s programmes, paying special focus on young people, women and vulnerable categories, acquiring skills, additional professional education and retraining, as well as support to entrepreneurship. In 2024, amid moderate growth of the economy, number of employees is projected to increase by 0.9%, with an average annual increase in the number of employees by 1.8% in the period 2025 - 2029. Such trends on the labour market are envisaged to provide for the unemployment rate to gradually drop, reaching 7.2% in 2029. At the same time, employment rate is projected to gradually pick up, reaching 51.6% in

2029. Average net wage in the period 2025 - 2029 is expected to rise at an average rate of 5.6%, underpinned by productivity growth.

Sources of Growth. In 2025, both fixed capital and labour are expected to have a positive contribution to growth, due to the recovery of the economy, increased activity rate and reduced unemployment rate, as well as growth of total factor productivity (TFP) [7]. Chart 3.11 shows projections for both labour productivity and TFP by 2029. In the period 2025 – 2029, productivity of production factors is expected to remain as a significant source of growth, i.e. TFP contributes by approximately one third (32%) to the economic growth in this period. Physical capital, according to the projections for investment growth, is expected to grow by 4% on average annually in the analysed period, contributing by around 48% to total economic growth. Labour is expected to contribute to economic growth with around 20%.

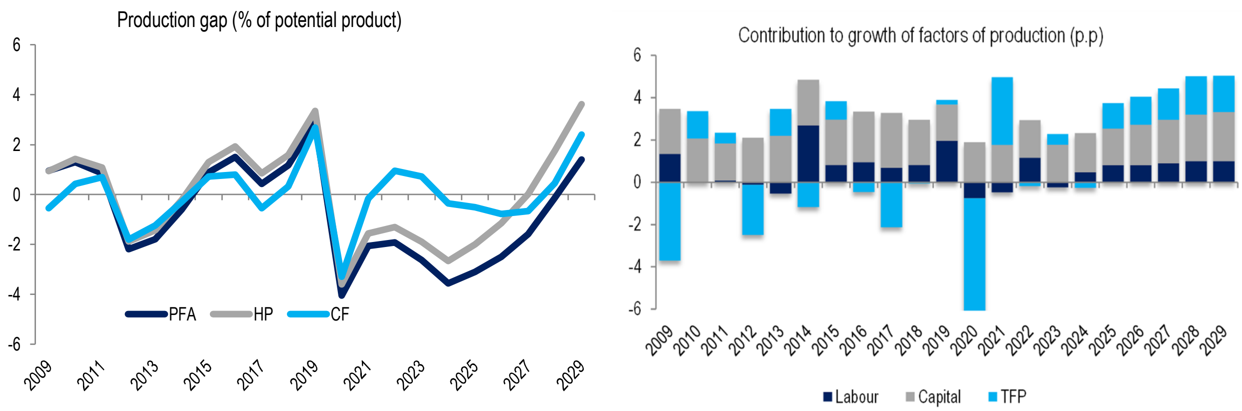
Chart 3.11. Labor productivity and TFP



Source: SSO and MoF forecast (* - forecast)

Potential Growth and Production Gap. Calculation of potential output is the basis for estimating the cyclical position of the economy. Two methods have been used to calculate the potential output. The first group of methods is based solely on historical data on real GDP, i.e. group of statistical methods (a-theoretical), whereby Hodrick-Prescott (HP) filter and Christiano-Fitzgerald (CF) filter are applied, while the second group, structural methods, applies the Production Function Approach (PFA)[8]. Results from the calculation of potential output are presented in the charts below, as well as in Table 5 in Annex 1.

Chart 3.12. (a) Production gap, % of potential product (left) and (b) contribution to growth of factors of production, in p.p. (right)



Source: MoF calculations

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[7] TFP is residual of growth of other factors to economic growth, labour and capital. As regards the calculation of physical capital, the so-called perpetual inventory method has been applied (see Berlemann and Wesselhöft, Estimating Aggregate Capital Stocks Using the Perpetual Inventory Method, 2014), by applying 4% depreciation rate to the accumulated capital. Average value of the share of income from capital is estimated at 50%, with the other 50% as income from labour.

[8] Based on the study of Havik et al, The Production Function Methodology for Calculating Potential Growth Rates & Output Gaps, 2014

According to the projections for real GDP growth in the upcoming medium-term period and the estimations regarding the trends of the potential output, amid economic recovery from the external shocks, cyclical component of output is in the negative zone in 2024, according to all three methods. In 2025, the output gap is expected to start closing according to the PFA and HP. Closing of the gap is due to the gradual recovery of the economy in the EU and the acceleration of the domestic economic activity. By 2029, all three methods show a production gap with positive values (Chart 3.12). The same chart also shows the decomposition of real growth according to the Production Function Approach.

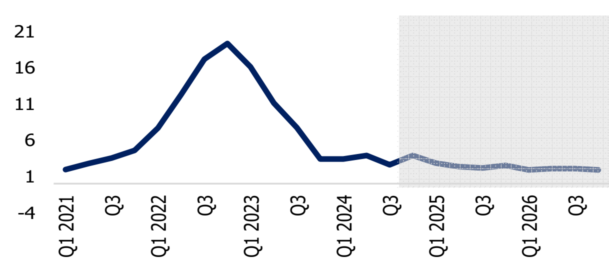
Potential growth is estimated to gradually intensify in the coming period, supported by accelerated employment growth, faster increase in physical capital and gradual increase in TFP growth (Graph 3.12).

Inflation. After the slowdown in the global inflation in 2023, given the downward movements of the world prices of primary products, the slowdown continued in 2024. Foreign effective inflation[9] in 2024 is estimated at a level of 3.2% (3.3% in last year's scenario). A further reduction of the price pressures is expected in 2025 and 2026, which would reduce the price growth in these years to 2.5% and 2.3%, respectively.

As a reflection of the global developments and the measures taken, after the slowdown in 2023, the average annual inflation in the domestic economy continued to slowdown in 2024. The average annual inflation in 2024 is estimated at 3.5% (versus 9.4% in the previous year). The inflation forecast in 2024 in this scenario is within the last year's scenario (expected inflation of 3.5-4%). The strong decline in the prices of oil and primary food products on the international market, the slower growth of foreign effective inflation, as well as the effect of the tightened monetary policy, contributed to the reduced domestic prices. The food and energy component registered a significant slowdown, while the adjustment in core inflation was slower due to greater inertia.

The inflation slowdown is expected to continue in the following years and the average annual price growth is expected to reduce to 2.5% in 2025 and 2% in the period 2026 - 2027. Downward trajectory of the prices is expected in all three components in 2025, while in terms of structure, the core inflation is estimated to have the largest contribution to the headline inflation. The gradual stabilization of inflation in the medium term is expected to result from the exhausted effects of the external price shocks, further anchored inflation expectations and the absence of significant pressures through the channel of domestic demand and the output gap. However, risks to the inflation forecast are upward and in view of the external environment they are associated with primary commodities prices, which are influenced by the unstable geopolitical context and climate factors. As for the domestic factors, risks arise from the possible price pressures due to the increased electricity price for small consumers on the regulated market as of July 2024, as well as for households in the following period, the increase in wages and pensions and slower fiscal consolidation according to the latest Fiscal Strategy.

Chart 3.13. Inflation rate (in %, on annual basis)



Source: SSO; forecast by NBRNM

[9] The foreign effective inflation is calculated as the weighted sum of consumer price indices of the countries that are major partners of the Republic of North Macedonia in the field of import of consumer goods. The calculation of this indicator includes Bulgaria, Germany, Greece, Spain, France, Italy, Austria, Poland, Slovenia, Croatia and Serbia. Inflation in Poland and Serbia has been adjusted for the changes in the exchange rate.

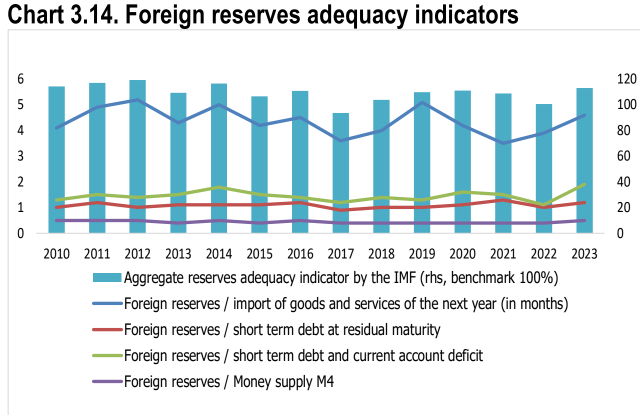
Monetary and exchange rate policies. Monetary policy is oriented towards preserving price stability by maintaining a stable exchange rate of the denar against the euro. After the period of the gradual increase in the policy rate of the National Bank, in response to the acceleration in inflation due to global supply side factors, from October 2023 to August 2024, the policy rate was unchanged, at a level of 6.3%. At the end of the third quarter of 2024, amidst significant slowdown in the dynamics of domestic inflation, favorable foreign exchange market, but still present risks, the National Bank started a vigilant monetary policy normalization. In September, there was policy rate cut by 0.25 percentage points, to the level of 6.05%, while the continuous favorable movements opened up room for additional decrease in October to 5.8%. In this period, interest rates on overnight and seven-day deposit facilities remained unchanged, at 4.20% and 4.25%, respectively. Regarding the macroprudential policy, a decision to extend the countercyclical capital buffer rate of 1.75% in the fourth quarter of 2025 was adopted in late September. Such policy setup is in support of the overall macrofinancial stability in the economy. Given the monetary strategy of a stable exchange rate of the denar against the euro, the changes in the domestic monetary policy were in line with the changes in the monetary policy of the European Central Bank, which also started to gradually reduce the interest rate from the middle of the year.

In order to further support the process of denarization of the banks' balance sheets, during the third quarter of 2023, the National Bank on two occasions further increased the reserve requirement rate for the foreign currency liabilities of banks, first from 19% to 20% (applied from November 2023), and then to 21% (from December 2023)**.**

Amid solid liquidity of the banking sector, from June 2024, the National Bank started to gradually normalize the reserve requirement rate for the banks' denar liabilities with maturity up to two years, to the level of the pre-crisis episode in 2022 (which will take place gradually), by applying a 6.5% rate (compared to 5% earlier).

This combination of monetary instruments suggests a process of cautious relaxation of the monetary policy, in conditions of further presence of risks from the global and domestic environment. The level of interest rates, together with the changes in reserve requirement and macro-prudential measures taken, are expected to contribute towards price stability in the medium run and exchange rate stability maintenance.

Chart 3.14. Foreign reserves adequacy indicators



Source; NBRNM calculations

Foreign reserves are further maintained at a solid and adequate level and the favorable developments on the foreign exchange market continued during the year. In addition, to further deal with the possible consequences of the uncertain global environment it is especially important to emphasize the access to foreign currency liquidity in euros which was granted to the National Bank by the European Central Bank, initially until June 2021, and then through four prolongations extended until January 2025.

In line with the applied strategy of targeting the denar exchange rate, the National Bank constantly monitors the movements of the interest rate differential for instruments in domestic and foreign currency, as well as the currency structure of deposits and loans. The interest rate differential on deposits in domestic and foreign currency in the previous few years was mainly on the decline, as a reflection of the relaxed domestic and global financial conditions, while in the conditions of monetary tightening, towards the end of 2022 and during 2023, it registered a slight increase, and during 2024 it remained unchanged. Retaining the benefits with regard to de-euroization (in the period 2009-2015, the share of deposits with a foreign currency component in total deposits decreased by about 18 percentage points, and the share of loans with a foreign currency component in total loans decreased by about 12 percentage points), in turn increases the credibility of the monetary policy based on the stability of the exchange rate of the denar against the euro. In the period 2020-22, as a reflection of the uncertainty arising from the pandemic-driven crisis, and then the increased inflation expectations due to the global energy crisis and uncertainty, there was a moderate upward movement of the share of deposits with a foreign currency component (by 6.7 percentage points in September 2022 compared to the end of 2019). From the last quarter of 2022 and during 2023 and 2024, there was a gradual reduction of the share of foreign currency deposits in total deposits of the private sector (by 2,7 percentage points compared to September 2022). In addition to the changes in reserve requirement, the currency aspect was taken into consideration also in the macro-prudential measures for the quality of credit demand, which started to be applied from 1 July 2023. In addition to other ratios, the DSTI ratio (debt service-to-income) has also been introduced whose level differs for loans in denars and in foreign currency/foreign exchange clause.

In terms of the set of monetary policy instruments, in order to face the challenges from the energy crisis, the measure for the release of banks from the reserve requirement for newly approved loans for green finance is applied from August 2022, in order to encourage both lending and the transformation of the economy toward greater use of renewable energy sources. Most of the approved loans from the beginning of the application of the measure onwards are long-term and are intended for constructing new facilities by using renewable energy sources.

In the next three years, the monetary policy will keep the price stability, by maintaining a stable exchange rate of the denar against the euro. The results of the evaluation models of the equilibrium denar real effective exchange rate[10] as of the last quarter of 2023, did not indicate major deviations from the equilibrium, and were maintained within acceptable range in the period 2004 - 2023[11]. Regarding the implementation of monetary policy, it is important to indicate the results of the models for analysis of the monetary transmission, which with the latest update as of 2023 point to a relatively stable transmission in total interest rates, and the findings are similar to the previous analyses. Compared to the results of the previous assessment, the transmission of the monetary signals remains the same in the lending denar interest rate, while the deposit denar and foreign currency interest rate and the lending foreign currency interest rate registered minor changes in the interest rate transmission. In addition, in the specification for denar interest rates, the change in the reserve requirement rate again proved statistically significant, which is in line with the expected effects of the changes made in this instrument.

Overall, after the series of global shocks, the r**ecovery of the domestic economy is expected to continue, amid simultaneous** slowdown in inflation, which in the medium run is expected to reduce to its historical average of 2%. The external position remains stable, amid moderate and relatively stable current account deficit in the next three years, expected inflows of FDIs and further access to capital markets. Consequently, foreign reserves will remain in the safe zone in the next period as well. Further credit support of the domestic economy by banks is expected. Global risks remain present and are primarily related to the global situation, the confidence of consumers and investors, the current mismatches of supply and demand, the global price movements. Inflation and inflation expectations, external sector developments, import structure and effects on the foreign

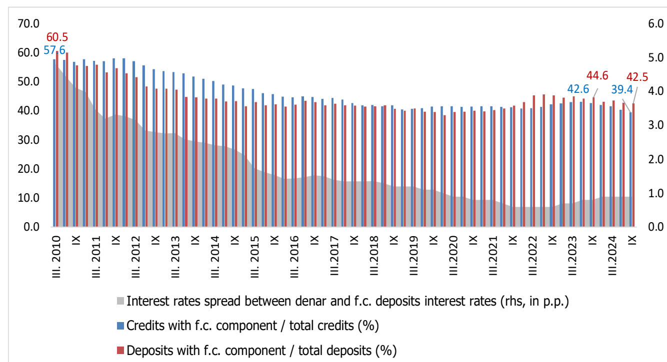
[10] Source: NBRNM. According to the BEER (behavioral equilibrium exchange rate) approach for assessment of the equilibrium denar exchange rate, which is based on a narrower definition of the real effective exchange rate and is designed on the basis of the five EU major trading partners of the Republic of North Macedonia. Models (set by different specification and evaluated by various techniques), include differential in productivity, trade openness, public consumption and total net foreign assets, as independent variables.

[11] IMF's analyses also indicate no significant deviation in the real exchange rate (IMF Staff Report 2023 Article IV Consultation, January 2024, p.62). According to the IMF methodology, deviations from the equilibrium level of +/- 5% indicate that the external position is generally consistent with the fundamentals and there is adequate policy nexus.

exchange market and foreign reserves, will be crucial for the monetary setup in future. There will be regular monitoring of the pace and structure of credit growth and of the movement of deposits and interest rate spreads. The coordination of the monetary and fiscal policy remains crucial for the following period as well. In the period ahead, the National Bank will continue to carefully monitor the trends and potential risks from the domestic and external surrounding in the context of the monetary policy setup.

Bank deposit and loan forecast[12]**.** In conditions of moderate monetary easing, the pace of growth of the lending activity is expected to continue, whereby by the end of 2024 the credit growth is estimated at 7.5% annually (increase of 5.1% at the end of 2023). In the medium run, stabilization of the credit growth rates is expected, which would average 7.2% in the period 2025 – 2027. Such forecasts are in line with the expectations for further gradual decrease in the interest rates, the acceleration in the economic growth, the stabilization of expectations and the growing confidence of economic agents. Regarding the deposits, as the main source of financing of lending activity, solid growth rates are also expected in the entire period of forecasts, given the further relatively stimulating savings conditions in the banks, the confidence in the banking sector, as well as due to the expected growth of the households' funds. Thus, in 2024 the growth of total deposits is expected to equal 7.9% (9.1% at the end of 2023), while in the period 2025 - 2027 an average growth of 7.7% is forecasted.

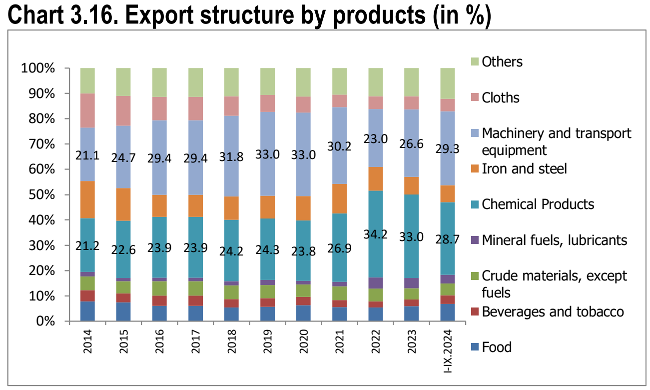
Chart 3.15. Currency structure of bank deposits and credits and interest rate spread



Source: NBRNM Calculations

External Sector Structural changes in the economy towards strengthening and diversification of the export sector acted towards improvement of the current account balance. Namely, the current account deficit in the last ten-year period 2014-2023 averaged 2% of GDP. A more notable exception to the average is the current account deficit of 6.1% of GDP in 2022, which is due to the global energy crisis and the expanded energy deficit, followed by a small surplus in 2023, reflecting the slowdown in energy prices. The solid performance on the current account that is being registered for a longer period already, points to strengthened economic fundamentals and greater external sector resilience to domestic and external shocks.

Chart 3.16. Export structure by products (in %)



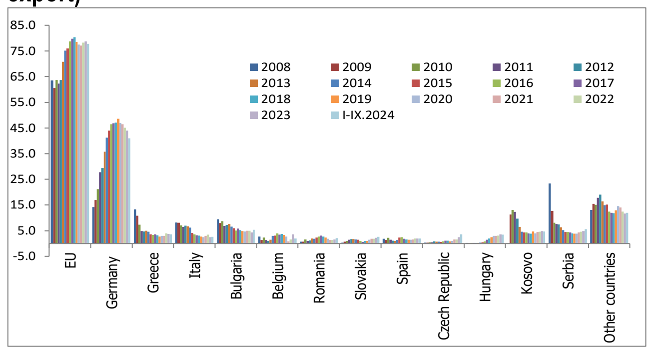
Source: SSO

According to the trends and estimates for the last quarter of 2024, the current account deficit for 2024 is estimated moderate at 2.1% of GDP, which is actually an expected widening compared to the previous year, when it narrowed after the global energy crisis. The estimated deficit for 2024 is similar to the last year's macroeconomic scenario presented in the last year's ERP (2.4% of GDP).

[12] The National Bank's external and monetary sectors forecasts are based on the Budget Revision for 2024 from August 2024 and the Fiscal Strategy 2025-2029 from September 2024.

In the period January - September 2024, the total trade deficit[13] widened by 16.7% given the annual decrease in the exports of 6.1% and simultaneous decrease in imports of 0.5%. In addition to the effect of still weak foreign demand and lower prices on an annual basis, the export has been affected by certain specific temporary factors[14]. Structurally, the decrease in export is primarily due to the export of part of the production facilities of the automotive industry in foreign ownership (related to the export of chemical products), followed by reduced export of vehicles, energy, iron and steel, and textiles and clothing. On the other hand, there was an increase in the export of food and beverages and tobacco, as well as the export of the remaining segment of the automotive industry, which contributed to an increase in the export of equipment and machinery. On the import side, a more noticeable fall was recorded in the import of energy, and then the import of non-ferrous metals, as a raw material of part of the export capacities in foreign ownership, as well as the import of inorganic chemical products, and to a lesser extent the import of iron and steel.

Chart 3.17. Geographical breakdown of export (% of total export)

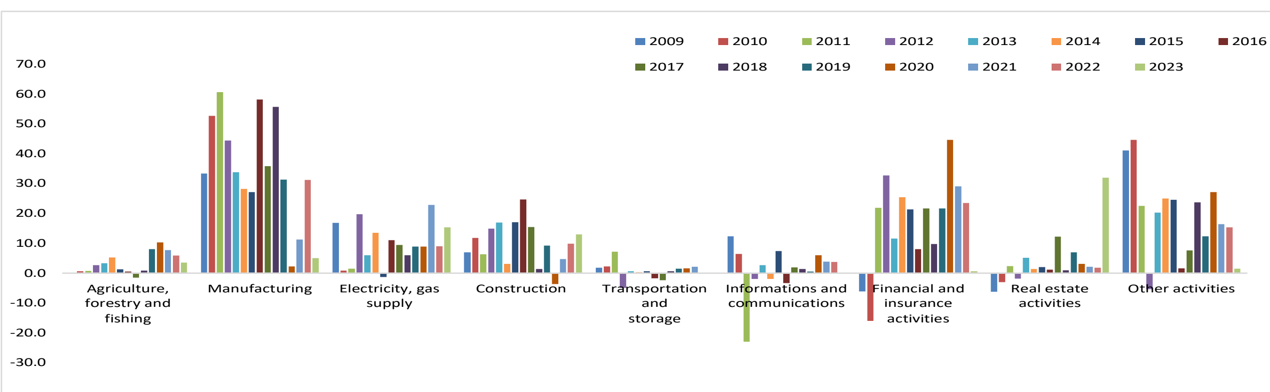


Source: SSO

On the other hand, a more significant increase was recorded in the import of equipment and machinery and food and beverages. The highest trade deficit in goods in the period under observation was registered in the trade with the Great Britain, while the highest surplus was reported in the trade with Germany.

Analyzed by structure, as a result of the foreign capital-based new facilities in the economy, the export structure improved substantially, towards gradual increase in the share of products with higher value added in exports, mainly chemicals, and machinery and transport equipment, which reached approximately 60% at the end of 2023. Changes in export structure correspond with foreign direct investment, which lately have been mainly concentrated in these sectors. On the other hand, there was a decrease in the share of traditional export products - iron and steel, and textile products, with their joint share decreasing from the dominant 40% in 2010 to about 12% at the end of 2023, which confirms the larger production dispersion and the modernization of export structure (additionally, the export of iron and steel is influenced by the fluctuation of the world prices).

Chart 3.18. Net FDI per activity (% of total FDI)



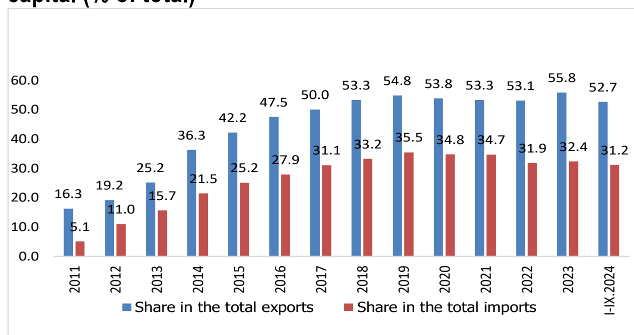
Source: NBRNM

[13] According to the foreign trade statistics, where the imports are presented on c.i.f. basis.

[14] It refers to non-functioning of important facilities in the metal and automotive industry, which are expected to partly overcome by the end of this year, and fully in the next.

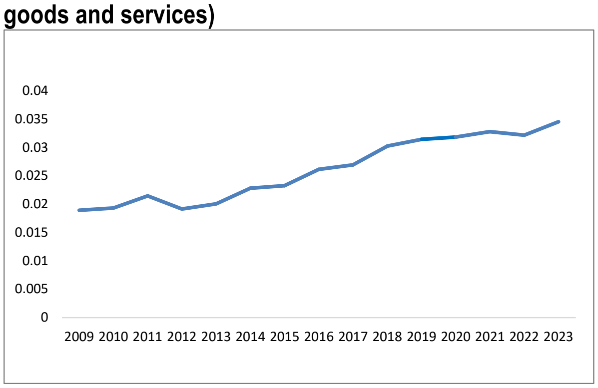
The share of the exports of the companies in foreign ownership in the total export of goods remained relatively high, registering certain growth in 2023, when the share in the total export reached the historical peak of 55.8%. In the first nine months of 2024, the share of the exports of these companies in the total export decreased moderately to 52.7%. Given that these companies import raw materials and equipment, the share of the imports of these facilities in the total import of goods also varies year by year, yet sustaining at a lower level compared to the exports (31.2% share in total imports in the first nine months of 2024).[15] The new foreign-owned companies reported a positive net foreign trade balance which averaged 1.5% of GDP in the period 2011-2013, while in the period that followed, it intensified, reaching 5.4% of the GDP in 2018 and 4.7% of GDP in 2019. In the pandemic 2020 and 2021, amid contracted economy, the positive balance of these companies reduced to 4.3% and 3.1% of GDP, respectively, followed by certain stabilization in 2022, when the net export of these companies equaled 4.0% of the GDP. In 2023, these companies' net export reached 7.1% of GDP, which is the highest historical performance, observed as a share in the GDP and analyzed in absolute amounts. In the first nine months of 2024, the net export equaled 3.7% of the GDP, which corresponded to the lower export activity. It is estimated that there is a room to strengthen additionally the links between foreign companies and local suppliers, which would additionally increase the secondary effects of FDI on the economy.

Chart 3.19. Exports and imports of companies with foreign capital (% of total)



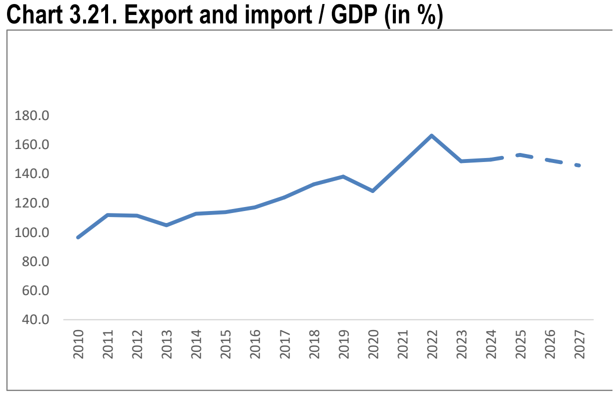
Source: NBRNM and SSO

Chart 3.20 Export market share (% of the world export of goods and services)



Source: IMF WEO, NBRNM.

Chart 3.21. Export and import / GDP (in %)



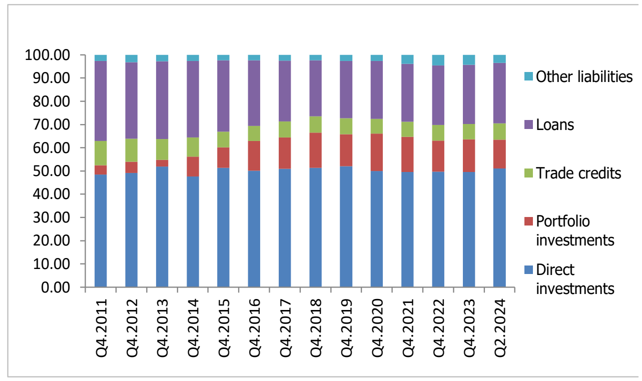
Source: SSO; NBRNM forecast for the period 2024-2026.

The analysis of geographic distribution of the exports validates the EU dominance as the major export destination, which in the period January - September 2024 imported around 78% of the country's exports, which is a significant increase compared to 2008, when about 64% of the exports was oriented towards the EU. Within the EU, in recent years, the share of exports to Germany has registered a significant growth (the highest level of 48.6% was reached in 2019), with positive movements in 2023 on annual basis also registered in the exports to Hungary, Romania, the Czech Republic, Belgium and Slovakia amid low initial shares, and decreased share

[15] Source: NBRNM. According to the foreign trade statistics (customs declarations), where export of goods is presented on f.o.b. basis, and import of goods on c.i.f. basis.

in the exports to Greece, Italy and Bulgaria. In the period January-September 2024, the total trade with the EU accounted for about 62% of the total trade of the Republic of North Macedonia and considering the decrease in the export at simultaneous increase in the import of goods from the EU, a surplus was registered, which was, however, by 55.5% smaller compared to the same period last year.

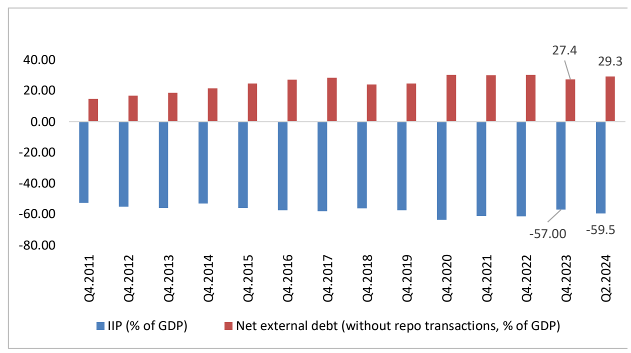
Chart 3.22. Structure of liabilities abroad (in %)



Source: NBRNM

In the period January - September 2024, the real effective exchange rate (REER)[16] of the denar deflated by CPI registered a small annual appreciation of 0.5%, while excluding primary commodities, the denar REER deflated by the same price index registered minimal depreciation of 0.1%, compared to the same period last year. Such movements in the two indices were registered amid decelerated appreciation of the nominal effective exchange rate of the denar against the currencies of some of the trade partner countries and a favorable ratio in relative prices.

Chart 3.23. Net debt and Net International Investment Position



Source: NBRNM

The export market share of the economy in the world export from 2013 onwards has been increasing, with a slowdown in the growth in the years of the pandemic and the prolonged global crisis (amid a slight decline in 2022). In 2023, the market share in the world export increased again. The degree of trade openness of the Macedonian economy is generally high, with a marked upward trend in the period 2014 - 2019. In 2020, there was a short-term slowdown in share of the trade in goods and services in GDP due to the pandemic, followed by continuation of the growth in the next two years, reaching about 166% of GDP in 2022 (amid higher prices in trade). In 2023, the trade to GDP ratio amounted to 149% of GDP, in 2024 it is estimated at about 150% of GDP, and it will be maintained at a similar level in the following three years.

International investment position and external debt. At the end of the second quarter of 2024, the net negative international investment position (IIP) in nominal terms increased by 3.7% compared to the end of 2023, amid higher increase in international liabilities compared to the increase in international assets. The expansion of the negative IIP is mainly due to the increased net liabilities of other sectors in the economy and moderate reduction of the positive net position of the central bank, amid slightly lower net liabilities of the banking sector and almost unchanged negative net position of the government[17]. In relative indicators, in June 2024 the

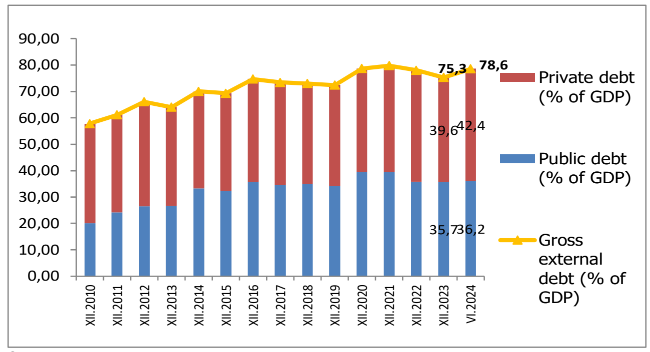
[16] NBRNM calculations. Within the REER, the calculation of the nominal effective exchange rate and relative prices includes 15 major trade partners of the Republic of North Macedonia by their share in foreign trade in the period 2010-2012 and a base period 2015.

[17] Government sector includes central government, local government and social security funds.

net negative IIP was 59.5% of the estimated GDP, and compared to the end of 2023, it expanded by 2.5 percentage points of GDP.

Given the significant share of foreign direct investment as external liabilities (about 50% in recent years), typical for the converging countries, the analysis of external position also needs to consider other variables, such as net external debt, which includes only net debt instruments. At the end of the second quarter of 2024, net external debt accounted for 29.3% of the estimated GDP, which is an increase compared to the end of 2023 of 1.8 percentage points of GDP, which is due to the increase in public net debt, amid a slight decline in private net debt.

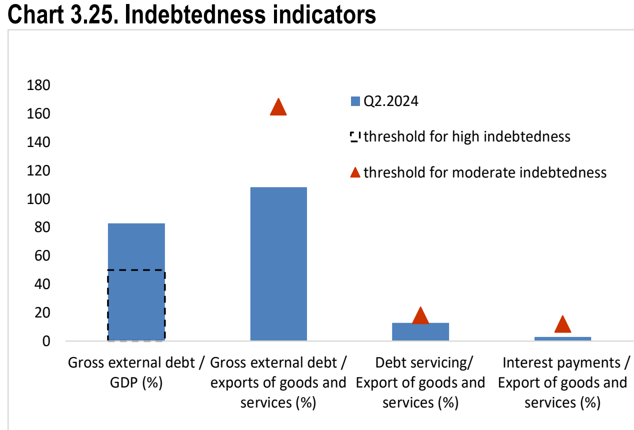
Chart 3.24. Gross external debt



Source: NBRNM

At the end of the second quarter of 2024, the **gross external debt** accounted for 78.6% of GDP (without the NBRNM repo transactions, which appear in almost the same amount on both the side of the liabilities to and the claims on non-residents). Compared to the end of 2023, gross debt increased by 3.3 percentage points of GDP. This increase is mainly due to the growth of private sector debt (by 2.8 percentage points of GDP), amid slight increase in public sector debt (by 0.5 percentage points of GDP). The long-term debt, occupying above 75%, still dominates the debt structure.

Chart 3.25. Indebtedness indicators



Source: Calculations by NBRNM

At the end of the second quarter of 2024, the coverage of short-term debt by residual maturity (excluding repo) with foreign reserves was 1, which indicates solid liquidity in terms of external payments. The analysis of foreign indebtedness[18] indicates a low indebtedness based on three indicators (gross external debt, debt servicing and repayment of interest, each relative to export of goods and services), whereas only gross debt-to-GDP indicates high indebtedness. However, the level of the gross external debt excluding trade credits and intercompany debt (as less risky flows) is lower and indicates moderate indebtedness.

Forecasts of the Balance of Payments[19] After the post-pandemic recovery and the period of prolonged global crisis, in 2023 there was a moderate growth of the global economy, which is expected to continue at a similar pace in 2024, still accompanied by uncertainty and geopolitical risks. Moreover, the global growth remains below the level of the pre-pandemic period. According to the latest forecasts, the increase in the foreign effective demand[20] for the domestic economy is estimated at 0.8% in 2024, and in 2025 it is expected to accelerate to

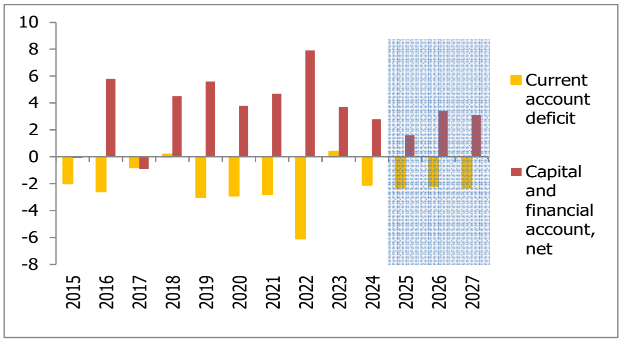
[18] Tailored use of the World Bank method, where the calculation of the indicators is based on three-year moving averages of GDP and exports of goods and services, as denominators. The methodology also defines criteria of indebtedness, as reference values for indebtedness level.

[19] Balance of payments forecasts and monetary and credit aggregates are based on SSO's GDP estimates for 2021 and the first two quarters of 2022.

[20] Foreign effective demand is calculated as the weighted sum of GDP indices of the major trading partners of the Republic of North Macedonia. The calculation of this index includes Germany, Greece, Italy, the Netherlands, Belgium, Spain, Serbia, Croatia, Slovenia and Bulgaria.

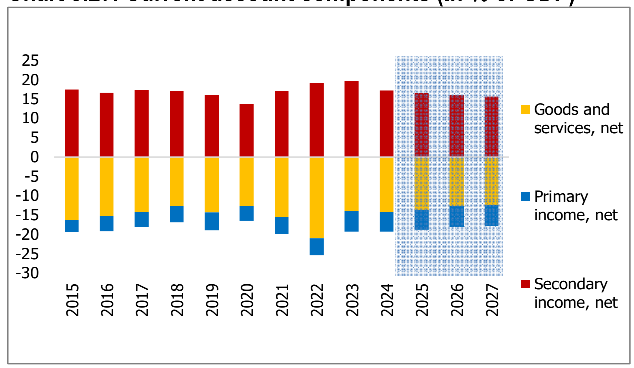
1.5% (1% and 1.7%, respectively, in last year's scenario). The downward correction for 2024 is largely due to the downward revisions for the expected economic activity in Germany, as our important trading partner. In 2026, the growth rate of foreign demand is expected to moderately accelerate to 1.7%.

Chart 3.26. Balance of payments (in % of GDP)



* Source: NBRNM. Estimate for 2024 and forecast for 2025-2027.

Chart 3.27. Current account components (In % of GDP)



* Source: NBRNM. Estimate for 2024 and forecast for 2025-2027.

The consequences from the global energy crisis expanded the current account deficit in 2022, whereby already in 2023 a small surplus was registered, while in 2024 a moderate deficit is estimated at 2.1% of GDP. The latest external sector estimates suggest that in the following three years the defict would stabilize at an average level of about 2.2% of GDP. In the next three years, the needs for external funding are expected to be covered by external borrowing and foreign direct investments. Financial inflows are expected to enable growth and maintenance of an adequate level of foreign reserves with import of the next year coverage ratio of over 4 months.

In 2023, the trade deficit normalized, after the energy crisis when it was significantly widened. In the past period of 2024, amid a slowdown in the trade exchange prices, exports registered a moderate decline, while imports recorded minor decrease, which moderately widened the trade deficit. Significant downward changes on both sides were registered in energy, amid a slowdown in the world energy prices. For 2024, trade deficit in goods and services is expected to slightly widen to 14.1% of GDP (in 2023, there was a deficit of 13.9% of GDP). This assessment is based on the estimated higher trade deficit in goods, which is expected to be significantly offset by the higher surplus in services. The trade balance widening is due to the larger deficit in non-energy trade balance, amid estimated narrowing in the energy trade balance. The estimated deficit in goods and services in 2024 is lower than expected in last year's scenario (15.7% of GDP). In the following three years, the trade deficit in goods and services is expected to moderately slowdown from 13.7% of GDP in 2025 to 12.4% of GDP in 2027. This forecast is based on the expectation that after the shock and consequences conditioned by the energy crisis, the overcoming of the temporary limiting factors present in 2024, the gradual recovery of foreign effective demand and the favorable conjuncture of metal prices will have a positive impact on the traditional export sector. At the same time, positive contribution is also expected from existing automotive companies, as well as from the new foreign investments in manufacturing sector. In this light, the narrowing would result from the expected gradual narrowing of the energy and non-energy trade deficit. The surplus in services, after the more intensive growth in 2024 when it is estimated at 7.5% of GDP, in the next three years would be more moderate and on average would be maintained at about 6.6% of GDP, amid solid expert perspectives of the services sector (especially in the area of IT services and services related to the projects in road infrastructure).

A significant part of the trade deficit will still be financed by inflows of secondary income (which primarily reflects the net purchase on the currency exchange market as the main component of private transfers). After the normalization of the net inflows from private transfers in 2024 when they are estimated at 17.2% of GDP (given the extremely high levels in the previous two years of about 19% of GDP), in the next three years these inflows are expected to slightly decline (to about 15.6% of GDP in 2027). The primary income deficit for 2024 is estimated at 5.2% of GDP, and it is expected to be maintained at similar levels in the next three years, in line with the forecasts for solid income from capital of foreign investors.

With such current account items forecast, in 2024 a moderate current account deficit of 2.1% of GDP is estimated, mainly due to the higher trade deficit in goods and the smaller net inflows in secondary income. In the next three years, the current account deficit would be maintained at a moderate average level of about 2.2% of GDP, amid gradual moderate narrowing of the trade deficit compared to the expected moderate slowdown in private transfers. Moreover, positive effects are expected from the gradual stabilization of the global situation, in terms of both the supply chains and the price pressures especially on the energy side, as well as further positive effects from companies with foreign capital. Such circumstances would return the deficit of goods and services in the medium run to the pre-pandemic levels of around 13% of GDP.

The financial account inflows will mainly result from the expected FDIs and the expected external public and private borrowings. In 2024, most inflows came from the FDIs and the external long-term government loans. FDIs in 2024 are estimated at 4.2% of GDP. The recovery of the domestic economy after the prolonged global crisis, together with the expected growth of the global economy, are expected to contribute to stable investors' perceptions, whereby the FDIs in the next three years are expected to be maintained at a level of around 4% of GDP. Such a forecast is supported by continuous inflows on this basis, the ongoing policies to attract new FDIs, further reforms towards improvement of the business environment, as well as prerequisites for the expansion of existing foreign capacities within the current regrouping of global supply chains towards closer locations. In the period 2024 - 2027, the financial account is expected to register net inflows of about 3% of GDP, annually, with the exception of 2025 when the net inflows are below 2% of GDP, amid outflow for repayment of a due Eurobond. Cumulatively, current and financial account flows forecasts are expected to ensure additional accumulation of foreign reserves in the next three years and maintain adequate coverage of the average imports of each coming year.

Financial Sector. Maintaining the stability of the financial system, its further development and increasing intermediation remain to be the main priorities in the area of the financial system. Therefore, the following activities will be undertaken:

- Amendments and modifications to the Law on National Bank were adopted in March 2024, pertaining to strengthening the financial stability as one of the primary objectives of the National Bank, assigning macroprudential mandate to the National Bank and competences for carrying out activities related to bank resolution. Under the modifications and the amendments, Executive Board is envisaged to be established as one of the management bodies of the National Bank, consisting of the Governor and three Vice Governors. The Executive Board is established as per both the best practices on decision-making bodies within the central banks and the IMF recommendations. The Executive Board is transferred the Governor's competences regarding issuing and revoking licenses and approvals for financial institutions, taking measures against banks and other financial institutions, as well as payment institutions, electronic money institutions and payment system operators that are subject to oversight by the National Bank. It will also decide on initiating a bank resolution procedure and applying bank resolution tools and powers. In addition, conducting monetary policy and exchange rate policy, as well as implementing macro-prudential measures is among the powers and tasks of the Executive Board. Under the amendments, independence of the National Bank is further strengthened. In fact, Article 58-a has deleted, which stipulated that both National Bank employees have the status of administrative servants and Law on Administrative Servants is applied thereon. Deleting the respective Article provides for greater independence of the National Bank as regards the attracting and retaining high-quality personnel, thus ensuring conditions for further strengthening of the capacity for performing the competences, including performing supervision.

- Considering the modifications to the Law on National Bank, modifications and amendments to the Law on Payment Services and Payment Systems were adopted in March 2024 ("Official Gazette of the Republic of North Macedonia", no. 64/24). In fact, part of Governor's powers and tasks have been assigned to the Executive Board, in particular those pertaining to deciding on issuing and revoking licenses and approvals for financial institutions and digital money institutions, as well as payment systems operators, and taking measures against banks, saving banks and other financial institutions that are subject to oversight by the National Bank.
- Under the amendments to the Law on Financial Companies, three new bylaws - Rulebooks were adopted in April 2024, as follows: Rulebook on the Manner of Financial Company's Credit Risk Management, Rulebook on the Manner of Performing Oversight of Financial Company and Rulebook on the Contents of Financial Company's Work Programme.
- Under the Rulebook on the Manner of Financial Company's Credit Risk Management, obligation is introduced for the financial company to assess the creditworthiness of the borrowers. Moreover, DSTI ratio (debt service-to-income) has been introduced for the financial companies as the one already introduced for the banks when extending loans the borrowers (individuals). By introducing this ratio, citizens' over-indebtedness will be significantly reduced. Furthermore, taking into account the detected weaknesses in the process of loan approval (misuse of personal data), the Rulebook prescribes mandatory identification of the clients.
- As per the Rulebook on the Manner of Conducting Supervision, the basic procedures, the rules and the manner of conducting supervision over financial companies by the Ministry of Finance is prescribed, while regulating, in more details, the competences of persons the Minister of Finance authorised to conduct supervision through permanent off-site supervision of operations, regular and extra-ordinary on-site supervision, maintenance of contacts with members of financial companies' management bodies and cooperation and exchange of data and information with other supervisory bodies.
- As per the Rulebook on the Contents of the Work Programme, the contents of the Work Programme is prescribed, which the financial company submits under the procedure for obtaining founding and operating license, as well as under the procedure for issuing consent for changing the ownership structure.
- By strengthening the regulatory framework for the operations of financial companies by adopting the amendments to the Law in 2023, as well as adopting the bylaws in 2024, it is expected to contribute to increasing the trust by both the population and the companies in these financial institutions.

- In 2024, Law on Modifications and Amendments to the Law on Denationalisation Bonds was adopted ("Official Gazette of the Republic of North Macedonia", no. 74/24), which will provide for issuing another three Denationalisation Bonds.
- In February 2024, two new laws in the field of capital market were adopted (Law on Financing Instruments (Official Gazette of the Republic of North Macedonia, no.66/2024) and Law on Securities Prospectus and Transparency Obligations for Issuers (Official Gazette of the Republic of North Macedonia, no. 64/2024), being, to a great extent, harmonised with the EU Acquis in the field of capital market. The new legal framework will provide for creating conditions for development of new products and services on the financial market in the country, introduce new trading markets, provide a higher level of market stability,

strengthen the powers of supervisory bodies, enhance transparency by providing high-quality information and improve the protection of investors and all market participants.

- Amendments to the Banking Law have been prepared, aimed at harmonising the Law on Payment Services and Payment Systems, in particular as regards the operations of saving banks, thus providing for expansion of the activities the savings banks will be able to perform. The proposed amendments have been adopted by the Government, and it is expected for them to be adopted by the Parliament by the end of 2024.
- Amendments to the Law on Foreign Exchange Operations have been prepared in view of its harmonisation with the Law on Payment Services and Payment Systems, all to the end of smooth execution of the current and capital transactions, while also providing for stable and efficient payment system in the Republic of North Macedonia, being adopted by the Government of the Republic of North Macedonia, and it is expected that they will be adopted by the Parliament of the Republic of North Macedonia by the end of 2024.
- In December 2024, amendments were prepared to the Law on Payment Services and Payment Systems in view of its harmonisation with the Regulation (EU) 2024/886 as regards instant credit transfers in euro, thus amending the Payment Services Directive 260/2012 (PSD2), for the purpose of successfully completing the country's process of joining SEPA as a result of the application submitted by the National Bank on 10th of July, 2024. Draft amendments to the Law on Payment Services and Payment Systems have been adopted by the Government of the Republic of North Macedonia, and their adoption by the Parliament of the Republic of North Macedonia is expected in the beginning of 2025.
- In the course of 2025, new Law on Deposit Protection System will be adopted, which will be further aligned with the Directive 2014/49/EC on deposit guarantee schemes with particular focus on expanding the coverage of deposits being insured, changing the basis for calculating the insurance premium, connecting with banks and savings houses that are members of the Fund, all to the end of reducing the payment period for compensation, as well as strengthening the promotion activities.
- In 2025, adoption of a new Banking law is planned, which will provide for further alignment with the EU Directive 2013/36 (CRD) and Regulation (EU) no. 575/2013 (CRR), including the latest changes of these directive and regulation from June 2024. In addition, the new Banking Law will provide for harmonisation with the provisions and requirements referred to in the Law on Bank Resolution and the Directive 2014/59/EU.
- During 2024, new Law on Alternative Investment Funds was prepared, implementing the Alternative Investment Fund Managers Directive 2011/61/EU and the Regulation 345/2013 on European venture capital funds. By implementing the Directive, rules and procedures for the operations of private investment funds will be strengthened, and the procedure of approving managers of private investment funds will be regulated. It is planned for this Law to be adopted by the end of 2026.
- In 2025, adoption of the new Insurance Law is planned, which will be harmonised with the Directive 2009/138/EC on the taking-up and pursuit of business of insurance and reinsurance (Solvency II), thus providing for compatibility and competitiveness of the domestic insurance industry with the one of the EU Member States. At the same time, partial harmonisation with the Directive IDD (Insurance Distribution Directive) on insurance distribution is being carried out. The Law will provide for increased security and stability of the insurance sector, enhancing the insured persons' protection. Capital requirements on operations of insurance companies will be strengthened, supervisory measures will be prescribed, adequate to the irregularities identified in the operations of the companies, and efficient mechanisms on

protection of the rights of consumers of insurance services will be established.

Financial companies. Financial companies on the financial market in Republic of North Macedonia operate pursuant to the Law on Financial Companies ("Official Gazette of the Republic of Macedonia", nos. 158/10, 53/11, 112/14, 153/15 and 23/16 and "Official Gazette of the Republic of North Macedonia", nos. 173/22 and 153/23). Financial company may perform one or more of the following financial activities: granting loans; factoring and issuing guarantees. As of 15th August 2024 inclusive, 27 financial companies were active on the financial market in the Republic of North Macedonia, being a decrease by eight companies compared to the previous year. Domestic capital accounted for the most - 55.2% in the ownership structure of financial companies, with foreign capital accounting for 44.8%.

As for the structure of total assets in the financial sector in the Republic of North Macedonia, financial companies had a small share of around 0.9%. As of 30th June 2024, total assets of financial companies amounted to Denar 10.1 billion million (EUR 164 million), increasing by 15.5% compared to 30th June 2023, mostly as a result of the increase in financial placements.

Number of newly concluded contracts in the first half of 2024 (99.8% out of which were approved loans) was 214,194, being an increase by 23.5% compared to the first half of 2023. Value of the concluded contracts, in this period, was Denar 8 million (EUR 130 million), increasing by 29.4% compared to the first half of 2023.

In the first six months of 2024, financial companies generated profit of Denar 980 million (first half of 2023: profit of Denar 790 million).

Financial leasing providers. Financial leasing providers (leasing companies) on the financial market in the Republic of North Macedonia operate pursuant to the Law on Leasing ("Official Gazette of the Republic of Macedonia", nos. 04/02, 49/03, 13/06, 88/08, 35/11, 51/11, 148/13, 145/15, 23/16 and 37/16 and "Official Gazette of the Republic of North Macedonia", no. 173/22).

As of 30th June 2024, 7 leasing companies were active on the financial leasing market, being a decrease by one company compared to the same period of the previous year. As for the ownership structure of leasing sector, foreign capital predominated with 52.3%, whereas domestic capital accounted for 47.7% thereof.

As for the structure of total assets in the financial sector in the Republic of North Macedonia, leasing companies had a small share of around 1%. As of 30th June 2024, the assets of the leasing sector amounted to Denar 13 billion (EUR 212 million), increasing by 34.8% compared to the same period of the previous year. Thereby, the two largest leasing companies accounted for 76.2% of the total assets.

Number of newly concluded contracts in the first half of 2024 was 1,431 or a decrease by 7.2% compared to the same period last year. Value of concluded contracts in the same period amounted to Denar 3.1 billion (EUR 50 million), being a decrease by 2.8%. Legal entities retained the main position in the structure of newly concluded contracts (80.8%). Observed by the subject-matter of leasing, most of the newly concluded contracts were contracts for passenger vehicles (82.3%).

Leasing companies in the first half of 2024 generated a profit amounting to Denar 78.8 million (first half of 2023: profit amounting to Denar 109.3 million).

3.3 Alternative Scenarios and Risks

Alternative Scenarios. Two alternative scenarios will be explained below, being related to some of the below mentioned risks.

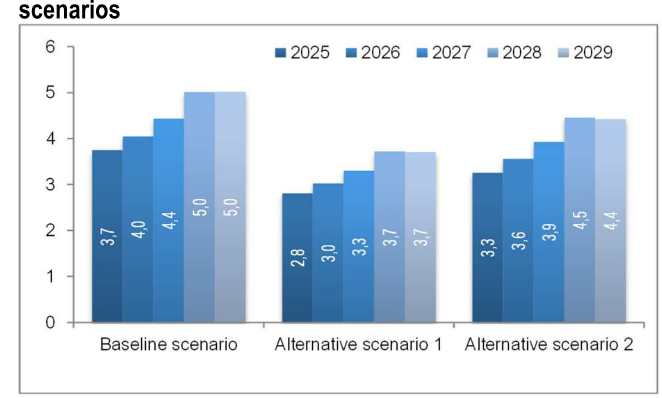
The first alternative macroeconomic scenario assumes for downside risks to materialise, being related to the geopolitical tensions, i.e. the conflicts in Ukraine and in the Middle East, the economic activity at major trade partners, as well as the domestic risks, as potential further delay of the implementation of major infrastructure projects. Such scenario implies slower growth of both export activity and industrial production, especially of the activities strongly integrated in the global supply chains and closely linked to the international trade flows. Hence, projected real growth of export would be lower by 1.4 p.p. on average annually compared to the baseline scenario, i.e. average annual growth of 4.3% is projected in the period 2025 - 2029.

Such scenario also assumes unfavourable effects on the inflow of capital in the country in th e form of direct investments, implying slower growth of gross investments in the medium term, as a result of the lower growth of investments in the construction sector, as well as machinery and equipment, also implying lower growth of import of capital goods. As a result thereof, real gross investments are projected to increase by 5.7% on average annually in the forecasting period, compared to the projected growth of 7.6% in line with the baseline scenario. Lower growth of gross investments is mainly due to the slower growth of private investments, and to a lesser extent to the growth of public investments.

Effects on both private and public consumption are also expected. Hence, real growth of public consumption is projected at 0.7%, while real growth of private consumption is by 0.8 p.p. lower in relation to the baseline scenario, projected at 2.1% on average annually in the forecasting period. Lower growth of both export and domestic demand implies slower growth of import which, in the analysed period, is envisaged to surge by 3.6% on average annually, as opposed to the projected growth of 4.8% according to the baseline scenario. Such adjustments with respect to GDP components imply average annual economic growth of 3.3% in the period 2025-2029 (Chart 3.28).

The second alternative macroeconomic scenario is related to the risk of weaker contribution of domestic demand to the economic growth, amid lower realisation of infrastructure projects and execution of capital expenditures, as well as weaker impact from the support to the enterprises' investment activity. Against such background, real growth of gross investments is projected at 5.7% on average annually in the forecasting period, being lower by 1.9 p.p. in relation to projection according to the baseline scenario, whereby it is estimated that most of this effect is due to public investments. Thereby, weaker growth of investments implies lower real growth of import which, under this scenario, is 4.5% on average annually in the forecasting period, compared to the projected growth of 48% in line with the baseline scenario. Effects on the export in this period are expected to be lower, with net export having slight positive contribution to the economic growth in the period 2025-2029. However, more favourabe net export demand does not offset the negative effect of the weaker growth of investments on domestic demand and economic growth. Thus, under this scenario, growth of economic activity in the period

Chart 3.28. Economic growth, baseline and alternative scenarios



Source: MoF forecast

2025 - 2029 is projected at 3.9% on average annually, i.e. by 0.6 p.p. lower compared to the baseline scenario (Chart 3.28).

As regards inflation rate, slower economic growth according to both alternative scenarios implies that the inflationary pressures by the demand are lower compared to the baseline scenario.

Effects of the alternative scenarios on the budget deficit are presented in point 4.7. Sensitivity Analysis.

Risks. Baseline macroeconomic scenario is accompanied by risks, mainly assessed as downside ones, in relation to the projected economic growth. Risks related to the external environment remain to be associated with geopolitical tensions. Warr in Ukraine adversely affects the European economy, in particular the economic activity in Germany, as a country to which the domestic companies export the most, and, coupled with the war conflict in the Middle East, it affects the global perception of peace. Further deepening of geoeconomic fragmentation, with higher barriers to the flow of goods, capital and people, would have unfavourable effects on the supply chains and the stock market prices, also affecting trade and external environment. Risks to inflation forecasts are related to commodities price trends, i.e. their increase due to geopolitical factors and disrupted supply chains.

The downward risks from the external environment are further pronounced and are associated with the escalation of the regional conflicts, with the risk for the interest rates to remain at a higher level for a longer time, with the possibility of prolonging the financial market volatility which would affect adversely the markets of government debt instruments. In addition, the risk for a greater slowdown in the growth of the Chinese economy and the continuous intensification of protectionist policies, could increase the global trade tensions, reduce the market efficiency and further disturb the global supply chains.

Observing domestic risks, in the short term they are related to the dynamics of implementation of major infrastructure projects. In the medium run, there could be positive effects of the NATO membership and the progress in the EU accession negotiations, as well as the new EU Growth Plan for the Western Balkans, which could enhance the economic integration and the social and economic convergence of the country, and the possible use of the geographic positioning of our economy within the initiated process of global chains adjustment. At the same time, the expected accession to the Single Euro Payments Area (SEPA) would encourage the market integration of the country by removing the financial flow barriers with the EU member countries, as part of the efforts to transform the payment infrastructure, and to lay the foundations in the financial area towards the EU. Joining SEPA would mean cheaper, faster and more efficient payment system which could ultimately contribute to greater competitiveness of the domestic corporate sector.

Significant risk in relation to the presented scenario for the exports in the next period includes the uncertainty about the dynamics of recovery of the countries - major trading partners (especially Germany, where about 45% of the Macedonian export is placed). Any weaker external demand may have adverse effects on the presence of domestic exporters at foreign markets. The weaker global outlook for growth and the potential financial market instability could increase investors' risk aversion and consequently, risks of lower capital inflows of non-debt financing or possible capital outflows for funding parent companies. In addition, the movement of the world prices of primary products is accompanied by increased uncertainty, with possible effects on both domestic inflation and export prices. The reduced energy prices, together with the more efficient and economical use of energy and the increased domestic production in the coming period, are expected to gradually narrow the energy deficit. The further diversification of exports and the improvement of the export performances is conducive to strengthening the economic resilience to external shocks.

After the expected normalization of net inflows based on secondary income (within their framework of net cash purchased on the currency exchange market) in the post-pandemic period and their high level in 2023, in 2024 they experienced a moderate slowdown, which is expected to continue at a moderate pace in the next three years. After the uncertainty caused by the pandemic, net inflows from FDIs returned to the current average moderate levels, with similar expectations for this and the next three years, taking into account the continuity of these inflows (at a moderate level, even in the years of crisis), as well as continuation of the FDI attracting policies.

The external risks to the inflation forecast remain upward and are associated with primary commodities prices, which are influenced by the unstable geopolitical context and climate factors. As for the domestic factors, risks arise from the possible price pressures due to the increased electricity price for small consumers on the regulated market as of July 2024, as well as for households in the following period, the growth of wages and pensions and slower fiscal consolidation according to the latest Fiscal Strategy.

The aforementioned risks to the macroeconomic scenario indicate a need for constant monitoring of the changes in the external and domestic economic environment in the period ahead and a need for the policy makers to take timely and adequate measures.

4. Fiscal Framework

4.1 Fiscal Strategy and Medium-Term Objectives

Public Finance Management System in the Republic of North Macedonia is regulated under the Organic Budget Law. Pursuant to the Organic Budget Law, Fiscal Strategy comprises medium-term guidelines and goals of the fiscal policy, main macroeconomic projections, amounts of the main categories of projected revenues and expenditures, as well as budget deficit and debt projections. The strategy is prepared having in mind the Fiscal policy statement adopted by the Government of the Republic of North Macedonia, which contains the guidelines for the public finances and the fiscal policy for the period of the Government’s mandate, including:

- improvement of the macroeconomic stability and support of the economic activity;
- disciplined budget policy, gradual fiscal consolidation, and reduction of the budget deficit level in accordance with fiscal rules;
- improvement of the structure and the management of the public finances, as well as keeping a high level of capital expenditures; and
- reaching a moderate level of total debt.

Key elements of the fiscal policy will comprise disciplined fiscal policy, reduced grey economy and higher budget revenue collection, as well as fiscal consolidation.

In addition to the commitment to fiscal consolidation and budget savings, economy will continue to be supported by investing in infrastructure projects, redesigning the public finance structure by maintaining high level of capital expenditures, as well as strengthening both the transparency and the accountability.

Over the medium-term, fiscal policy envisages gradual fiscal consolidation, thereby, budget deficit is reduced as a percentage share of GDP, as follows: 4% in 2025, 3.5% in 2026, 3% in 2027, 3% in 2028 and 2.8% in 2029. Primary budget deficit will accordingly decline gradually, as follows: 2% of GDP in 2025, 1.6% in 2026, 0.9% in 2027, 1% in 2028 and 0.7% in 2029.

Share of capital expenditures accounting for around 5% of GDP on average on annual basis is of key importance for generating economic growth and development.

In the period 2025 - 2029, tax policy will be based on reducing grey economy and higher budget revenue collection. In fact, the objective is to reduce grey economy through increased digitalisation and establish an efficient tax system, all to the end of ensuring that everyone pays their fair share of taxes. It will allow for keeping the low tax rates at the other taxes, at the same time contributing to higher amounts for capital investments accounting for around 5% of GDP, tax exemptions, subsidies intended for supporting the private sector and the citizens.

The process of increasing own revenues of municipalities and the strengthening of capacities for management of funds and other assets continues, through improved performance of the transferred competences.

For the purpose of improving fiscal decentralisation, in the period to come, plenty of activities and measures are planned, as follows:

- further improvement of fiscal capacity and increased municipal revenues,
- strengthened fiscal discipline and
- increased transparency and accountability throughout the operations of the municipalities.

Public debt management policy will be aimed at ensuring the funds necessary to finance the budget deficit and repay the due liabilities on the basis of prior borrowings, as well as funds for project financing, thereby not increasing the debt to a level that can jeopardise the stability of the economy and the economic growth of the country.

Table 4.1. General government budget

	millions of denars								% of GDP							
	2022	2023	2024	2025*	2026*	2027*	2028*	2029*	2022	2023	2024	2025	2026	2027	2028	2029
Central budget																
Income	124,185	142,731	159,069	183,003	199,290	219,085	240,636	266,199	15.5	17.0	16.6	17.9	18.3	18.8	19.2	19.9
Expenditures	157,700	181,848	202,428	221,767	237,745	253,636	277,979	303,902	19.6	21.6	21.1	21.7	21.8	21.7	22.2	22.7
Budget balance	-33,515	-39,117	-43,360	-38,764	-38,455	-34,551	-37,344	-37,703	-4.2	-4.7	-4.5	-3.8	-3.5	-3.0	-3.0	-2.8
Budget funds																
Income	94,795	104,051	119,720	137,657	146,667	152,235	158,560	163,121	11.8	12.4	12.5	13.5	13.4	13.1	12.7	12.2
Expenditures	96,043	106,371	121,027	140,243	146,676	152,245	158,570	163,131	12.0	12.7	12.6	13.7	13.4	13.1	12.7	12.2
Budget balance	-1,248	-2,320	-1,306	-2,586	-10	-10	-10	-10	-0.2	-0.3	-0.1	-0.3	0.0	0.0	0.0	0.0
RSM budget (Central budget and funds)																
Income	218,980	246,782	278,789	320,660	345,957	371,320	399,196	429,322	27.3	29.4	29.1	31.4	31.7	31.8	31.9	32.0
Expenditures	253,743	288,219	323,455	362,010	384,422	405,881	436,550	467,033	31.6	34.3	33.8	35.4	35.2	34.8	34.9	34.8
Budget balance	-34,763	-41,437	-44,666	-41,350	-38,465	-34,561	-37,354	-37,711	-4.3	-4.9	-4.7	-4.0	-3.5	-3.0	-3.0	-2.8
Local government budget																
Income	38,716	47,375	56,609	57,973	61,440	65,240	69,794	75,450	4.8	5.6	5.9	5.7	5.6	5.6	5.6	5.6
Expenditures	38,911	44,309	56,609	57,973	61,440	65,240	69,794	75,450	4.8	5.3	5.9	5.7	5.6	5.6	5.6	5.6
Budget balance	-195	3,066	0	0	0	0	0	0	0.0	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Budget of the general government (Consolidated Budget of RSM and Budget of municipalities)																
Income	257,696	294,157	335,398	378,633	407,397	436,560	468,990	504,771	32.1	35.0	35.0	37.0	37.3	37.4	37.5	37.6
Expenditures	292,654	332,528	380,064	419,983	445,861	471,121	506,343	542,482	36.4	39.6	39.7	41.1	40.9	40.4	40.5	40.5
Budget balance	-34,958	-38,371	-44,666	-41,350	-38,464	-34,561	-37,353	-37,711	-4.4	-4.6	-4.7	-4.0	-3.5	-3.0	-3.0	-2.8
Source: Ministry of Finance and Ministry of Finance projections (*)																

Source: Ministry of Finance and Ministry of Finance projections (*)

4.2 Budget Execution in 2024

State Budget revenue and inflow performance is within the expectations for this period of the year, while expenditures are executed on regular and timely basis. In the period January – October 2024, total revenues were collected in the amount of Denar 251,134 million (79% compared to the projections under the 2024 Supplementary Budget), being higher by around 11.9% in relation to the revenue collection in the analysed period last year. Denar 146,875 million out of this amount was tax revenues, increasing by 15% compared to last year. VAT revenues were collected in the amount of Denar 67,942 million, being higher by 20.9% compared to the same period in 2023, predominating with 46.3% in the tax revenue structure. Compared to the analysed period last year, profit tax revenues also increased by 17.9%, PIT revenues surged by 16.9%, excise duties grew by 7.6% with import duties increasing by 15.8%.

Revenues collected on the basis of social contributions amounted to Denar 85,570 million during this period of the year. This amount was by Denar 14.6% more in relation to the respective period in 2023. Denar 57,829 million was collected on the basis of pension insurance, while revenues collected on the basis of health insurance contributions amounted to Denar 24,192 million.

In the period January-October 2024, non-tax revenues were collected in the amount of Denar 14,708 million, which compared to the same period in 2023, were higher by 8.3%. Capital revenues were collected in the amount of Denar 1,625 million, being generated from sale of construction land and social flats. Budget users generated Denar 2,356 million on the basis of donations from international multilateral and bilateral cooperation.

Table 4.2. Budget Execution as of October 2024 Inclusive

	Revised Budget 2024	Realization January-October 2024
1. Total Revenues	**318,150**	**251,134**
1.1. Taxes and Contributions	284,469	232,445
1.1. 1 Taxes	179,257	146,875
1.1. 2 Contributions	105,212	85,570
1.2. Non Tax Revenues	22,541	14,708
1.3. Capital Revenues	3,240	1,625
1.4. Donations and other revenues	7,900	2,356
2. Total Expenditures	**362,816**	**275,146**
2.1. Current Expenditures	318,118	256,385
2.1.1 Wages and Allowances	44,537	35,668
2.1.2 Goods and Services	25,509	17,885
2.1.3 Transfers	230,439	187,029
2.1.4 Interest	17,632	15,803
2.2. Capital Expenditures	44,698	18,761
3. Budget Balance	**-44,666**	**-24,012**
4. Financing	**44,666**	**24,012**
4.1. Inflow	83,727	61,034
4.1.1 Other inflows	500	829
4.1.2 Foreign Loans	48,487	44,937
4.1.3 Domestic borowing	55,128	46,217
4.1.4 Deposits	-20,388	-30,949
4.1.5 Self of Shares	0	0
4.2 Outflow	39,061	37,022
4.2.1 Repayment od Foreign	20,334	19,138
4.2.2 Repayment of Domestic	18,727	17,884

Source: Ministry of Finance

In the period January – October 2024, State Budget expenditures were executed in the amount of Denar 275,146 million (75.8% of the projected ones under the 2024 Supplementary Budget), i.e. by 10.3% more compared to the same period last year.

Within these frameworks, current expenditures amounted to Denar 256,385 million or by 16.5% more compared to the same period in 2023. During this period, Denar 35,668 million was paid for wages and allowances to the employees with the budget users, while expenditures related to goods and services were executed in the amount of 17,885 million.

Transfer-related expenditures accounted for the most in the current expenditures, amounting to Denar 287,029 million in this period. Government liabilities on the basis of payments related to exercising the rights to guaranteed social protection of the citizens (pecuniary allowances to vulnerable categories of citizens, as well as child allowance and parenting payments) were settled on regular basis, amounting to Denar 12,290 million. As regards regular payment of pensions, Denar 74,235 million was allocated therefore, with respect to financing health services and benefits, Denar 37,617 million was paid, while Denar 2,154 million was allocated for payment of unemployment benefits through the Employment Service Agency. Denar 21,628 million was transferred from the Budget of the Republic of Macedonia to the municipalities, as block grants for financing the transferred competences, as well as earmarked grants for financing the operating costs in local public institutions. In addition, Denar 3,476 million was transferred on the basis of VAT revenues. During this period, as of November inclusive, agricultural subsidies accounted for most of the paid subsidies, i.e. around 77% of the projected ones throughout the year.

Denar 15,803 million was allocated for regular servicing of liabilities on the basis of interest, according to the repayment schedules on domestic and foreign borrowing. Denar 10,144 million out of this amount was allocated for payment of interest on foreign borrowing.

In the period January-October 2024, capital expenditures were executed in the amount of Denar 18,761 million or by 35.9% lower compared to the same period in 2023.

In the period January-October 2024, State Budget deficit amounted to Denar 24,012 million or 2.5% of GDP projected in 2024.

4.3 Budget Plan for 2025

2025 Budget of the Republic of North Macedonia is prepared on the basis of 2024-2028 Fiscal Policy Statement and the adopted 2025 - 2029 Fiscal Strategy.

2025 Budget is based on the following priorities:

- restoring confidence in the institutions, strengthening the security, efficient fighting against corruption and crime, independence of judiciary and rule of law;
- country's economic revival, enhancing the energy transition, encouraging strong economic growth, stable public finances, improving the overall transport infrastructure, increasing the living standard, better and quality life for everyone;
- improving the national defense policy and planning in support of protecting independence, territorial integrity, safety of the citizens, as well as collective safety;
- integration of the Republic of North Macedonia in the European Union;
- extensive improvement of quality, infrastructure and availability of/accessibility to education, creating a knowledge-based society and successfully coping with the modern challenges;
- professional and efficient public administration, development of digital economy, ICT sector, artificial intelligence, innovations and startup ecosystem;
- creating a setting for clean environment and coping with climate changes, and
- implementing the Ohrid Framework Agreement in full, strengthening multicultural cohesion and promoting multicultural values.

Fiscal consolidation and redesigned budget policy, via scaled-up capital investments, are key elements of fiscal policy aimed at supporting the macroeconomic stability, accelerating the economic growth, thus strengthening the growth potential of the national economy.

Budget policy will continue contributing to maintaining the macroeconomic stability via further fiscal consolidation over the medium term, optimizing the budget structure and strengthening the fiscal sustainability. Moreover, throughout 2025 as well, support to the economy continues through investments in priority infrastructure projects, redesigning the public finance structure by increasing the share of capital expenditures, strengthening the social security for the vulnerable categories of citizens and companies, as well as strengthening the process of planning, executing and accountability as regards public finances.

2025 Budget is aimed at providing funds for targeted support for the vulnerable categories of citizens and companies, all to the end of preserving the living standard, increasing the social inclusion and social cohesion, as well as supporting the liquidity of the vulnerable categories of businesses.

As regards achieving fiscal consolidation, it is planned to continuously improve the Budget planning system via redesigning expenditures, better control of costs and undertaking certain measures on the revenue and the expenditure side.

Total revenues of the 2025 Budget of the Republic of North Macedonia are projected in the amount of Denar 358.8 billion, being higher by 13% in relation to 2024, while expenditures are projected in the amount of Denar 400.2 billion, being higher by 10% in relation to 2024.

Exception from the budget deficit fiscal rule is a result of the need to provide financial resources for the following:

- wage adjustment as per the General Collective Agreements signed in several sectors,
- covering the high amount of arrears,
- implementation of infrastructure and energy projects aimed at improving quality life of the citizens and boosting the competitiveness of businesses,
- digital transformation of the public sector,
- improved education quality and student standards, improved quality of helathcare,
- encouraging balanced economic growth,
- financing LGUs' capital projects
- implementing the new policies of the Government aimed at improving the living standard of the citizens via linear increase of pensions,
- implementing prior agreed large infrastructure projects, such as Corridors 8 and 10d Motorway Project, for which a special Law was adopted, without thereby taking into account the costs related to expropriation, geological surveys, design and other costs related to the project construction works.

2025 budget revenue projections are based on 2024 revenue performance, the expected macroeconomic indicators, historical data on revenues and the adopted measures for improvement of public revenue efficiency.

For the purpose of attaining the revenue projections, measures and activities have been planned, geared towards: reducing the tax evasion by implementing measures for formalisation of the informal economy; introducing advanced technologies; modernisation and automation of the working processes; strengthening the revenue collection capacities to the end of increased and more efficient tax revenue collection; and strengthening the institutional coordination.

Introduction of e-invoicing is one of the first activities planned to be undertaken in the coming period, aimed at carrying out tax audit in a more efficient manner and saving the tax administration resources, as well as saving time and effort of the taxpayers. E-Invoicing and E-Fiscalisation Project would be crucial for easier detecting and combating informal economy, i.e. closely monitoring the supply and payment of taxes by the taxpayers.

Thus, the tax system optimisation provides for a fair, efficient, transparent and modern tax system based on contemporary digital technologies and innovations, all to the end of attaining an accelerated, inclusive and sustainable economic growth.

Table 4.3. Budget of the Republic of North Macedonia (% of GDP)

	2017	2018	2019	2020	2021	2023	2024	2024	2025
TOTAL REVENUES	**29.1**	**28.5**	**29.4**	**28.3**	**29.9**	**30.3**	**30.9**	**33.2**	**35.1**
Taxes and Contributions	**25.5**	**25.9**	**25.8**	**25.9**	**26.9**	**27.4**	**27.9**	**29.7**	**31.2**
Tax Revenues	16.9	17.3	16.9	16.0	17.2	17.8	17.6	18.7	19.8
Personal income tax	2.5	2.7	2.7	2.8	2.8	3.0	3.0	3.3	3.5
Profit tax	1.8	2.2	1.7	1.6	1.5	2.0	1.9	2.2	2.3
VAT	7.7	7.5	7.5	7.0	8.0	8.1	7.8	8.2	8.5
Excise duties	3.7	3.8	3.8	3.4	3.5	3.2	3.0	3.1	3.5
Customs	0.8	0.8	0.9	1.0	1.2	1.2	1.3	1.4	1.6
Other taxes	0.1	0.1	0.1	0.1	0.1	0.1	0.4	0.1	0.1
Tax revenues (own accounts)	0.2	0.3	0.2	0.2	0.2	0.3	0.2	0.4	0.3
Contributions	8.6	8.6	9.0	9.9	9.7	9.7	10.3	11.0	11.5
Pension insurance contribution	5.8	5.7	6.1	6.7	6.6	6.5	7.0	7.5	7.9
Employment contributions	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Health insurance contribution	2.4	2.4	2.5	2.8	2.7	2.7	2.9	3.0	3.1
Non-tax revenue	**2.2**	**1.9**	**2.7**	**1.7**	**1.9**	**2.1**	**1.9**	**2.4**	**2.6**
Capital income	**0.2**	**0.3**	**0.3**	**0.3**	**0.3**	**0.3**	**0.2**	**0.3**	**0.3**
Donations	**1.2**	**0.5**	**0.6**	**0.5**	**0.8**	**0.4**	**0.9**	**0.8**	**1.0**
TOTAL EXPENDITURES	**31.8**	**30.3**	**31.4**	**36.4**	**35.2**	**34.7**	**35.5**	**37.9**	**39.1**
Current expenditures	**28.6**	**28.4**	**28.8**	**34.0**	**32.0**	**31.1**	**30.6**	**34.0**	**34.5**
Salaries and allowances	4.2	4.0	4.0	4.4	4.3	4.0	4.1	4.6	4.7
Goods and services	2.5	2.2	2.3	2.3	2.8	2.6	2.4	2.7	2.6
Transfers to LSGUs	2.8	2.7	2.8	3.2	2.9	2.9	3.1	3.2	3.3
VAT subsidy	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.5
Subsidy block	2.4	2.4	2.4	2.8	2.6	2.5	2.7	2.8	2.8
Subcidies and transfers	2.4	3.1	2.9	5.2	4.2	4.1	3.1	3.5	3.3
Social Transfers	15.3	15.2	15.6	17.6	16.6	16.4	16.6	18.1	18.7
Pensions	8.4	8.2	8.1	9.0	8.5	8.4	8.7	9.5	10.3
Transition costs	1.0	1.1	1.3	1.3	1.3	1.3	1.4	1.6	1.4
Unemployment benefits	0.1	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.2
Active employment measures	0.1	0.1	0.1	0.2	0.2	0.2	0.1	0.2	0.2
Social benefits	1.3	1.3	1.4	1.7	1.6	1.5	1.5	1.5	1.4
Health care	4.4	4.4	4.4	5.2	4.8	4.8	4.7	5.1	5.1
Interest payments	1.4	1.2	1.2	1.2	1.2	1.1	1.4	1.8	2.0
Capital Expenditures	**3.2**	**1.8**	**2.6**	**2.4**	**3.2**	**3.6**	**4.8**	4.0	**4.6**
BUDGET BALANCE	**-2.7**	**-1.7**	**-1.9**	**-8.0**	**-5.3**	**-4.4**	**-4.6**	**-4.7**	**-4.0**

Source: Ministry of finance

Introduction of e-invoicing is one of the first activities planned to be undertaken in the coming period, aimed at carrying out tax audit in a more efficient manner and saving the tax administration resources, as well as saving time and effort of the taxpayers. E-Invoicing and E-Fiscalisation Project would be crucial for easier detecting and combating informal economy, i.e. closely monitoring the supply and payment of taxes by the taxpayers.

Thus, the tax system optimisation provides for a fair, efficient, transparent and modern tax system based on contemporary digital technologies and innovations, all to the end of attaining an accelerated, inclusive and sustainable economic growth.

Tax revenues in 2025 are projected in the amount of Denar 202.2 billion, being higher by around 12.8% compared to the revenues projected in the 2024 Budget. VAT accounts for the most of the projected tax revenues, accounting for 42.9%, while excise duties account for 17.5% thereof.

Under 2025 Budget, around Denar 26.3 billion is projected to be generated on the basis of non-tax revenues (administrative fees, concessions and other non-tax revenues) and Denar 3.5 billion as capital revenues (on the basis of sale of agricultural land and social flats, as well as on the basis of planned dividend from AD Makedonski Telekom (JSC Macedonian Telecom).

Social contributions, as genuine revenues of both the Pension and Disability Insurance Fund and the Employment Agency, are projected in the amount of Denar 117.1 billion, being by 11.3% higher in relation to 2024.

During 2025, Denar 9.8 billion is envisaged on the basis of donations, which are planned for the budget users to use through special revenue accounts for specific projects, as well as on the basis of disbursements under the EU pre-accession funds.

Total budget expenditures in 2025 are projected in the amount of Denar 400.2 billion, or by Denar 10.3% billion more compared to 2024 Budget. Next year's budget expenditure projections have been prepared on the basis of the following assumptions:

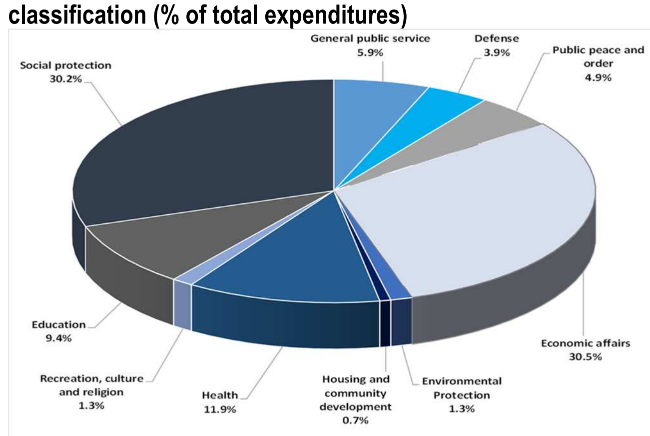
- increase of efficiency, productivity, transparency and accountability of public sector employees, public administration optimisation through corresponding changes in its structure and quality and adjustment of employees' wages as per economic growth and the existing legal regulation;
- more efficient use of operating resources by improving the planning and the execution of operating expenditures,
- reducing the non-essential expenditures, as well as introducing spending standards,
- better quality services under the decentralised competences of the municipalities by redefining the criteria for allocation of funds and more efficient and earmarked use of grant funds;
- ensuring greater positive impact on the economic activity by more efficient and targeted use of funds for subsidies and transfers;
- reducing poverty by properly targeting the use of social assistance and greater workforce participation in the labour market.

Current expenditures in 2025 are projected in the amount of Denar 353 billion, being higher by 11% compared to 2024. They are intended primarily for regular payment of wages to the public sector employees, timely and regular payment of pensions, guaranteed minimum income and other social benefits, payment of agricultural subsidies, support to small- and medium-sized enterprises, support and subsidising of innovation activities, as well as allocating funds for targeted support to vulnerable categories of citizens and businesses.

Under the current expenditures, the following is projected:

a) expenditures related to wage payment are projected in the amount of Denar 48.1 billion, being higher by around 8% in relation to 2024. Projected wage bill includes wage adjustment as per the Collective Agreements signed in several sectors, while new employments will take place primarily through mobility and taking over employees from other public sector institutions. As regards wages, adopted government measures and recommendations for optimising public sector employees have been implemented, all to the end of increasing the incentive for professional and high-quality fulfillment of the working tasks.

Chart 4.1. Expenditures of the Budget of RNM 2025 – funcional classification (% of total expenditures)



b) expenditures related to goods and services are projected in the amount of Denar 26.3 billion, accounting for around 3.2% of the projected GDP, i.e. accounting for 6.5% of the total expenditures, decreasing by 0.5% compare to 2024. Funds are thereby also provided for smooth functioning of the institutions, carrying out election activities, as well as fulfilment of the obligations arising from NATO standards.

c) current transfers and subsidies are projected in the amount of Denar 257.7 billion, including the following:

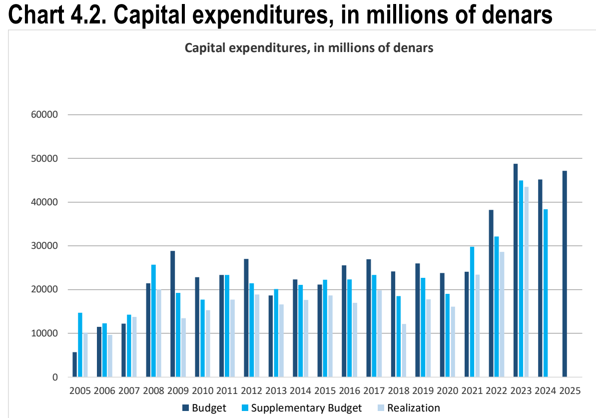
- Social transfers projected in the amount of Denar 191 billion, as follows:
  - payment of pensions, with Denar 105.5 billion being projected, including the effect from the linear increase of pensions of Denar 2,500 for each pensioner, starting March 2025, aimed at proving for a descent living standard for the pensioners.
  - payment of social protection benefits for the most vulnerable categories, with around Denar 14.5 billion being projected, including the beneficiaries of guaranteed minimum income, as well as funds for social safety of elderly,
  - payment of unemployment benefits, with Denar 1.6 billion being projected therefor,
  - implementation of active employment policies and measures, with Denar 2.3 billion being projected, aimed at creating employment programmes, measures and services to the end of improving the functioning of the labour market, supporting the job creation, employing young persons, supporting employment of disabled persons, including the working-age household members, and providing for the beneficiaries of guaranteed minimum income (GMI) to be included in the active employment policies and measures.
  - funds in the amount of around Denar 52.5 billion are projected for health care, to be employed through the Health Insurance Fund, with most of the funds being intended for financing health care services and payment of liabilities of the public health institutions.
  - agricultural subsidies provide support to the agriculture sector, to the end of increasing the domestic plant and animal production, stimulating yields, increasing the productivity and boosting the competitiveness, as well as cushioning the price pressures on the basic food products.
  - transfers to LGUs are projected in the amount of Denar 33.2 billion, intended for financing the competences transferred to the municipalities and grants to municipalities.
- Transfers to the municipalities
  - VAT revenues distributed to the municipalities in 2025 will account for 6% of the VAT collected in the previous year, hence general grants to municipalities will be increased by Denar 505 million compared to 2024. These funds will be distributed as follows: General Fund - 4.5%, Performance Fund - 0.75% and Equalization Fund - 0.75%. Under the Performance Fund, funds are awarded to the municipalities showing improved own revenue collection compared to the projected and higher collection of own revenues in the current year compared to the average of own revenues collected in the previous three years. Equalisation Fund is intended for overcoming the differences in line with the fiscal capacity of the municipalities due to their limited resource capacity, i.e. the municipalities with lower PIT revenues per capita receive additional funds.
  - block and earmarked grants are intended for financing the operating costs and payment of wages to employees in the institutions which the LGUs are being transferred competences for, i.e. wages for employees at schools, kindergartens, elderly homes, cultural institutions and firefighters.
  - additional increase of Denar 3 billion is intended for financing the increased wages in the local institutions financed with block and earmarked grants and payment of vacation allowance arising from the General Collective Agreement for the public sector employees, as well as covering the operating costs of the institutions financed through block grants.

In line with the projections, they include a strong development component, with a significant share of capital expenditures of around 4.6% of GDP annually, and they are a key element of public finances. Hence, capital expenditures amount to around Denar 47.2 billion in the 2025 Budget, accounting for 11.8% of the expenditures.

The Budget puts the focus on capital investment implementation, exclusively intended for efficient projects, in particular transport and energy projects in support of the business sector and capital projects in the field of utilities and other local infrastructure, aimed at improving the living conditions of the citizens, such as improvement of the conditions in the health, education and social system, agriculture and environmental protection.

Government's financial support and cooperation with the municipalities will be geared towards providing budget resources for capital infrastructure projects in the municipalities, increased financial stability of municipalities by ensuring equal distribution of funds, while paying attention to the balanced regional development principles, benefits and incentives for those municipalities with well-designed budgets, high expenditure execution, high local tax collection, as well as improved methodology for calculating the ongoing maintenance costs.

Chart 4.2. Capital expenditures, in millions of denars



Source:MoF

As regards the road infrastructure, construction of the eastern part of Road Corridor 8, Rankovce - Kriva Palanka section, financed with a loan from the World Bank, as well as construction of the section Kriva Palanka - Border with the Republic of Bulgaria, financed with a loan from the European Bank for Reconstruction and Development - EBRD and grant funds under the Wester Balkans Investment Framework - WBIF, will continue in 2025. Western part of Road Corridor 8 will also be financed in 2025, by constructing Kichevo – Bukojchani motorway section, with an EBRD loan, as well as Kichevo - Ohrid motorway section with EXIM Bank loan. Substantial investments are projected in the field of road infrastructure, related to the design process and the construction of part of Corridor 8, such as Tetovo – Gostivar highway (highway expansion), construction of Gostivar - Bukojchani section, as well as Prilep - Bitola section as part of Corridor 10d.

Moreover, construction of Skopje – Blace motorway section (border with Kosovo) is envisaged, financed with a loan from EBRD, alongside improvement of the road infrastructure in the municipalities in the Republic of North Macedonia through the Local Roads Connectivity Project, financed with World Bank loans. National Roads Programme, financed with an EBRD loan, continues to be implemented, as well as the activities under the Western Balkans Trade and Transport Facilitation Project, which is part of the World Bank regional initiative, with funds for its financing being provided therefrom.

During 2025, as regards the railway infrastructure, funds are projected for continuing the implementation of the first and the second phases of the Rail Corridor VIII Project - Kumanovo - Beljakovce - Kriva Palanka section, financed by EBRD. In addition to EBRD loan and grant funds under the Western Balkans Investment Framework, activities are envisaged under the Project, being aimed at improving the technical features of the railroad tracks, construction and rehabilitation of bridges, railway stations, stops, underpasses and overpasses.

As for railway infrastructure, in 2025, in cooperation with the EBRD, a project will be prepared and implemented, foreseeing a construction of a joint railway border crossing with the Republic of Serbia, i.e. construction and equipping of Tabanovce rail station.

IPA funds will be used for implementing the Project for Construction of Road Section Gradsko - Intersection Drenovo, as part of Road Corridor 10d.

With respect to water supply and utilities infrastructure and waste management, construction of water supply and sewerage systems in the municipalities is envisaged, to be financed from own sources of revenues and funds under the new EIB credit line. Moreover, major capital project to be implemented in this area is the Regional Solid Waste Management Project, to be financed with an EBRD loan. The Project will support the development and the construction/reconstruction of regional waste management systems in the following selected regions in the Republic of North Macedonia: Southwest Region, Pelagonija and Polog Regions, Vardar and Southeast Regions. Activities under one of the major capital projects in the country - Project for Construction of Skopje Wastewater Treatment Plant, financed with loans from both EIB and EBRD, as well as investment grant under the Western Balkans Investment Framework - WBIF.

Projected 2025 deficit in the amount of Denar 41,350 million and outflow in the amount of Denar 82.6 billion (out of which Denar 49.3 billion for repayment of foreign debt, Denar 16.9 billion for repayment of domestic debt, Denar 1 billion on the basis of guarantees and Denar 15.4 billion on the basis of a loan to the Development Bank of North Macedonia) will be financed through domestic and foreign borrowing.

Repayment of principal on the basis of foreign debt, amounting to Denar 49.3 billion, includes repayment of 2018 Eurobond - Denar 30.7 million, NSV Bond - Denar 7.7 billion, and servicing of liabilities towards foreign creditors: IMF - Denar 2.6 billion, IBRD - Denar 3.5 billion, EBRD - 2.1 billion, IDA - Denar 0.9 billion, CEB - Denar 0.6 billion, EIB - Denar 0.7 billion and the remaining Denar 0.5 billion towards other bilateral creditors (IFAD, KfW, JICA, etc.).

Principal repayment on the basis of domestic debt in the total amount of Denar 16.9 billion pertains to repayment of 2-year, 3-year, 5-year and 10-year government bonds in the amount of Denar 16.5 billion and repayment of structural bonds in the amount of Denar 0.4 billion. Remaining long-term bonds with maturities of 7, 15 and 30 years do not fall due in 2025.

Domestic borrowing is projected in the amount of Denar 56.5 billion, which will be provided by borrowing with GS and/or domestic loan. Borrowing on the domestic market will provide for financing under favourable terms and conditions, by using more favourable interest rates. At the same time, for the purpose of optimising the government securities' portfolio, all to the end of reducing the refinancing risks, Ministry of Finance will be also committed to lengthening maturity of the government securities' portfolio.

External borrowing will be in the form of disbursement of the second tranche under the EU macro-financial assistance in the amount of EUR 50 million, bilateral loan in the amount of EUR 500 million, as well as disbursements under other credit lines from international financial institutions intended for financing individual projects and/or budget deficit.

On 30th September 2024, general government debt of the Republic of North Macedonia amounted to EUR 7,659.8 million, accounting for 49.3% of GDP, while public debt amounted to EUR 8,847.0 million, accounting for 56.9% of GDP. According to the latest projections of the Ministry of Finance, at the end of 2024, general government debt will account for 53.7 of GDP, with public debt expected to account for 62.7%.

4.4 Medium-Term Budgetary Outlook

2025 - 2029 fiscal policy will be aimed at the following goals:

- improving macroeconomic stability, supporting economic activity, accelerating economic growth,

- adhering to the fiscal rules, through gradual fiscal consolidation and disciplined budget spending,

- growth in capital expenditures by making investments in infrastructure projects,

- reducing the grey economy and higher budget revenue collection,

- strengthening the growth potential of the domestic economy.

Fiscal policy for the period 2025 - 2029 will be also aimed at creating preconditions for a new cycle of economic growth via boosted public capital investments, gradual fiscal consolidation and improved public finance management.

Over the medium-term, fiscal policy envisages gradual fiscal consolidation, thereby, budget deficit is reduced as a percentage share of GDP, as follows: 4.0% in 2025, 3.5% in 2026, 3.0% in 2027, 3.0% in 2028 and 2.8% in 2029.

Total revenues of the Budget of the Republic of North Macedonia (Central Budget and Funds: Pension and Disability Insurance Fund, Health Insurance Fund and Employment Agency) for the period 2025 - 2029 are projected to around 35.5% of GDP. Revenue projections in the coming medium-term period are based on revenues generated in the previous years, projections for macroeconomic indicators and the effects from the planned tax reforms.

Main objective of the tax policy in the coming period is to ensure sustainable economic growth and development, thereby providing for legal certainty for taxpayers and collection of public revenues on regular basis. Its main priorities are the following:

- greater fairness in taxation, in order to ensure that everyone meets its social obligation and pays its fair share of tax;

- increased efficiency and productivity of the tax system for the purpose of improved revenue collection, via more efficient fight against illicit activities and tax evasion, and a strengthened institutional capacity, as well as reduction of the tax arrears,

- increased tax transparency, including an improvement in the exchange of information between tax authorities and other entities, to be, in particular, based on e-services, which will result in enhanced fiscal literacy and increased voluntary compliance,

- improved quality of services rendered by tax system institutions, designed to simplify and speed up the procedures and reduce the administrative burden, by increasing digitalised services, better management of the import-export licenses' issuance, elimination of unnecessary non-tariff barriers and improved internal and tax audit,

- introducing environmental (green) taxation, in order to stimulate taxpayers to contribute, through duties and fees, to pollution reduction, i.e. discourage them to pollute the environment. Effects of this priority are also expected to reflect on the budget revenues, as well as the environment.

Tax policy in the coming period will be aimed at keeping the low tax rates at certain direct and indirect taxes. As regards CIT, it will be aligned with the global minimum corporate income tax. Our country has already signed the OECD/G20 initiative and, starting 2025, 15% tax rate will apply on profit generated by corporations with consolidated revenues exceeding EUR 750 million.

During the previous period, changes were introduced in several tax areas, based on analyses of the national legislation and the tax revenue indicators, as well as the comparative analyses of the tax practice in the EU Member States and the other Western Balkan countries. Moreover, they incorporated findings and recommendations of international organisations, such as IMF, World Bank, OECD and EU, pointing out to the need to ensure increased vertical and horizontal fairness of the tax system and broadening of the tax base by revising the tax exemptions. In particular, as regards direct taxes, tax policy reforms are aimed at abolishing the non-productive tax expenditures which disrupt the neutrality of the tax system by favouring same or similar categories of taxpayers or activities, which have an adverse effect on the fair distribution of the tax burden and lead to increased inequality in the society, disrupt the robustness of the tax system by creating substantial room for tax arbitrage and/or avoidance and evasion and can cause inefficiency in the real economy.

Table 4.4 Review of Tax Rates in the Republic of North Macedonia – 2024

Type of Tax	Tax Rate %
Personal income tax	10% for all types of income
	15% on income on the basis of games of chance
CIT	10%
VAT	18% standard tax rate
	10% and 5% preferential tax rate
Mandatory Social Insurance Contributions (all)	28%
Property Tax, Annual	0.1%-0.2%
Tax on Sales of Real Estate	2%-4%
Tax on Inheritance and Gift	0% - first-order heir
	2% - 3% - second-order heir
	3% - 4% - other

Source: Ministry of FInance

Under the Law on Modifications and Amendments to the **Personal Income Tax Law**, the fiscal implications of which were estimated in the amount of Denar 533 million in 2024 ("Official Gazette of the Republic of North Macedonia", no. 274/22), tax exemptions as regards life insurance premium, premium for voluntary health insurance and contributions in a voluntary pension funds paid by the employers on behalf of and for the account of employed people are abolished, while tax base for certain benefits, considered as employees' income (benefits in kind for managers), is regulated more closely. Moreover, modifications and amendments to the Personal Income Tax Law envisage taxation of capital gains generated on the basis of sale of securities and shares issued by investment funds acquired after 1st January 2023, also closely regulating the tax base for capital gains generated on the same basis in case of inheritance or in case when their purchase price cannot be determined. The Law also regulates more closely the manner of PIT assessing and taxation of capital gains, as well as the PIT exemption on capital gains generated on the basis of sale of real estate and sale of securities. Furthermore, modifications and amendments to the PIT Law also govern the PIT exemption on interest on time deposits, and it will apply by the day the Republic of North Macedonia joins the European Union.

Under the Law on Modifications and Amendments to the **Corporate Income Tax Law**, the fiscal implications of which were estimated in the amount of Denar 872 million in 2024 ("Official Gazette of the Republic of North Macedonia", no. 199/23), tax exemptions as regards life insurance premium paid by the employers on behalf of and for the account of employed people are abolished, i.e. they are envisaged to be deemed as unrecognised expenditures for tax purposes. In addition, amendments are envisaged regarding the mandatory submission of transfer price report, i.e. it is prescribed for the respective report to be submitted upon request by the tax authority. To the end of greater tax discipline, the Law envisages increased fines for the entities failing to use the funds committed to making investments from the profit generated in the previous year, but having used the tax exemption on the basis of reinvested profit and having their tax base deducted by the respective amount. Moreover, pursuant to the Law, tax exemptions as regards donations to sports entities through the voucher system are abolished, i.e. the respective donations are equally treated with the donations in the other activities of public interest, such as health, education, culture, etc..

Under the modifications and amendments to the **VAT Law**, the fiscal implications of which were estimated in the amount of Denar 2,300 million in 2024 ("Official Gazette of the Republic of North Macedonia", no. 199/23), the respective Law is further harmonised with the EU Acquis in the field of value added tax. In fact, under the

Law on Modifications and Amendments to the VAT Law, the respective Law is further harmonised with the EU Directives as regards defining the VAT treatment of vouchers, defining the place of supply of services and introducing VAT tax representative so as for the foreign entities having no head office or subsidiary on the territory of the Republic of North Macedonia, but rendering supply of goods and services in country, subject to VAT taxation, to be able to report and pay the tax. Modifications and amendments to the Law also envisage increase of the VAT refund threshold and changes to the requirements for VAT refund to foreign diplomatic or consular representative offices. Moreover, the respective Law also envisages increase of the VAT rate (from 5% to 10%) on foodstuff for human consumption other than basic foodstuff for human consumption, reduction of VAT rate on supply of digital textbooks and menstural hygiene products for the purpose of advancing the digitalisation process and supporting the maintenance of hygiene, and it closely regulates the provisions pertaining to issuance of a VAT number and registration, and prescribes a special type of tax base.

Under the modifications and amendments to the **Law on Excises** ("Official Gazette of the Republic of North Macedonia", no. 209/23), the respective Law is further harmonised with the EU Acquis in the field of excises. The Law envisages alignment of the minimum overall excise duty on cigarettes with the minimum excise duty in the EU, as per Council Directive 2011/64/EU of 21 June 2011 on the structure and rates of excise duty applied to manufactured tobacco. Thereby, step-by-step process of harmonising the minimum excise duty on manufactured tobacco is envisaged by introducing a new Excise Calendar, by which excise duty on cigarettes and other tobacco products, as well as e-liquid, will be aligned with the respective Directive by 2030 inclusive. Furthermore, the Law regulates closely the excise duty on heated herbal products for smoking, regardless of whether they contain nicotine or not. The Law also envisages regulating more closely the legal provisions pertaining to the procedure for denaturing ethyl alcohol and its use, as well as facilitating the procedure for issuing approval for a preferential user in line with Council Directive (EU) 2020/1151 of 29 July 2020 amending Directive 92/83/EEC on the harmonisation of the structures of excise duties on alcohol and alcoholic beverages. In the area of misdemeanour procedures, excise duty-related misdemeanours have been revised and classified per the severity of the misdemeanour. The reform activities, as regards the Law on Excises, are projected to generate additional budget revenues, as follows: Denar 797 million in the second year, Denar 883 million in the third year and Denar 782 million in the fourth year of the reform implementation.

With respect to taxation of motor vehicles, the Government adopted the Decree on Modifications and Amendments to the **Decree on the Manner of Assessing Motor Vehicles Tax and the Amounts Needed for Calculation of the Motor Vehicles Tax** ("Official Gazette of the Republic of North Macedonia", no. 220/23), envisaging increased coefficients of the environmental component for taxation of passenger motor vehicles falling in the category of the largest CO2 polluters. For the purpose of assessing the environmental component of the motor vehicles tax, application of the new WLTP method (Worldwide Harmonised Light Vehicle Test Procedure), which complies with Regulation (EU) 2019/631 of the European Parliament and the Council of 17 April 2019, is envisaged alongside the existing NEDC method (New European Driving Cycle). Application of the WLTP method is geared towards implementing part of the environmental protection measures and the commitment to introducing "green taxation", incorporated in the Tax System Reform Strategy of the Republic of North Macedonia.

The Law on Modifications and Amendments to the **Law on Public Revenue Office** stipulates provisions on digitalisation and exchange of acts and information for tax purposes among the institutions and between the tax authority and the taxpayer. Moreover, the adopted Law on Modifications and Amendments to the PRO Law prescribes/introduces an integrated tax information system (ITIS) and a working body in charge of its implementation, strengthens the provisions on exchange of data among the institutions and increased interoperability, also envisaging greater independence of the PRO Director in terms of the organisational setup of this tax authority. The Law envisages for the status of administrative servants to change to tax officers and new/enhanced requirements as regards employment at the tax authority, as well as certain wage and allowance increases for the tax officers as per the labour market conditions.

Under the modifications and amendments to the Law on Partial VAT Refund to Individuals, which entered into force in March 2023, the amount of partial VAT refund to individuals has been increased and the model of declaring the highest amount of tax subject to refund has been changed, i.e. instead of Denar 12,000 tax base for a single quarter, the amount of VAT subject to refund to individuals has increased to Denar 2,100 per quarter. Moreover, the measure for partial VAT refund to individuals of 20% for Macedonian products and services and 10% for other goods and services continued to apply during this period, providing for additional income to each family, strengthening the purchasing power and having positive effect on increased consumption and VAT collection, as well as contributing to reduced tax evasion and informal economy.

In the course of 2022, Ministry of Finance informed the Government about the need to prepare and implement the E-**Invoicing and E-Fiscalisation Project**. In particular, to the end of increased efficiency and effectiveness and digitalisation of the tax processes, as well as reducing the informal economy by regularly monitoring the supply among the taxpayers and increased VAT control, both Ministry of Finance and PRO prepared draft E-Invoicing and E-Fiscalisation Project. However, the Project has not been implemented so far. The Project is planned to become operational as soon as possible, contributing substantially to reducing the tax burden on the taxpayers and speeding up and enhancing the conducting of tax audits. The goal is for the taxpayers to be given the opportunity to issue, transmit and receive invoices in a simplified manner. Moreover, better recording of and strengthened control over invoices will provide for efficiency of both the tax audits and the tax system, reducing the time for carrying out audits by the PRO.

In line with the adopted **2023 - 2027 Strategy on Formalisation of the Informal Economy** and related 2023 - 2025 Action Plan (September 2023), share of informal economy in the total economic activities in the country is expected to be reduced over the medium term, by reducing and eliminating the factors stimulating informal activities. All this will contribute to reducing both the number of unregistered business entities and the number of informally employed persons. To that end, by efficiently implementing the measures and the activities within the deadlines set in the Action Plan, informal economy is expected to be reduced to 26% of GDP by the end of 2027.

Table 4.5 Projections for the Current and the Next Five Years by Type of Tax (Denar million)

	Supplementary budget 2024	2025*	2026*	2027*	2028*	2029*
PIT	31,542	35,676	40,084	42,809	47,256	51,154
CIT	21,118	23,287	25,616	27,319	29,208	31,011
VAT	78,458	86,692	97,668	106,352	115,972	126,691
Customs Duties	29,837	35,388	34,064	35,923	38,834	42,264
Excise Duties	13,556	16,255	17,125	18,960	20,843	22,366
Other income tax	4,746	4,841	5,410	5,754	6,148	6,545
Total	179,257	202,139	219,967	237,117	258,261	280,031

Source: Ministry of Finance and Ministry of Finance's Projections(*)

Tax Expenditure Report. Tax expenditures are indirect expenditures incurred on the basis of tax and customs legal provisions, resulting in reduction of tax revenues or delay in their collection for the purpose of achieving certain economic or social goal. They can take the form of exceptions, exemptions, deductions, preferential tax rates, etc.

Preparation and submission of Report on the Impact of Tax Expenditures on the Inflows for 2025 is an obligation stipulated under the Organic Budget Law. The Report is to be submitted to the Parliament of the Republic of North Macedonia annually, as a document accompanying the Annual Financial Statement, reporting on the State Budget execution for the previous budget year. The Table below outlines the total tax expenditures on the basis of PIT, CIT, VAT, duties, assessed and estimated for the period 2022 - 2029.

Table 4.6: Tax expenditures by type of tax (Denar million)

Type of Tax	2022	2023*	2024*	2025*	2026*	2027*	2028*	2029*
Personal Income Tax	663	757	876	991	1,087	1,163	1,286	1,394
CIT	4,469	4,795	5,982	6,596	7,083	7,566	8,102	8,615
VAT	32,330	34,961	39,166	43,276	47,579	51,891	56,680	62,010
Total	37,461	40,513	46,024	50,863	55,749	60,619	66,068	72,019

Source: MInistry of Finance, projections of Ministry of Finance (*)

To the end of reducing the tax expenditures, latest modifications and amendments to the VAT Law ("Official Gazette of the Republic of North Macedonia", no. 199/23) stipulate for the VAT tax rate to be increased from 5% to 10% for food stuff for human consumption other than basic foodstuff for human consumption.

With respect to the tax policy, as per the **2024 - 2028 Work Programme of the Government**, several reforms in the tax area and increasing of both efficiency and effectiveness of the tax administration are envisaged, all to the end of successfully carrying out the tax procedures.

Modifications and amendments to the Law on Tax Procedure, pertaining to simplifying and accelerating the process of tax assessment and collection and introducing the integrated tax information system, would provide for a more efficient tax collection and reduction of the bureaucratic burden on the taxpayers, so as for both the taxpayers and the tax authority to assess and collect the tax liabilities efficiently.

Digitalisation of tax procedures is one of the main objectives of the tax reform process, with the goal being to use the resources utterly and facilitate the process of paying taxes. Introduction of **e-invoicing** is one of the first activities planned to be undertaken in the coming period, aimed at carrying out tax audit in a more efficient manner and saving the tax administration resources, as well as saving time and effort of the taxpayers. E-Invoicing and E-Fiscalisation Project would be crucial for easier detecting and combating informal economy, i.e. closely monitoring the supply and payment of taxes by the taxpayers.

Combating the informal economy will be also focused on strengthening public administration capacities for detecting, monitoring and addressing informal economy via special tools; enhancing the legal regulation and the efficiency in its implementation; improving the business environment and creating a stimulative framework for formalising the informal economy and increasing the efficiency of the inspection services and the sanctions and fines system, to be monitored through greater digitalisation of all administrative processes and procedures.

On the other hand, efforts will be also dedicated to strengthening the awareness of informal economy and enhancing tax morale and trust in the institutions; increasing predictability when preparing legal solutions, policies and measures and strengthening transparency, accountability and integrity at all government levels.

With respect to tax revenues, adhering to the Government's initiative to base economic growth on investments, the objective is to increase the share of direct taxes in the total tax revenues, a distinctive feature of the advanced economies.

Moreover, the tax policy envisages more efficient controls as regards the **transfer prices**, as well as enhanced and regular monitoring of the "arm's length" principle at taxpayers in cases of transactions with associated parties. Furthermore, consolidation of revenues at taxpayers is also envisaged to be regulated more closely.

As regards international taxation, it is planned to adopt **draft Law on Administrative Cooperation for Tax Purposes**, aimed at efficiently exchanging information between tax authorities, all to the end of carrying out more efficient tax audits in terms of international taxation so as to avoid double taxation or double exemption. Respective draft Law would also be basis for implementing the global minimum corporate tax rate (Pillar 2) for taxation of multinational corporations meeting the requirements therefor.

Harmonisation of the **legal framework pertaining to VAT** with the Council Directive on the common system of value added tax and its Implementing Regulations will continue in the coming period as well. The objective is to achieve greater compliance and create a broader tax base for tax revenue collection. VAT regulations in the Republic of North Macedonia are fully compliant with the VAT Directive as regards the tax rates and partially compliant with the respective Directive as a whole. Moreover, as per the Government Programme, more efficient, yet safe, manner of tax credit refund is envisaged through enhanced control mechanisms and risk analysis.

With respect to **direct taxes,** the tax policy envisages certain tax incentives aimed at boosting both the employees' and the businesses' productivity, as well as improving the demographic image of the country. It is envisaged for the **treatment of recognised expenditures for tax purposes regarding the expenditures for voluntary life insurance premium paid to be reinstalled. It is also planned for PIT to be refunded to mothers of newborns, with the duration of this measure depending on the number of newborns (first, second, third child, etc.).** Moreover, it is envisaged for the companies employing mothers of three or more children to be exempted from paying health insurance contributions and unemployment insurance contributions and PIT for a period of three years as of the date of employment, with an obligation for the employer to retain the mothers at the workplace for as many years as the measure was applied.

Table 4.7 2022 -2029 Budget of the Republic of North Macedonia (Denar million)

	Final account 2022	Final account 2023	2024	2025*	2026*	2027*	2028*	2029*
Total revenues	**243,085**	**277,129**	**318,151**	**358,838**	**386,817**	**415,050**	**446,520**	**481,301**
Tax revenues and contributions	**220,186**	**250,355**	**284,469**	**319,234**	**347,539**	**374,976**	**406,996**	**441,386**
Tax revenues	142,567	157,733	179,257	202,139	219,967	237,117	258,261	280,031
Contributions	77,619	92,622	105,212	117,095	127,572	137,859	148,735	161,355
Non-tax income	**17,189**	**16,866**	**22,541**	**26,302**	**26,276**	**26,872**	**26,322**	**26,713**
Capital income	**2,273**	**2,071**	**3,240**	**3,510**	**3,510**	**3,710**	**3,710**	**3,710**
Donations	**3,437**	**7,836**	**7,900**	**9,792**	**9,492**	**9,492**	**9,492**	**9,492**
Total expenditures	**278,596**	**318,539**	**362,817**	**400,188**	**425,281**	**449,611**	**483,873**	**519,013**
Current expenditures	**249,959**	**275,015**	**325,443**	**353,032**	**372,068**	**392,898**	**420,034**	**446,859**
Wages and allowances	32,159	36,877	44,361	48,141	52,658	55,924	60,289	63,691
Goods and services	21,001	21,117	26,043	26,325	27,412	28,612	30,612	33,212
Transfers to LGUs	23,365	27,459	30,787	33,239	36,234	39,591	43,612	48,689
Subsidies and transfers	32,536	27,754	33,189	33,436	33,930	35,930	39,930	41,930
Social transfers	131,758	148,867	173,432	191,046	200,462	209,310	220,636	231,257
Interest payments	9,140	12,941	17,632	20,845	21,373	23,532	24,955	28,080
Homemade	3,413	4,181	7,066	9,124	10,747	12,211	13,936	15,906
Foreign	5,727	8,760	10,566	11,721	10,626	11,321	11,019	12,174
Capital expenditure	**28,637**	**43,524**	**38,349**	**47,156**	**53,213**	**56,713**	**63,839**	**72,154**
Budget balance	**-35,511**	**-41,410**	**-44,666**	**-41,350**	**-38,464**	**-34,561**	**-37,353**	**-37,712**
Primary budget balance	**-26,371**	**-28,469**	**-27,033**	**-20,505**	**-17,091**	**-11,029**	**-12,398**	**-9,632**
Total revenues, % of GDP**	**29.8**	**30.9**	**33.3**	**35.2**	**35.5**	**35.6**	**35.7**	**35.9**
Total expenditures, % of GDP**	**34.1**	**35.5**	**37.9**	**39.1**	**39.0**	**38.5**	**38.7**	**38.7**
Budget balance, % of GDP**	**-4.4**	**-4.6**	**-4.7**	**-4.0**	**-3.5**	**-3.0**	**-3.0**	**-2.8**
Primary budget balance, % of GDP**	**-3.2**	**-3.2**	**-2.8**	**-2.0**	**-1.6**	**-0.9**	**-1.0**	**-0.7**

Source: MInistry of Finance, projections of Ministry of Finance (*)

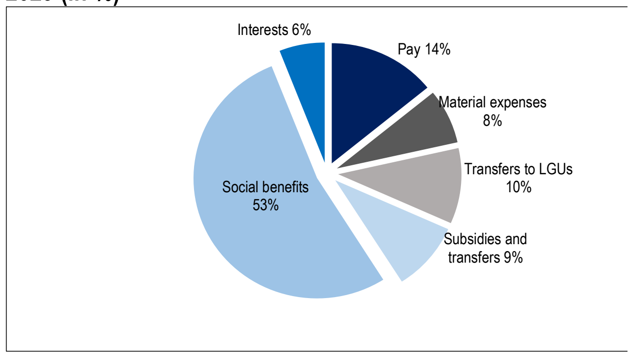
Negotiations for text alignment and initialing of the **Agreements on Avoidance of Double Taxation and Protection of Fiscal Evasion** with respect to taxes on income are envisaged to continue in the coming period.

Budget expenditures in the following medium-term period are based on the following assumptions:

- disciplined budget spending in order to increase budget discipline and responsibility,
- reduction of non-essential expenditures and significant improvement in efficiency and expediency in spending the budget funds,
- subsidising citizens and business sector based on clearly defined budget support criteria,
- performance-based budgeting in order to improve public expenditure efficiency and effectiveness through development and continuous monitoring of performance indicators as regards budget policy implementation,
- redesigning budget structure and higher capital investments aimed at infrastructure project implementation, primarily for transport and utilities infrastructure construction, energy capacity investments, investments in educational, health and other public infrastructure, as well as
- strategic planning of major infrastructure projects.

The expenditure side of the State Budget in the following period is completely designed in support of strategic priorities implementation, revival of the economy, energy transition improvement, boosting sound economic growth, stable public finances, improvement of complete transport infrastructure and better living standard.

Chart 4.3. Average structure of current expenditures 2025-2029 (in %)



Source: Ministry of Finance and Ministry of Finance's Projections(*)

Quality medium-term budgeting is central to developing the medium-term fiscal framework. Thus, in the forthcoming period, it should be taken into account that the medium-term fiscal projections are based on a medium-term baseline scenario, which means that the determination of the fiscal projections results from the exercise of the competencies of budget users under the applicable legislation, the existing obligations and tasks, resulting from already approved multi-annual commitments, contracts, and ongoing projects. Positions beyond the baseline scenario, requiring additional financing, are showcased through new initiatives.

Average share of total State Budget expenditures in the 2025-2029 period accounts for around 38.8% of GDP. Budget expenditure projections for the forthcoming medium-term period are prepared on the basis of three key postulates:

- compliance of revenue projections with planned economic activities;
- total Budget expenditure projections ensure continuous fiscal consolidation, and
- projected expenditures provide for regular and effective execution of all legal obligations.

When projecting the amount and the structure of current expenditures for the coming period, intended for regular wage payment to employees in the public sector, timely and regular payment of pensions and other social rights, interest payments to foreign and domestic creditors, payment of agricultural subsidies, support to small- and medium-sized enterprises, as well as subsidising innovation activities, the following presumptions are taken into account:

- increase of efficiency, productivity, transparency and accountability of public sector employees, public administration optimisation through corresponding changes in its structure and adjustment of employees' wages in line with both the economic growth and the existing legal regulation;

- more efficient use of operating resources by improving the planning and the execution of operating expenditures,

- reducing the non-essential expenditures, as well as introducing spending standards,

- better quality services under the decentralised competences of the municipalities by redefining the criteria for allocation of funds and more efficient and earmarked use of grant funds;

- ensuring greater impact on the economic activity by more efficient and targeted use of funds for subsidies and transfers;

- reducing poverty by properly targeting the use of social assistance and greater workforce participation on the labour market.

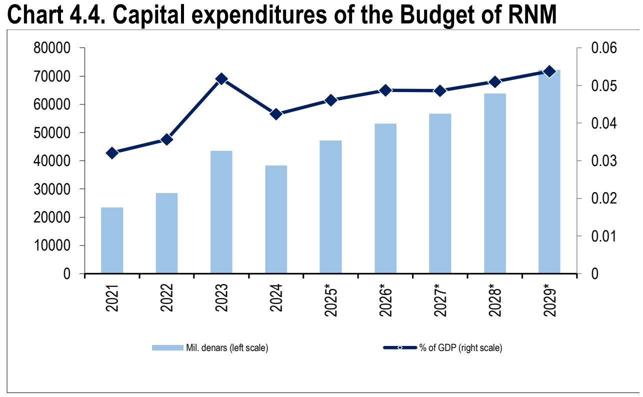
Medium-term fiscal projections include a strong development component, with a significant share of capital expenditures with over 5% in GDP on annual basis, and they represent key elements of the public finances.

In the period 2025-2029, fiscal policy will be aimed at creating preconditions for a new economic growth cycle, ensuring a substantial level of public investments, being basis for improvement of the economic perspectives and better quality of life for the citizens.

Therefore, substantial capital investments are projected by allocating Budget funds, including funds extended under loans from international financial institutions and bilateral creditors. The projected amounts speak of infrastructure projects picking up pace, i.e. investments in road and railway infrastructure, energy and utilities infrastructure, as well as capital investments aimed at improving the conditions in the health, education and social systems, agriculture, culture, sports, environmental protection and judiciary.

For the purpose of ensuring sustainable and inclusive growth, as per the priorities under the Work Programme of the Government of the Republic of North Macedonia, the Government will put the focus on capital investment implementation, exclusively intended for efficient projects: infrastructure and energy projects in support of the business sector, capital projects in the field of utilities and other local infrastructure, aimed at improving the living conditions of the citizens (improvement on the conditions in the health, education and social system, agriculture and environmental protection), strategic planning of major infrastructural projects, as well as scaled-up capital investments with a significantly improved structure and substantial amount of funds as capital transfer for municipalities.

Chart 4.4. Capital expenditures of the Budget of RNM



Source: Ministry of Finance and Ministry of Finance's Projections(*)

Major investments are being projected under the Budget in the field of road infrastructure, aimed at planning, projecting, construction and expansion of Corridor 8 and Corridor 10d road sections.

As regards road infrastructure, reconstruction of the eastern part of Road Corridor 8, Rankovce - Kriva Palanka section, as well as construction of the western part of Road Corridor 8, Kichevo – Bukojchani motorway section and Kichevo – Ohrid motorway section, is to continue, all this being financed with loans. Construction of Skopje - Blace motorway section (border with Kosovo), improvement of road infrastructure of the municipalities in the Republic of North Macedonia through the Local Roads Connectivity Project, the National Roads Programme and the Western Balkans Trade and Transport Facilitation Project are also financed with loans.

Road infrastructure capital projects of relevance, to be financed through IPA 2 Programmes in the period 2020 - 2025, are construction of the road section Gradsko - Drenovo Interchange as part of the Road Corridor 10d, rehabilitation of regional road A2, Kumanovo - Strachin section (phase 1), construction of new expressway from Prilep to Lenishka River bridge and construction of a third lane on the road section from the Village of Belovodica to Mavrovo quarry, replacement of safety barriers, according to EN standards on highways, on 100 km of Corridor 10, procurement and installation of new signalisation at railway crossings, as well as implementation of measures to improve road safety along selected road sections.

As regards the railway infrastructure, financing of both phases of construction and rehabilitation of the eastern part of the Corridor 8 railway, railway sections Kumanovo-Beljakovce-Kriva Palanka, whereby an amount of EUR 68.5 million as grant funds through WBIF (Western Balkans Investment Framework) were provided for the second phase. At the same time, construction of “Tabanovce“ rail joint border station with accompanying facilities between the Republic of North Macedonia and the Republic of Serbia will commence as well, financed with a loan and WBIF grant (Western Balkans Investment Framework).

Regarding gasification, construction of national gas pipelines, in particular Skopje - Tetovo section, Gostivar - Kichevo section and Sveti Nikole - Veles section is envisaged, as well as construction of Gas Interconnection Pipelines between the Republic of North Macedonia and the Republic of Kosovo, between the Republic of North Macedonia and the Republic of Serbia, and between the Republic of North Macedonia and the Republic of Greece.

Major planned projects in the field of municipal and utilities infrastructure are the Municipal Water Infrastructure North Macedonia and the implementation of the North Macedonia Public Sector Energy Efficiency Project.

Irrigation Programme North Macedonia and North Macedonia Agriculture Modernisation Project are major capital projects in the field of agriculture.

With respect to environment, in addition to the aforementioned major Skopje Wastewater Treatment Plant Project, North Macedonia Regional Solid Waste Project is of vital importance, by putting management systems in place, i.e. solid waste stations in the Southwest, Vardar, Pelagonija, Southeast and Polog regions.

With respect to wastewater collection and treatment infrastructure and integrated and financially self-sustainable waste management system meeting EU Standards, major capital projects being financed via IPA2 Programmes, in the period 2020-2025, are the following: Skopje Sewage Network Rehabilitation and Expansion Project, Tetovo Wastewater Treatment Plant and Sewage Network Rehabilitation and Expansion Project, Kichevo Sewage Network Rehabilitation and Expansion Project, Bitola Wastewater Treatment Plant and Sewage Network Rehabilitation and Expansion Project, Eastern and Northeastern Regions Landfill Closure Project, with construction of a central waste management facility, a sorting plant, a Mechanical Biological Treatment (MBT) plant, a landfill, a composting plant and a green point in the Municipality of Sveti Nikole, construction of six local waste management facilities, each consisting of a transfer station, a composting plant and a green point for the Eastern and Northeastern Regions, support in establishing a regional waste management system, procurement of equipment for the Eastern Region, support and preparation of the necessary documentation for the procurement of water equipment for the municipalities of Radovish, Kichevo, Strumica, Bitola, Tetovo, Berovo, Kumanovo and Prilep, preparation of project documentation for improving wastewater collection and treatment infrastructure and water supply network in the Municipality of Arachinovo.

With respect to education, the Project for Construction of Physical Education Facilities in Primary Schools and Rehabilitation of Primary and Secondary Schools, funded with a CEB's loan and supported by a WBIF grant and co-financed by the state, is implemented, aimed at improving physical education and comprehensive learning conditions for students in primary and secondary schools. For the purpose of improving the primary education learning conditions in the country, implementation of Primary Education Improvement Project will continue, being supported by a World Bank loan. With respect to higher education, reconstruction of student dormitories in the Republic of North Macedonia, aimed at improving accommodation and learning conditions for university students, is foreseen.

With respect to social protection, the implementation of the Social Insurance Administration Project will continue, as well as completion of the Social Services Improvement Project is planned, whereas Second Social Services Improvement Project will start. With respect to judiciary, activities on construction and reconstruction of Idrizovo Penitentiary will be carried out, all to the end of meeting the international and the European Prison Rules, in support of improved accommodation conditions for the prisoners and their enhanced protection.

As regards the fair access to high-quality inclusive education at all levels, reconstruction of public preschool institutions is one of the major capital projects to be financed via IPA 2 Programmes, covering the 2020-2025 period.

As regards energy infrastructure, projects envisaged to be financed are those implemented by JSC Power Plants of North Macedonia (AD ESM) and JSC for Electricity Transmission and Power System Control (AD MEPSO), such as: Wind Park Bogdanci - Phase 2, District Heating System Bitola, District Heating System Bitola, Elbasan (AL) – Bitola (MK) 400kV Transmission Line, Photovoltaic Power Plant Oslomej, ESM Solar PV Transition (Photovoltaic Power Plant Oslomej 2 and Photovoltaic Power Plant Bitola), as well as Rehabilitation of Hydroelectric Power Plants Programme.

With respect to public finance reforms, improvement of fiscal framework, strengthening the process of State Budget planning and execution, improvement of revenue collection, strengthening the public procurement system, internal and external control and transparent reporting, Building Effective, Transparent and Accountable Public Financial Management Institutions Project, is to be implemented.

During the past period, to the end of supporting the private sector and providing fresh capital for the need thereof, six EIB credit lines, extended through Development Bank of North Macedonia, with the total amount of EUR 550 million, were provided and implemented. In this segment, implementation of the seventh credit line amounting to EUR 100 million will commence, being intended for financing the Project for Financing Small- and Medium-Sized Enterprises, Mid-Cap Companies and Green Transition, in line with the economic measures of the Government, aimed at protecting the consumers and companies against the energy crisis.

Table 4.8 Overview of Loan-Funded Projects

Project	Financed by	Loan Amount (EUR)
Western Balkans Trade and Transport Facilitation Project	MBRD - WB	26,200,000
Local Roads Connectivity Project	MBRD - WB	33,000,000
	MBRD - WB	37,000,000
Skopje Wastewater Treatment Plant Project	EIB	68,000,000
	EBRD	58,000,000
	WBIF Grant	68,558,824
North Macedonia's Municipal Water Infrastructure Improvement Project	Council of Europe Development Bank	50,000,000
Regional Solid Waste Project	EBRD	55,000,000
	SECO	5,000,000
	WBIF Grant	22,562,513
Second Municipal Service Improvement Project	World Bank	25,000,000
Public Sector Energy Efficiency Project	World Bank	25,000,000
Social Services Improvement Project	World Bank	28,700,000
Second Social Services Improvement Project	World Bank	27,500,000
Social Insurance Administration Project	World Bank	13,800,000
Agriculture Modernisation Project	World Bank	46,000,000
North Macedonia's Irrigation Programme	KfW	80,000,000
Reconstruction of Penitentiary Institutions	Council of Europe Development Bank	46,000,000
Primary Education Improvement Project	World Bank	21,500,000
Building Effective, Transparent and Accountable Public Financial Management Institutions Project	World Bank	20,000,000
Energy Efficient Rehabilitation of Student Dormitories in North Macedonia	KfW	20,000,000
Rehabilitation of the Eastern Part of Rail Corridor 8 – Phase 1 (Kumanovo – Beljakovce Section)	EBRD	46,400,000
Rail Corridor 8 - Phase 2 (Eastern Section of Rail Corridor 8 - Beljakovce - Kriva Palanka)	EBRD	145,000,000
Rail Joint Border Crossing - Tabanovce Project	EBRD	5,000,000

Projected deficit and its financing. Financing of the projected deficit, as well as refinancing of the debt repayments, will be provided by foreign and domestic borrowing. As regards financing the budget deficits, in the period 2025-2029, the state is expected to borrow abroad, by both concluding loans for budget financing and issuing debt securities, as well as through disbursements under loans extended by foreign financial institutions under favourable terms and conditions and credit lines intended for financing certain projects. Thereby, the choice of a specific external financing source will be based on the ongoing and the expected developments on the international capital market. Furthermore, borrowing on the domestic market will be made in the form of issuance of government securities or domestic loans, thus providing for additional financing under favourable terms and conditions. For the purpose of optimising the payments and reducing the refinancing risk, Ministry of Finance will continue issuing government securities with longer maturities, thus reducing the debt refinancing risk. To the end of efficiently managing the public debt, over the medium term, Ministry of Finance will also take into account the possibility for early repayment of part of the debt, i.e. determining more favourable debt maturity, currency and interest structure.

Table 4.9. Deficit financing

	2022	2023	2024	2025*	2026*	2027*	2028*	2029*
Budget balance	**-35,511**	**-41,410**	**-44,666**	**-41,350**	**-38,464**	**-34,561**	**-37,353**	**-37,712**
Deficit financing	**35,511**	**41,410**	**44,666**	**41,350**	**38,464**	**34,561**	**37,353**	**37,712**
Inflows	**46,869**	**84,998**	**83,727**	**123,917**	**105,668**	**101,235**	**120,737**	**76,582**
Domestic sources	15,587	37,431	55,638	57,007	52,461	50,320	55,320	39,391
Foreign sources	24,895	61,855	48,486	37,925	53,800	54,200	61,526	43,100
Deposits ("-" is account accum	6,387	-14,288	-20,397	28,985	-593	-3,285	3,891	-5,909
Outflows	**11,358**	**43,588**	**39,061**	**82,567**	**67,204**	**66,674**	**83,384**	**38,870**
Repayment after domestic borrowing	5,571	7,474	18,727	33,276	11,976	19,060	20,985	20,431
Repayment after foreign borrowing	5,787	36,114	20,334	49,291	55,228	47,614	62,399	18,439
Memorandum:								
Net domestic borrowing	10,016	29,957	36,911	23,731	40,485	31,260	34,335	18,960
Net foreign borrowing	19,108	25,741	28,152	-11,366	-1,428	6,586	-873	24,661

Source: Ministry of Finance and Ministry of Finance projections (*)

Local government budget. One of the priorities indicated in the 2024-2028 Work Programme of the Government of the Republic of North Macedonia, covers developed local government units and equal regional development. Government's main principles are aimed at having modern, transparent and financially stable municipalities in place, through an even distribution of funds between the planning regions and the municipalities, while also providing for equal development of all regions.

Government's financial support and cooperation with the municipalities will be geared towards: continuous investment of the Central Budget funds in capital infrastructure projects for the municipalities, up to EUR 250 million, increased financial stability of municipalities by ensuring equal distribution of funds, while paying attention to the balanced regional development principles, benefits and incentives for those municipalities with well-designed budgets, high expenditure execution, high local tax collection, as well as improved methodology for calculating the maintenance costs of educational facilities in the municipalities, as per which funds are paid thereto via block grants.

In cooperation with local government units, Government will work on enhancing the decentralisation process via continuous increase of the transfers of competencies by the state administration bodies to the local government units in line with the built capacities of local government units.

Capital investments are the key factor for boosting the competitiveness of the economy and improving the quality of life for the citizens. In the upcoming period, the Government be dedicated to the following: capital investments to be solely aimed at productive projects: infrastructure and energy projects in support of the business sector, and capital projects in the field of utilities and other local infrastructure, geared towards improving the living conditions of the Macedonian citizens.

During its term of office, the Government will be also focused on revising the system for distribution of the transfers from the Central Budget to the municipalities. Central Budget transfers will be in correlation with efficient genuine revenue collection. Correlating the budget transfers with the performance of municipalities in collecting their own revenues will imply fair taxation and transfer of budget funds to the municipalities.

Municipalities are expected to continue the trend of improved collection of own revenues, as well as strengthening the capacities for development of policies for financing the municipalities and enhancing the capacities for financial management. Strong devotion will continue in the coming period, by encouraging sustainable local development, sound local governance and creating conditions for more active, more effective and more innovative role of the local authorities in accomplishing the national objectives for growth and development, all to the end of realising the strategic commitments.

Taking into account the activities undertaken in 2023 related to completing the second phase of fiscal decentralisation, in the following period, it is expected for all activities for entering of Plashnica Municipality in the second decentralisation stage, to be completed.

In 2025 and in the medium term, many activities and measures are envisaged for the purpose of strengthening the fiscal decentralisation, in particular improved fiscal capacity and increased municipal revenues, strengthened fiscal discipline and increased transparency and accountability as regards municipalities' operations.

Amendments to the Law on Financing Local Government Units provided for improved fiscal capacity and increased municipal revenues, by which PIT revenues gradually increased from 3% in 2022 to 6% in 2024. In addition, as per these amendments, in 2025 and the next years, municipalities will receive 6% of the collected PIT revenues. In 2024 and beyond, VAT revenues will account for 6% of the collected VAT generated in the previous year.

New Law on Financing Local Government Units will be prepared with UNDP technical assistance, as per the assessment of the existing Law carried out in 2022, which will be harmonised with the new Organic Budget Law, to be followed by adopting the respective bylaws.

As regards strengthening the fiscal responsibility of the municipalities, the legal amendments are expected to provide for increased transparency of their operations, by which the municipalities are obliged to publish financial data, in a transparent manner, on their websites, coupled by spending accountability for all funds transferred by the Government. Data on revenue collection and expenditure execution of municipalities, as well as the arrears reported in the Electronic System for Reporting and Recording of Liabilities are published on MoF's website on quarterly basis, whereby the Annual Report on the Budget of the Republic of North Macedonia also includes the Annual Report on the Municipal Budgets. With UNDP support, the financial data under the periodical financial reports of around 45 municipalities were published on the websites of the municipalities, as well as on MoF's website.

Additional revenues are also transferred to the municipalities' budgets as grants from the Budget of the Republic of North Macedonia and the Funds' budgets for the purpose of financing their competences stipulated by law. Block grants for the transferred competences in the field of primary and secondary education, culture, kindergartens and elderly homes, earmarked grants for firefighting, as well as capital grants from the Central Budget, have been transferred from the Budget of the Republic of North Macedonia. For the purpose of more even distribution of the grants by municipalities, the competent ministries will carry out analyses of the criteria, as per which the funds are distributed for the separate transferred competences, while also determining new distribution models in line with the needs, thus rendering better-quality services. Ministry of Education and Science, in cooperation with UNICEF and the World Bank, is working on determining new criteria for distributing the block grant for primary education on the basis of a pupils' standard, whereby reforms are proposed, all to the end of optimising the school network, reducing the number of teaching staff, as well as improving the conditions in primary schools, as well as the curriculum thereof. Purpose is to increase the efficiency and the effectiveness of the primary education, while also ensuring equality as regards the access to schools.

Funds are distributed to the municipalities through the competent ministries and other institutions in the form of capital grants, for the purpose of implementing capital infrastructure projects in the respective municipalities. Distribution is carried out in line with the Programme, being adopted by the Government upon proposal by the competent ministry.

Ministry of Finance, while reforming the normative framework for designing a formalised capital transfer system, needs to prepare Methodology on Capital Grant Distribution, including unified, transparent and clear criteria, as well as a proposal for setting ex post evaluation of the implemented projects financed via capital grants and potential inclusion of the success as regards the assessment in the distribution criteria.

In the next medium-term period, stable revenues have been provided by allocating funds from lease of state-owned agricultural land to the municipalities, the proportion of which is 50% for the Budget of the Republic of North Macedonia and 50% for the municipalities and the municipalities in the City of Skopje, which distribution depends on the location of the agricultural land under lease, provided that collection of revenues on the basis of tax on real estate exceeds 80% in relation to the projected ones. Stable own revenues are provided from funds distributed to the municipalities on the basis of the fee collected by issuing concession for usage of water resources for electricity generation (50% for the central government budget and 50% for the municipalities), depending on which area the concession activity is performed.

Moreover, increase will be recorded at own revenue performance at the municipalities, in particular revenues collected on the basis of taxes on real estate, as a result of greater coverage of the real estate of natural persons and legal entities and re-assessment of the value of the real estate. In the coming period, higher revenues are expected to be generated by determining the real market value of the real estate after completing the procedure on recording and legalising the illegally built facilities on construction and agricultural land. As per the latest amendments to the Law on Property Taxes, in the next period, the real estate market value is to be revised, as a property tax base, by the municipalities, the municipalities in the City of Skopje and the City of Skopje, every fourth year, all to the end of getting harmonised with the ongoing developments. Property tax rates on agricultural land, which is not used for agricultural production, are increased from three to five times in relation to the base rates. Tax base for the tax on sales of real estate is the market value of the real estate at the moment the liability occurs. As an exception, in case when the price attained when transferring the ownership right is higher than the market value set as per the Methodology for Determining the Market Value of the Real estate, the tax base is the price attained when transferring the ownership right.

Special efforts will be put in supporting the municipalities by encouraging the local development via supporting the local projects and harmonising them with the national ones. The goal of fiscal equalisation within the context of the Strategy for Regional Development is to ensure equal offer of public goods and services at all LGUs, thereby achieving a complementary effect of more balanced development of certain planning regions. Providing joint assistance to the financially weakest municipalities, i.e. municipalities with the least revenue collection capacity, yields positive effects for both their development and the development of the planning region which they belong to.

In addition to the support as regards the transfer of competences for collection of part of the public revenues, as well as the Central Budget transfers, support to building municipal capacities is also implemented through projects of the central government funded by international financial institutions.

In 2023, Municipal Services Improvement Project (MSIP) was completed. This Project, being implemented by the Ministry of Finance with support from the World Bank and the European Commission, which commenced a decade ago, with total fund of more than EUR 100 million, was aimed at improving the municipal services through loans and grants for the municipalities in support of implementing capital projects such as water supply, sewerage and waste water treatment, energy efficiency (street lighting, insulation of municipal facilities, etc.), local road infrastructure (street and road modernisation and reconstruction), utility services (procurement of vehicles for the public utility enterprises), as well as other municipal services and competences (construction of kindergartens, green markets, infrastructure in the industrial zone, etc.). In cooperation with the World Bank, new Sustainable Municipal Development Project will be prepared, all to the end of further extending the support for the municipal projects by awarding loans and grants thereto.

Under the Local Roads Connectivity Project, which is part of the ongoing Country Partnership Framework, implemented by the Ministry of Transport and Communications, EUR 70 million is intended to be disbursed to all 80 municipalities and the City of Skopje for construction and rehabilitation of local roads and streets, as well as other road infrastructure in local government units. Such direct support ranging from EUR 500,000 up to EUR 2 million per municipality (depending on the project the respective municipality applies for) provides for improved local infrastructure in the municipalities.

In the period to come, Public Sector Energy Efficiency Project will continue to be implemented via the Ministry of Finance with World Bank support under Loan Agreement in the total amount of EUR 25 million. Public Sector Energy Efficiency Project will be implemented by the MSIP Project Implementation Unit. Main objective of this Project is reducing energy consumption in the public sector, at the same time improving the energy class and the quality of the public buildings and the public lighting. All local government units are eligible to use the funds under this component. Amount of funds per municipality can vary from EUR 50,000 to EUR 750,000 and is dependent on the municipal borrowing capacity and the estimated investment value of the proposed municipal project. By signing a sub-loan agreement with the Ministry of Finance, 80% of the loan funds is allocated to the municipality as on-lending, with the remaining 20% being allocated as a grant. Moreover, within the funds under this Project, the Ministry of Finance also covers the expenses for preparation of energy audit and technical design.

Another major project implemented in the past ten years, aimed at improvement of the municipal infrastructure, is Water Supply and Wastewater Collection Project, funded by the European Investment Bank (EIB) and implemented by the Ministry of Transport and Communications. Funds in the amount of EUR 50 million are provided to all municipalities, all to the end of constructing better water supply infrastructure and wastewater treatment plants. Such significant activities continue to be implemented within the Municipal Water Infrastructure North Macedonia Project, funded with European Investment Bank's loan amounting to EUR 50 million, being implemented via the Ministry of Environment and Physical Planning.

In the field of environment, major capital Project for Construction of Skopje Wastewater Treatment Plant is implemented, funded with European Investment Bank's loan amounting to EUR 68 million, loan by the European Bank for Reconstruction and Development in the amount of EUR 58 million, as well as investment grant under the Western Balkans Investment Framework, amounting to EUR 70 million. As regards solid waste management, Regional Solid Waste Management Project is of vital significance, foreseeing establishment of management systems, i.e. solid waste stations in Southwest, Vardar and Pelagonia Regions, Southeast Region and Polog Region, funded with a loan amounting to EUR 55 million by the European Bank for Reconstruction and Development and investment grant under the Western Balkans Investment Framework, amounting to EUR 23 million.

What is also envisaged in the coming medium-term period is introducing fiscal decentralisation monitoring indicators, increasing local tax collection efficiency, improving the effectiveness and profitability of public enterprises and the municipalities, as well as increasing the transparency and the accountability of the municipalities.

Table 4.10. Medium-Term Projection of Local Government Budget (Denar million)

	2022	2023	2024*	2025*	2026*	2027*	2028*	2029*
Total revenues	**38,716**	**47,445**	**54,547**	**57,973**	**61,440**	**65,240**	**69,794**	**75,450**
Tax revenues	10,716	11,881	12,474	12,860	13,320	13,770	14,330	14,880
Non-tax income	1,419	1,585	865	3,085	3,310	3,590	3,790	4,040
Capital income	1,784	1,899	1,904	2,050	2,050	2,150	2,250	2,350
Transfers	24,105	30,347	39,304	38,478	41,160	44,030	47,624	52,280
Donations	692	1,733	0	1,500	1,600	1,700	1,800	1,900
Total expenses	**38,911**	**44,309**	**54,605**	**57,973**	**61,440**	**65,240**	**69,794**	**75,450**
Wages and allowances	19,899	23,981	27,470	29,370	31,280	33,410	36,210	40,120
Goods and services	9,900	9,832	10,518	12,092	12,592	13,742	14,666	15,647
Interest payments	37	67	105	105	105	105	105	110
Subsidies and transfers	2,857	3,421	3,726	3,810	3,930	3,950	4,070	4,180
Social transfers	67	71	81	90	90	90	90	90
Capital expenditure	6,151	6,937	12,705	12,506	13,443	13,943	14,653	15,303
Balance	**-195**	**3,136**	**-58**	**0**	**0**	**0**	**0**	**0**

Source: MoF and MoF projections (*)

In cooperation with foreign donors, activities are undertaken in order to create municipal "sustainable development index", harmonised with the sustainable development objectives, to serve as a local development policy instrument, thus assisting the authorities at all levels, in planning and distributing funds for development, all to the end of promoting equal social and economic growth, as well as easing the monitoring of the development progress. For the purpose of a complete review of municipal development, Municipal Development

Index will be set. Index will incorporate 11 main pillars with 44 indicators for measuring development, which will be used for further projected the funds allocated from the Central Budget, thus providing information on the development of each municipality separately. Municipal Development Index offers valuable insights into the overall development of municipalities by providing a comprehensive assessment of the key indicators, promoting sustainable and inclusive municipal development. Activity is carried out within UNDP project activities.

Public enterprises and trading companies owned by the state. Operations of public enterprises and state-owned companies are regulated in the Law on Public Enterprises, the Company Law, as well as other laws defining the operations in the specific area (Law on Energy, Law on Railway System, Law on Public Roads, etc.)

Government of the Republic of North Macedonia has founded 15 public enterprises, being a single shareholder/member in 14 companies. These entities employ around 14 thousand workers, accounting for a significant part of the Macedonian economy.

Total revenues of public enterprises and state-owned companies in 2023, in line with the data from the quarterly and the annual reports, amounted to Denar 68.7 billion, total expenditures were executed in the amount of Denar 62.7 billion, resulting in gross profit to approximately Denar 6 billion in 2023, mostly as a result of the subsidies from the State Budget, paid to the energetic companies, all to the end of cushioning the price shock triggered from the energy crisis.

Financial indicators from the operations of public enterprises and companies are shown on accrual basis, in line with the stipulated accounting methodology, differing from the one of budget users showing the financial data on cash basis, thereby taking into account that these entities keep accounting records, prepare and submit the annual account and the financial reports in line with the Company Law and the adopted international accounting standards and the International Financial Reporting Standards. The loss presented at certain public enterprises and state-owned companies is a result of the calculated depreciation of fixed assets, which is basically an accrual expense.

Budget revenues on the basis of payment of dividend by companies, wherein the state is full or partial shareholder and the payment of surplus of funds from the operations of state-owned public enterprises amounted to total of Denar 487.9 billion at the end of 2023, whereby in 2024, revenues on this basis, are expected to amount to approximately Denar 500 million.

On the other hand, although the annual Law on Execution of the Budget of the Republic of North Macedonia does not directly cover public enterprises and state-owned companies, they are transferred funds, via their line ministries, as budget support for the purpose of implementing certain infrastructure projects, given that they perform activities of public interest, i.e. they are entities performing activities essential for Macedonian economy.

Pursuant to the Law on Public Enterprises, and for the purpose of increasing transparency, public enterprises are obliged to publish the annual and the quarterly reports on their websites, thus providing for timely and transparent monitoring of financial operations of these entities, at the same time providing opportunity for more realistic prediction of the fiscal risk in this field and timely undertaking of appropriate measures. As of 2020, on its website, Ministry of Finance publishes consolidated quarterly data on the collected revenues and executed expenditures at the level of public enterprise/state owned-company.

Public enterprises and state-owned companies are obliged, pursuant to the Law on Reporting and Recording of Liabilities, to report, on monthly basis, undue liabilities and arrears in the Electronic System for Reporting and Recording Liabilities, being kept by the Ministry of Finance. On the basis of the recorded data on reported liabilities, Ministry of Finance publishes, in continuity and on quarterly basis, summary reports on its website, thus additionally contributing to strengthened and increased transparency.

Government of the Republic of North Macedonia, as founder of public enterprises and state-owned companies continuously monitors their financial operations via the annual accounts and annual reports, 3-month reports, financial plans and investment programs, under which consideration and approval, observations and remarks are provided to the competent bodies of the enterprises/the company, being geared towards reducing the non-productive expenditures, undertaking measures for collection of uncollected claims and timely settlement of the liabilities.

Contemporary public financial management concept designed in the new Organic Budge Law is aimed at improving the public finance management and strengthening the medium-term budgeting, as one of the biggest priorities of the Government of the Republic of North Macedonia in the EU accession process. This concept also covers public enterprises and state-owned companies as substantial segment in the public sector, thus, activities are planned for the next period, pertaining to introduction of medium-term planning at these entities as well. To that end, during 2024, Ministry of Finance required, under circular letter, data from public enterprises and state-owned companies for projected revenues and expenditures in medium term, i.e. in the period 2024-2029.

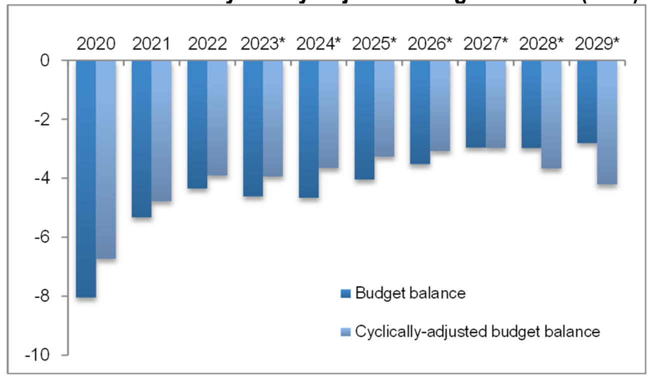
Table 4.11: Main financial indicators for planned operations of public enterprises and state-owned companies (Denar billion) for the period 2024-2029

PROJECTED TOTAL REVENUES AND EXPENDITURES IN PE AND JSC in the period 2024-2029 (Denar million)							
No.		2024	2025	2026	2027	2028	2029
1	TOTAL REVENUES	58.7	67.1	68.4	69.0	69.7	72.7
2	TOTAL EXPENDITURES	59.8	57.2	57.7	57.6	57.4	57.3
3	FINANCIAL PERFORMANCE	-1.1	9.9	10.7	11.4	12.3	15.4

4.5 *Structural Deficit (cyclical component of the deficit, one-off and temporary measures, fiscal stance)*

Economic activity, over time, tends to grow, but, moving along the trend line, the economy usually fluctuates above and below the long-term trend. Such cyclical developments in the economy are also reflected in the fiscal developments, through automatic stabilisers. In order to exclude the effects from fluctuations of economic activity on the fiscal indicators and to estimate the basic fiscal stance of the country, we calculate and analyse the cyclically adjusted budget balance, which is obtained by adjusting the budget revenues and the budget expenditures by the effect of deviation of the potential from the actual/projected GDP, whereby the adjustment is made on aggregate level for the central government budget as well.

Chart 4.5. Main and cyclically-adjusted budget balance (in %)



Source: Calculations by MoF, * forecast

In 2024, amidst deteriorated international environment and heightened uncertainty, as well as their adverse effects on the economic activity, GDP is expected to remain below the potential one, by which Budget cyclical component is negative, accounting for 1.0%. Thus, cyclically adjusted budget deficit accounted for 3.7% of the potential GDP (Chart 4.5)

In 2025 and 2026, in conditions when the production gap remains in the negative zone, automatic stabilisers have negative effect on the budget balance, whereby the calculated cyclically adjusted budget deficit is lower than the projected budget deficit, reaching 3.2% on average. In 2028 and 2029, cyclical budget component is to shift to the positive zone, while cyclically adjusted budget deficit is to account for 3.9% on average annually. (Table 4.12.)

Table 4.12. Aggregate fiscal indicators (%)

	2024	2025	2026	2027	2028	2029
Total budget balance	**-4,7**	**-4,0**	**-3,5**	**-3,0**	**-3,0**	**-2,8**
Primary budget balance	-2,8	-2,0	-1,6	-0,9	-1,0	-0,7
Cyclical budget component	-1,0	-0,8	-0,4	0,0	0,7	1,4
Cyclically adjusted total budget balance	-3,7	-3,3	-3,1	-3,0	-3,7	-4,2
Cyclically adjusted primary budget balance	-1,8	-1,2	-1,1	-1,0	-1,7	-2,1

Source: Calculations of the Ministry of Finance
Note: Data on cyclically adjusted total/primary budget balance are expressed in relation to the potential GDP.

4.6 Public Debt Management, Stock and Projections of Public Debt Trends

Institutional Framework. Dedicated organisational unit within the Ministry of Finance, i.e. Public Debt Management Department (PDMD), performs the activities related to debt management in the country. The Department carries out the activities related to borrowing by the state for the purpose of financing the budget needs by both issuing government securities on the domestic and the international financial markets and/or concluding loan agreements with domestic and foreign creditors. Moreover, PDMD is also in charge of making public debt management policy on the basis of assessment and analysis of the debt portfolio risks, as well as servicing the general government debt. It also keeps Public Debt Registry which, in addition to general government debt, also includes the guaranteed and the non-guaranteed debt, and is, as well, engaged in the process of issuance of sovereign guarantees to public debt issuers.

Legal Framework. As regards the legal framework, Public Debt Law is the underlying law regulating the purposes of general government debt, the procedure and the method of borrowing by public debt issuers, the procedure for issuance, servicing and termination of sovereign guarantees, as well as public debt transparency. Furthermore, Law on Financing Local Government stipulates limits on long-term and short-term borrowing by the municipalities, while the Organic Budget Law lays down fiscal rules according to which total debt of the general government may not exceed 60% of nominal GDP and guaranteed debt may not exceed 15% of nominal GDP. Maximum amount of borrowing[21] in the current fiscal year is set at the amount necessary for financing the budget deficit and refinancing the general government debt liabilities falling due in the current and the next two fiscal years.

Public Debt Management Strategy is a separate document, which defines the debt management policy in the course of 3 years with additional 2-year prospects, provides data on debt trends in the past period and forecasts for both the general government debt and the public debt and sets short-term and medium-term limits and objectives of specific debt indicators related to public debt level and debt structure.

As regards debt transparency, Ministry of Finance prepares Annual Report on Public Debt Management, presenting in details the features of the debt portfolio and the measures undertaken for its efficient management. In addition, it regularly publishes data on the stock and the structure of the general government and the public debt on its website.

Debt data the Ministry of Finance publishes are in line with the national methodology set in the Public Debt Law according to which general government debt comprises all financial liabilities incurred on the basis of borrowing by central government entities, local government and extra-budgetary funds, while public debt comprises

[21] As set under the Public Debt Law and the Organic Budget Law.

liabilities incurred on the basis of general government debt and the debt of public enterprises established by the state or the municipalities[22].

To the end of aligning this methodology with the ESA 2010 methodology, Organic Budget Law outlines new definition on general government debt, hence, it will encompass consolidated financial liabilities incurred on the basis of borrowing by general government entities, i.e. institutions classified in General Government Sector (S.13), as per the SSO National Classification of Institutional Sectors. Such defined debt will be subject to monitoring as regards the adherence to the above-mentioned fiscal rules on general government debt.

General Government Debt and Public Debt. Trends of general government debt and public debt in the Republic of North Macedonia are determined by the medium-term budget framework and the implementation of capital projects financed by borrowing. In fact, global economic crisis triggered by the COVID-19 pandemic, followed by the energy crisis caused by the war conflict in Ukraine, led to inflationary pressure on the global economy, forcing most of the European Union countries, as well as the countries in the region, to widen their budget deficits so as to provide funding for overcoming the consequences from these shocks. At most of the economies, this resulted in increased level of public debt by around 10 percentage points. Republic of North Macedonia was not an exception to this trend, hence, with a budget deficit of 8% of GDP, general government debt and public debt increased by significant 10 p.p. in 2020 compared to 2019. Furtehrmore, in the period that followed, the reduction of the negative budget balance resulted in slowing down the raising trend of the debt. Hence, as of Q3 2024 inclusive, general government debt amounted to EUR 7,659.8 million, i.e. 49.3% of projected GDP, with public debt amounting to EUR 8.847,0 million, accounting for 56.9% of projected GDP. Compared to end-2023, government and public debt-to-GDP ratio dropped by 0.5 p.p. and 1.2 p.p. respectively. (Table 4.13)

Table 4.13. Trends of General Government Debt and Public Debt (2015 - Q3 2024)

EUR million	2015	2016	2017	2018	2019	2020	2021	2022	2023	Q3 2024
External Public Debt	**2,847.5**	**3,286.0**	**3,187.5**	**3,537.8**	**3,709.3**	**4,323.7**	**4,668. 9**	**5,055.5**	**5,345.4**	**5.301,5**
General Government Debt	2,096.7	2,446.6	2,376.8	2,695.0	2,763.5	3,382.5	3,648.9	3,983.7	4,171.0	4,151,8
Guaranteed Debt	750.8	839.4	810.7	842.7	929.9	920.0	999.9	1,048.9	1,149.7	1.123,0
Non-Guaranteed Debt	N/A	N/A	N/A	N/A	15.9	21.2	20.2	22.9	24.7	26,8
Domestic Public Debt	**1,379.7**	**1,425.4**	**1,599.4**	**1,664.4**	**1,831.6**	**2,159.6**	**2,466.4**	**2.647,4**	**3,131.4**	**3.545,5**
General Government Debt	1,356.6	1,404.9	1,581.7	1,649.4	1,793.3	2,133.4	2,431.4	2,597.4	3,085.1	3.508,0
Guaranteed Debt	23.2	20.5	17.7	15.0	12.3	9.5	7.5	4.8	1.4	0,0
Non-Guaranteed Debt	N/A	N/A	N/A	N/A	26.0	16.6	27.5	45.2	45.0	37,5
Public Debt	**4,227.2**	**4,711.4**	**4,786.9**	**5,202.2**	**5,540.9**	**6,483.3**	**7,135.3**	**7,702.9**	**8,476.8**	**8.847,0**
as % of GDP	46.6	48.8	47.7	48.4	49.2	59.7	60.3	58.2	58.1	56,9
General Government Debt	**3,453.3**	**3,851.5**	**3,958.5**	**4,344.4**	**4,556.8**	**5,516.0**	**6,080.2**	**6,581.1**	**7,256.2**	**7.659,8**
as % of GDP	38.1	39.9	39.4	40.4	40.5	50.8	51.4	49.7	49.8	49,3
Guaranteed Debt	**774.0**	**859.9**	**828.4**	**857.7**	**942.2**	**929.5**	**1,007.4**	**1,053.7**	**1,151.0**	**1.123,0**
as % of GDP	8.5	8.9	8.3	8.0	8.4	8.6	8.6	8.2	7.9	7,2
Non-Guaranteed Debt	**N/A**	**N/A**	**N/A**	**N/A**	**41.9**	**37.8**	**47.7**	**68.2**	**69.7**	**64,3**
as % of GDP	N/A	N/A	N/A	N/A	0.4	0.3	0.4	0.5	0.5	0,4

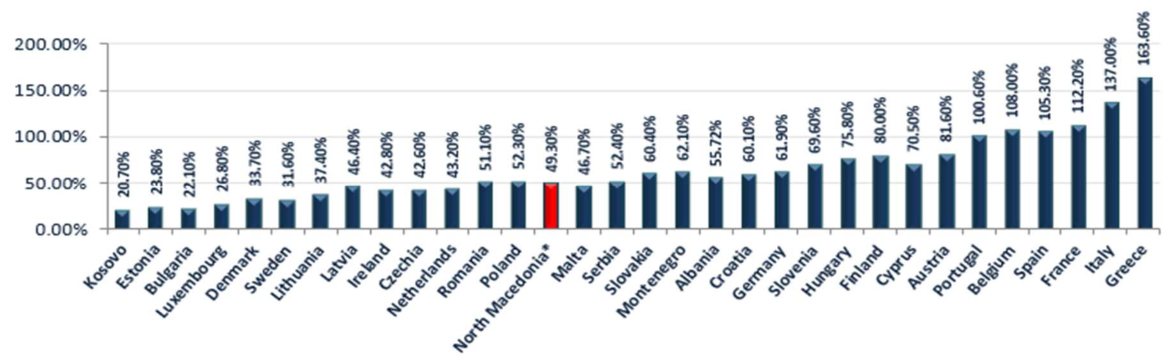
Source: Ministry of Finance and National Bank of the Republic of North Macedonia

[22] Pursuant to the Law on Modifications and Amendments to the Law on Public Debt, national definition of public debt is expanded, also covering the non-guaranteed debt of public enterprises established by the state or the municipalities. Thus, starting Q2 2019, public debt stock also includes non-guaranteed debt of the public enterprises.

Compared to the level of debt of the EU Member States and the countries in the region, Republic of North Macedonia is a moderately indebted country (Chart 4.6) and it remains to be moderately indebted as a result of the commitment to conduct a disciplined fiscal policy in the coming period.

Public debt trends in the coming period will reflect medium-term budget framework, refinancing needs with respect to previously incurred debts and implementation of capital projects. In the coming medium-term period, implementation of new and already commenced investment projects in road and railway infrastructure, education, health, energy, environment, reforms in agriculture and social sectors, development of municipalities and other projects in line with the strategic priorities and priorities of the Government of North Macedonia are expected to continue, co-financed with foreign loans, thereby being strongly committed not to jeopardise the long-term sustainability of the debt level of the country. The projects will be implemented by the state administration bodies, the municipalities, the public enterprises and the companies being predominantly owned by the state. In addition to investment projects, part of the borrowing is aimed at covering the budget deficit, i.e. providing for uninterrupted Budget execution. Furthermore, part of the borrowing will be also intended for repayment of debt liabilities falling due in the coming period. In the period 2025 - 2027, around EUR 2.470,0 million is to be repaid on the basis of prior foreign borrowing, including the Eurobond in the amount of EUR 500 million, issued in 2018, to be repaid in January 2025, the Eurobond in the amount of EUR 700 million, issued in 2020, to be repaid in June 2026, the Eurobond in the amount of EUR 500 million, issued in 2023, to be repaid in March 2027, as well as repayment of other forex debt liabilities.

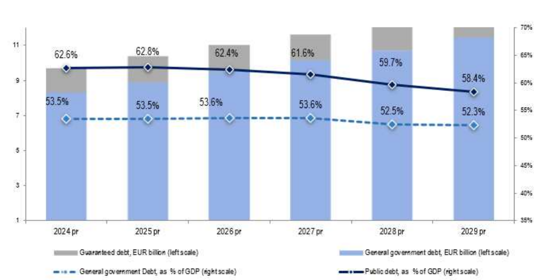
Chart 4.6. General Government Debt of EU Member States and Countries in the Region (% of GDP)



*Data on North Macedonia pertain to the third quarter in 2024
Source: Ministry of Finance, Eurostat, October 2024

In order to keep sustainable level of public debt, without thereby disrupting the fiscal sustainability, the Public Debt Management Strategy sets for the limit on total public debt level not to exceed 60% of GDP. Under the medium-term debt projections prepared in line with the new fiscal projections, public debt is expected to exceed the maximum threshold of 60% in 2024. However, as a result of the fiscal consolidation measures, it is anticipated the debt to follow downward trend, and return to the stipulated limit of below 60% of GDP by 2028. (Chart 4.7)

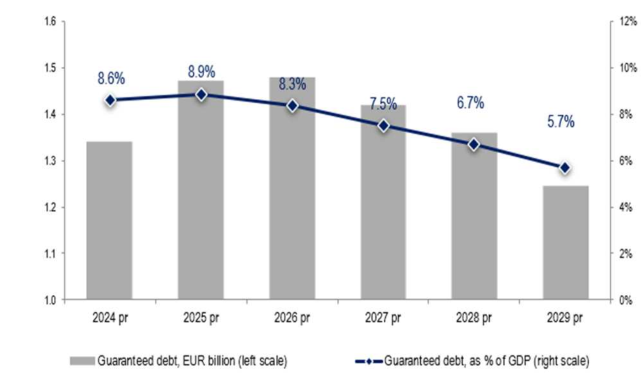
Chart 4.7. Projections for Total Public Debt (General Government Debt and Guaranteed Public Debt)



Sovereign Guarantee Debt. Issued sovereign guarantees are a contingent liability for the State Budget and a risk to increasing the budget expenditures in case they are called up. Therefore, the Ministry of Finance pays special attention to the amount of issued guarantees to be at a sustainable level over the medium term, focusing in particular on projects that are self-sustainable and generate revenues, at the same time underpinning the economic growth and providing for boosted competitiveness of the domestic economy. Moreover, when issuing sovereign guarantees, Ministry of Finance, in line with the Rulebook on the Manner of Analysing Data Submitted by the Public Debt Issuer, the Application and the Valuation of Financial Ratios ("Official Gazette of the Republic of North Macedonia", no. 198/2020), performs credit analysis and assesses the creditworthiness of public debt issuer - beneficiary of sovereign guarantee. The assessment encompasses detailed analysis of its financial balance sheets, including analysis of liquidity, solvency and profitability indicators.

As of Q3 2024 inclusive, issued sovereign guarantees amounted to EUR 1,123.0 million, i.e. 7.2% of GDP, declining by 0.7 p.p. compared to the stock of guarantees at the end of 2023. Most of the sovereign guarantees, i.e. 69.2%, is issued for financing investment projects in road infrastructure, with remaining 20.3% for financing projects aimed at supporting SMEs, 9.2% for funding projects in the field of energy and 1.3% for financing projects in the field of railway infrastructure.

Chart 4.8. Guaranteed Debt



Source: Ministry of Finance and projections of Ministry of Finance

To the end of maintaining a sustainable level of the amount of guaranteed debt, under the Public Debt Management Strategy, a limit on the amount of guaranteed public debt over the medium term is set not to exceed 15% of GDP.

In the period 2025 - 2029 the guaranteed debt is expected to moderately increase by 2025, and starting in 2026, it is anticipated to stabilise and drop to 5.7% of GDP in 2029. Thereby, level of guaranteed debt throughout the whole period is below the set maximum limit of 15%. (Chart 4.8).

General Government Debt Structure and Risks Associated with Debt Portfolio. General government debt structure of the Government of the Republic of North Macedonia reflects the medium-term limits sets under the Public Debt Management Strategy, being defined on the basis of detailed analysis of the debt portfolio exposure to market risks arising from the changes of interest rates on domestic and international capital markets, risks associated with the trends of foreign exchange rates and re-financing risk.

Taking into account that the changes in the foreign exchange rates may provide for increased costs for foreign currency debt repayments, as well as given the exchange rate peg to the euro as applied by the Republic of North Macedonia since 1995, foreign currency general government debt limit is set under the Public Debt Management Strategy, i.e. minimum threshold of euro-denominated debt in the foreign currency general government debt portfolio is projected to account for 80%. As of Q3 2024 inclusive, Denar-denominated debt accounts for 33.9% of the total general government debt, with foreign currency debt accounting for 66.1%. The share of euro-denominated debt in the foreign currency general government debt portfolio accounted for 91.1%, significantly above the limit of 80% determined under the Strategy and, compared to end-2023, it decreased by 1.5 p.p..

For the purpose of minimising the adverse effects from the ongoing increase of interest rates on interest-related costs in the Budget from potential market shocks triggered by the unfavourable changes of the interest rates, general government debt interest structure limit is set under the Strategy, as per which the minimum threshold of the fixed interest rate debt accounts for 60%. As of Q3 2024 inclusive, fixed interest rate debt accounted for 75.4% and compared to end-2023, it surged by 1.7 p.p..

For the purpose of protecting the central government debt portfolio against the re-financing risk and the interest rate risk, under the Strategy, short-term limits (minimum thresholds) are set as regards the indicators: average time to maturity - 4 years in 2025 and the average time to refixing – 3 years in 2024.

For the purpose of further smoothening the redemption profile and reducing the re-financing risk, as well as generating additional interest savings, in the coming period, Ministry of Finance will continue considering the possibilities and the conditions for optimisation of debt-servicing costs by actively managing the debt portfolio. In the coming period, Ministry of Finance will also continue considering the possibility and the conditions for debt restructuring by actively managing the debt portfolio.

Primary Government Securities Market. In 2024, Ministry of Finance regularly issued 12-month government securities without a forex clause, as well as 2-year, 3-year and 5-year government bonds, all without forex clause, and 15-year government bonds with and without forex clause. The ferquency of government securities auctions was determined in accordance with the Calendar for Issuance of Government Securities.

As of Q3 2024 inclusive, total of 15 auctions of GS were held. The total amount offered for sale at the auctions was Denar 62.303,00 million, the demand amounted to Denar 59.395,82 million, and the amount realized amounted to Denar 58.301,06 million.

In the course of 2024, the Ministry of Finance carried out measures adopted under the Denarisation Strategy, i.e. issuance was focused on Denar-denominated securities which, as of the third quarter inclusive, amounted to Denar 938.56 million as opposed to Denar 9.41 million issued through government securities with forex clause.

Interest rates on government securities in the domestic market during 2024 showed a decreasing trend. Although this trend was of a weaker intensity compared to the reduction of interest rates on the international financial markets, they still remained at a lower level in relation to the rates on the international financial markets. This imposed the need for the Ministry of Finance, when borrowing for budget needs to focus more on domestic financial markets. Consequently, the initially planned net amount of government securitues in the 2024 Budget, set at 350 million euros, was revised to 608 million euros with the supplementary budget in August 2024. As of Q3 2024 inclusive, stock of outstanding government securities amounted to 3,469.37 million euros, of which 735.77 million euros are short-term government securities, and 2,733.60 million euros are long-term government bonds.

Secondary Government Securities Market. Legal regulations on secondary trading in the Republic of North Macedonia provide for trading in all structural and continuous government bonds on the Macedonian Stock Exchange AD, as well as trading in short term government securities on over-the-counter markets.

In the period January - September 2024, the Macedonian Stock Exchange AD Skopje had a total turnover of 3.6 million euros from trading with government bonds. From the total turnover achieved, 2.9 million euros is turnover from trading structural government bonds, while 0.6 million euros is turnover from denationalization bonds and 0.05 million euros is turnover from continuous government securities

International Capital Market. By September 2024, 4 Eurobonds issued by the Republic of North Macedonia, falling due in 2025, 2026, 2027 and 2028, were traded on the international capital market. The yields for the Eurobonds accounting for 5.202%, 4,873%, 5.034% and 5.003%, respectively, on 30th September 2023.

Credit Rating of the Republic of North Macedonia. In April 2024, “Fitch“ Credit Rating Agency awarded the Republic of North Macedonia with “BB+” rating with a stable outlook. In October 2024, “Fitch“ Credit Rating Agency affirmed the previously awarded credit rating grade to the Republic of North Macedonia.

In January and June 2024, “Standard & Poor’s“ Credit Rating Agency affirmed Republic of North Macedonia’s previously awarded credit rating for local and foreign currency at BB-, at the same time affirming the country’s stable outlook.

4.7 Sensitivity Analysis and Comparison with the Previous Programme

Sensitivity of Budget Deficit. Medium-term economic projections are based on certain assumptions, primarily on macroeconomic environment, designing of economic policies and their implementation, as well as the absence of greater shocks.

Medium-term economic and fiscal projections are always accompanied by certain level of uncertainty and risks. The possible occurrence of these risks would result in deviations from the baseline medium-term scenario, i.e. different movements of the key fiscal variables.

Therefore, this section includes an overview of the results from the sensitivity analysis, examining the central government budget deficit sensitivity under three risk scenarios, which assume different conditions than the ones taken as basis for medium-term projections discussed above. Thereby, all risks are analysed separately, and all scenarios assume absence of other deviations from the baseline scenario.

Taking into account that medium-term fiscal scenario is based on certain macroeconomic assumptions, they are considered to be primary factor with a potential effect on the fiscal trends. Hence, as a first risk scenario, we assume the materialisation of downside risks in relation to the external environment, according to the first alternative scenario explained in point 3.3. Under this scenario, projected average annual real GDP growth in the period 2025 - 2029, accounts for 3.3%, i.e. being by 1.2 p.p. lower compared to the baseline scenario. Thereby, the potential lower economic growth would also imply a lower performance of the cyclical component of the budget revenues. Thus, this scenario would result in budget deficit of 3.8% of GDP on average annually in the coming five-year period, i.e. deficit widening by 0.5 p.p. on average compared to the baseline projections. Table 4.12 shows the budget deficit in the this period according to the baseline and the risk scenarios.

The second risk scenario assumes lower execution of capital expenditures, according to the second alternative scenario explained in point 3.3, i.e. their execution, accounting for approximately 75% in relation to the those projected in the baseline scenario. Lower execution of capital expenditures would cause a slowdown of growth of gross investments, and accordingly a lower real GDP growth rate in relation to the baseline scenario, by an average of 0.6 p.p. per annum in the period 2025-2029. This scenario would adversely affect tax revenues as well, which would exceed the effect of the reduced expenditures. Therefore, according to this scenario, budget deficit would worsen by 0.2 p.p. on average annually compared to the baseline scenario in the analysed period.

Table 4.14. Sensitivity Analysis of Budget Deficit

	2025	2026	2027	2028	2029
Budget deficit (% of GDP)					
Baseline scenario	-4,0	-3,5	-3,0	-3,0	-2,8
Scenario 1. Lower economic growth	-4,4	-3,9	-3,5	-3,6	-3,5
Scenario 2. Lower execution of capital expenditures	-4,2	-3,7	-3,2	-3,3	-3,1
Scenario 3. Lower collection of tax revenues	-5,0	-4,5	-4,0	-4,0	-3,9

Source: Calculations of the Ministry of Finance

The third scenario assumes a reduced collection of total tax revenues by 5% per year in the analysed period compared to the baseline scenario. In conditions of unchanged level of budget expenditures and unchanged economic growth, lower tax revenues would lead to higher budget deficit, which would account for 4.3% of GDP on average annually during the analysed period, thus getting closer to around 3.9% of GDP in 2029.

Materialisation of any of the above risk scenarios in the upcoming period would result in relatively limited effects on the budget deficit, i.e. sustainability of fiscal policy in the medium term is in no case disrupted.

Public Debt Risks. Uncertainty arising from the future trends of macroeconomic variables on the international capital market significantly affects the decision making for efficient management of debt portfolio of the country. In conditions of large oscillations of economic variables, need arises to actively manage risks which public debt portfolio in the Republic of North Macedonia is exposed to. Main risks identified when managing this portfolio are re-financing risk, market risk, including interest rate risk and exchange rate risk, risk associated with contingent liabilities and operational risk.

Public Debt Sensitivity. In order to analyze the exposure of debt portfolio of the Republic of North Macedonia to the market risk, i.e. interest rate risk and foreign exchange rates, short simulation is prepared regarding the effects of variation of interest rates and changes in foreign exchange rate on the costs related to servicing the external general government debt (Table 4.15). Sensitivity analysis of the trends at the servicing-related costs in the Budget of the Republic of North Macedonia on the basis of external debt is based on the following assumptions: by changing one variable, all other variables remain unchanged, (ceteris paribus); in conditions of potential trends in the other currencies in relation to the euro, Denar exchange rate in relation to the euro retains the stable value, and non-correlation between interest rate trends and trends in the foreign exchange rate.

The analysis covers the period 2025-2029, being based upon scenarios of increase of interest rate by 1 p.p. compared to the baseline scenario, as well as euro depreciation by 10% compared to the other currencies.

Table 4.15. Sensitivity analysis of servicing-related costs of the external general government debt when changes occur in both the interest rates and the foreign exchange rates

Index figures	2025	2026	2027	2028	2029
Baseline Scenario	100.0	100.0	100.0	100.0	100.0
Scenario 1: Increased interest rates on 1 percentage point	107.6	107.3	106.3	105.2	103.5
Scenario 2: Appreciation of other currencies under the portfolio in relation to the euro by 10%	101.9	101.7	102.4	101.5	102.0

Source: Calculations of the Ministry of Finance

Main conclusions that may arise from this analysis are the following:

- amount of interest-related costs on the basis of external general government debt are significantly sensitive to the interest rate trends. Should interest rates in 2025 surge by 1 percentage point in relation to the baseline projection, it would cause for interest-related costs to increase by 7.6%, i.e. by EUR 12.31 million, with similar effects in the period 2026-2029.
- potential euro depreciation in relation to the other currencies in the portfolio (US dollar, Japanese yen and Special Drawing Rights) by 10% will cause an increase of servicing-related costs by 1.9% in 2025, i.e. by EUR 18.46 million. Given the obtained results, it may be concluded that possible unfavourable trends at exchange rates of other currencies in relation to the euro will not cause any significant increase of the servicing–related costs, as a result of the fact that most of the external general government debt is euro-denominated.

4.8 Quality of public finances

Improving macroeconomic stability and supporting economic activity, disciplined budget policy, gradual fiscal consolidation and budget deficit reduction in line with the fiscal rules, improvement of the public finance management structure, as well as maintenance of high level of capital expenditures, along with attainment of moderate level of total debt, are the main benchmarks for quality public finances.

Effective public finance management is of key significance not only for improving the fiscal discipline and the strategic distribution of the scarce public resources, but also for ensuring transparency, accountability and efficiency in budget spending, as well as rendering high-quality public services, which play major role in gaining public trust and increasing overall domestic support for implementing the challenging reforms.

To that end, the Government carries out major public finance reforms aimed at accelerated, inclusive and sustainable economic growth, higher living standard and better- quality of life for the citizens.

Public finances reform is aimed at longer-term and better planning of budget programmes and budgets, sustainability and continuity in implementing the policies, more just model in view of revenues and expenditures and the manner of financing, as well as monitoring and measuring the performance.

Public Financial Management Reform Programme is a strategic document for development of the public financial management system, always including the civil society, the development partners and other relevant stakeholders in its preparation. Such concept of an inclusive and open dialogue with all stakeholders about the PFM policies is applied, as a good practice, for the preparation of all PFM Programmes.

Public Financial Management Reform Programme covers all aspects of public financial management: economic analysis, macroeconomic and fiscal framework, revenue mobilisation and collection, budget planning, public investment management, effective instruments under the Growth Acceleration Plan, public procurement, including PPP, establishment of integrated financial management information system (IFMIS), Public Finance Academy, budget accounting, public internal financial control, external control and parliamentary oversight and PFM at local level.

Key goals of the Programme are improved fiscal framework, strengthened process of public finance planning, execution and reporting, increased revenue collection, strengthened public procurement system and improved internal and external control by increasing transparency and accountability in operations, which are to ensure accelerated and sustainable economic growth, higher living standard and better quality of life for the citizens. All this encompasses maintaining stable budget in the long run, thereby continuing the rendering of quality and prompt services to the citizens and the businesses through a modern and efficient public administration based on digitalisation. Further improvement of public financial management is necessary not only to underpin the measures aimed at fiscal consolidation and structural reforms, but also as a process, which improves the quality of the public administration and ensures an attractive and desired environment for the investors. Moreover, the Government has developed sub-system reform strategies in the areas of public internal financial control and tax system.

In the period to come, fiscal policy will be aimed at creating preconditions for a new economic growth cycle, ensuring a substantial level of public investments, being the groundwork for improved economic prospects, as well as better quality of life for the citizens In addition to the considerable capital investments projected under the Budget, substantial funds have also been provided under loans extended by international financial institutions and bilateral creditors Hence, the Budget puts the focus on capital investment implementation, exclusively intended for efficient projects, in particular infrastructure and energy projects in support of the business sector, capital projects in the field of utilities and other local infrastructure, aimed at improving the living conditions of the citizens, such as improvement of the conditions in the health, education and social system, agriculture and environmental protection.

Total revenues of the Budget of the Republic of North Macedonia (Central Budget and Funds: Pension and Disability Insurance Fund, Health Insurance Fund and Employment Agency) for the period 2025 - 2029 are projected at around 35.5% of GDP. Revenue projections in the coming medium-term period are based on revenues generated in the previous years, projections for macroeconomic indicators and the effects from the planned tax reforms.

Average share of total State Budget expenditures in the 2025-2029 period accounts for around 38.8% of GDP. Budget expenditure projections for the forthcoming medium-term period are prepared on the basis of three key postulates:

- compliance of revenue projections with planned economic activities;
- total Budget expenditure projections ensure continuous fiscal consolidation, and
- projected expenditures provide for regular and effective execution of all legal obligations.

Medium-term fiscal projections include a strong development component, with a significant share of capital expenditures with over 5% in GDP on annual basis, and they represent key elements of the public finances.

4.9 Fiscal management and budget frameworks

In order for the fiscal policy to be sustainable over the medium term, fiscal projections envisage a framework for adhering to the fiscal rules, designed so as to be harmonised and consistent with the EU fiscal rules.

Fiscal rules are introduced for the first time under the OBL and entered into force in January 2023.

The Budget and the Fiscal Strategy should be in conformity with the fiscal rules pertaining to both the deficit and the total general government debt:

1. General government deficit for the respective year may not exceed 3% of the nominal gross domestic product (GDP).

2. Total general government debt may not exceed 60% of the nominal GDP, while the guaranteed public debt may not exceed 15% of the nominal GDP.

3. Exception from the stipulated fiscal rules is prescribed in case of occurrence of one of the following extenuating circumstance:

   - natural disasters and external shocks jeopardising the national security or the lives and the health of the people;
   - state of emergency and/or crisis situation;
   - abrupt financial or economic shocks, resulting in a negative or a very low annual real GDP growth close to zero, the overcoming of which requires a significant support from the fiscal policy.

4. Exceptions from the fiscal rules are allowed in cases of implementation of investment projects with a positive impact on GDP. The respective exceptions should not exceed 0.5% of GDP annually and on cumulative basis over a period of five years.

5. The Government is obliged, as regards any exception, to clearly explain the following to the Parliament when submitting the immediate subsequent Budget or Supplementary Budget, or the immediate subsequent Fiscal Strategy:

   - reasons for the exception from the fiscal rules;
   - corrective measures it undertakes and plans to undertake, all to the end of re-establishing compliance with the fiscal rules within a period not longer than five years from the moment the exception occurred.

Over the medium term, fiscal policy envisages gradual fiscal consolidation. Thereby, budget deficit is reduced as a percentage share of GDP, as follows: from 4.9% in 2024 to 4.0% in 2025, 3.5% in 2026, 3.0% in 2027, 3.0% in 2028 and 2.8% in 2029.

In the period 2024 - 2026, exceptions from the fiscal rules as regards the budget deficit and the public debt are incorporated in the Fiscal Strategy, however, with a strong trend of gradual alignment with the respective rules in the period in question. In line with the projections in the Fiscal Strategy, fiscal rule on budget deficit is to be met in 2027.

Reasons for exceptions from the fiscal rules in the period 2024 - 2026 arise solely from the arrears incurred by the previous Government and the need to provide financial resources for the following: wage adjustment as per the General Collective Agreements signed in several sectors, arrears not envisaged, covering the high amount of arrears incurred by the previous Government, implementation of infrastructure and energy projects aimed at improving quality life of the citizens and boosting the competitiveness of businesses, digital transformation of the public sector, improved education quality and student standards, improved quality of healthcare, encouraging balanced economic growth, implementing the new policies of the Government aimed at improving the living standard of the citizens via linear increase of pensions and wage adjustment as per the General Collective Agreement, implementing prior agreed large infrastructure projects, such as Corridors 8 and 10d Motorway Project, for which the Parliament of the Republic of North Macedonia adopted a special Law.

This kind of arrears cannot be settled with a one-year budget, since they are not of a short-term nature. They rather generate costs over a period of several years. Hence, any possible abrupt cutting of other expenditures envisaged under the Programme of the Government so as to incorporate these substantial arrears could have huge negative consequences for the economy, i.e. the capital investments, the wages, the pensions and the social benefits which are important for the business sector and the living standard of the citizens. Government of the Republic of North Macedonia will gradually align with the fiscal rules by implementing measures on both the revenue and the expenditure side.

Quality medium-term budgeting is central to developing the medium-term fiscal framework. Thus, in the forthcoming period, it should be taken into account that the medium-term fiscal projections are based on a medium-term baseline scenario, which means that the determination of the fiscal projections results from the exercise of the competencies of the budget users under the applicable legislation, the existing obligations and tasks, resulting from already approved multi-annual commitments, contracts, and on-going projects. Items beyond the baseline scenario, requiring additional financing, are showcased through new initiatives.

Fiscal Council has been established as an independent institution and a separate budget user, which is to provide independent and professional analyses and views on the macroeconomic and fiscal assumptions, the Fiscal Strategy, the Budget, the Budget execution reports, the fiscal risks, and similar.

Fiscal risks represent the exposure of public finances to certain circumstances that may cause deviations from the projected fiscal framework, most often caused by macroeconomic shocks and execution of any contingent liabilities. Possible materialisation of these risks, assuming conditions different from those taken as basis for the medium-term projections, would result in deviations from the medium-term baseline scenario, i.e. different performance of the key fiscal variables. Sources of fiscal risks specific for our country are: macroeconomic risks, public enterprises and state-owned companies, implementation of public investments and PPP, municipalities, public debt and unrepaid liabilities, legal claims against the state and environmental risks.

Under the adopted amendments to the OBL ("Official Gazette of the Republic of North Macedonia", no. 272/24), provisions in the existing Law have been modified and amended, thus ensuring continuity of the obligation for earmarked, rational, economic and efficient use of appropriations by the public entities, i.e. extension of the deadline for implementation of the OBL by one year, i.e. 1st January 2026 instead of 1st January 2025, regulating more closely (from a technical point of view) certain definitions, including the Spending Review as part of the Fiscal Strategy, as well as creating pre-conditions for its implementation by adopting respective bylaws as per the Reform Agenda, which were in part adopted in the course of 2024 (published in the Official Gazette of the Republic of North Macedonia and MoF's website).

4.10 Sustainability of Public Finances

Calculations for long-term sustainability of public finances are based upon the following assumptions:

- average labour productivity growth of 4.4%;
- increase of male participation rate (from 78.6% in 2020 to 74.4% in 2060);
- more intensive increase of female participation rate (from 56.2% in 2020 to 72.6% in 2060), by which share of female population in the total active population is expected to reach 48.2% in 2060;
- reduction of unemployment rate with higher intensity by 2030, projected at 7.3% the same year, and with lower intensity in the upcoming years, whereby unemployment rate is projected at 5.6% in 2060;
- gradual increase of the share of population above 65 years of age, reaching around 30% in 2060.

On the basis of the employment and wage growth projections in the country, an average annual growth of 5.4% of revenues on the basis of pension insurance contributions is envisaged in the analysed period, with their share in GDP accounting for 5.1%. As for pension-related expenditures, it is worth mentioning that only those of the Pension and Disability Insurance Fund have been taken into account. Taking this into account, and according to the projected demographic trends, 6.3% average annual increase of pension-related expenditures is envisaged in the analysed period, which is expected to account for 11.3% in 2060. Public expenditures for health protection as percentage of GDP are projected to remain stable and reach 6.7% in 2060. Education-related expenditures are envisaged to increase by 6.8% on average annually in the next forty years, thus, their share in GDP is expected to reach 5% in 2060. Interest-related costs are envisaged to account for 2.0% of GDP on average in the analysed period, in line with the projected trend of budget balance, i.e. general government debt and projected effective interest rate.

5A. Consistency of the Reform Agenda with the ERP's macro-fiscal framework

Process of selecting reforms from the Reform Agenda for impact assessment

According to the European Commission's Guidance for the preparation of the Economic Reform Programme 2025-2027, this chapter should provide a quantification of the potential economic impact of the reforms contained in the Reform Agenda 2024-2027[23]. The Reform Agenda includes a large number of reforms related to the foundations of the EU accession process and not all of them can be expected to have a strong economic impact. Hence, the focus in selecting reforms to be included in this chapter was on those with the greatest potential impact on the economy.

The selection of reforms was made according to a scoring and selection tool developed by CEF Ljubljana experts. It uses a criteria-based approach according to which reforms with the greatest potential for national development, economic growth and strong feasibility for implementation would be prioritized[24]. The selection process took place in several steps:

Step 1 – Defining the scope of the impact assessment, with a primary focus on economic growth.

[23] https://mep.gov.mk/en/post/?id=15800

[24] Selecting Reforms for Impact Assessment in the ERP - Scoring Tool (Alkete Buçaj, Janez Šušteršič, Regional EU project "Better Integrated Structural Reforms in Fiscal Frameworks-FISR2")

Step 2 – Three sets of criteria were applied for reform selection: A. Intensity and measurability of the economic impact; B. Time required to implement the reform and achieve the impact; C. Additional impact dimensions.

Step 3 – Calculation of the overall score, whereby the reforms with the highest score should be selected for assessment of potential impact. The use of a scorecard allowed for the use of objective, measurable criteria, whereby in the case of equal high scores, additional dimensions or existing capacity and tools for impact assessment were taken into account.

Considering that ERP is a program that in previous cycles focused on structural reforms aimed at overcoming key challenges for growth, such as addressing the lack of appropriate skills in the labor market, increasing energy independence and transition to clean energy, and accelerating the digital transition, when defining the scope for the impact assessment, the following priority areas from the Reform Agenda with an expected direct impact on the country's economic potential were taken into account: Energy/Digital transition; Human capital; and Private sector development and business environment.

The scoring and selection of reforms for impact assessment was carried out based on three sets of criteria, namely: whether the reform provides an opportunity to measure the direct economic impact, and whether it indicates that it will have a strong positive impact on the economy; whether the reform has a clear plan with activities that will begin immediately after the adoption of the Reform Agenda and when the final step is planned to be completed; and as additional dimensions for selection, the impact on the business environment and on vulnerable population groups (social equality) were taken into account.

As a final step, each reform was rated on a scale of 1-5 for each criterion and appropriate weights were applied, ultimately resulting in a selection of six reforms for assessment of their potential economic impact.

The selection of the six reforms from the Reform Agenda was carried out during the first workshop held on 22 October 2024, where the ministries and institutions whose reforms were assessed actively participated in the scoring and selection proces. The next step was to assess the potential economic impact, for which a two-day workshop was held on 12-13 November 2024, with the institutions whose reforms were selected. Expert assistance was provided by CEF, within the framework of the Regional EU Project FISR2.

The following six reforms were subject to an economic impact assessment:

2.1.1.1 Align with electricity integration package to enable electricity market coupling of the EU and North Macedonia: establish the day ahead electricity market, operationalise the package in line with the market coupling operator integration plan by the end of 2025.

2.1.3.1 Deployment of renewable energy: Implementation of the Renewable Energy Directive (permitting, guarantees of origin,) and transparent and competitive procedures for the deployment of renewable energy.

2.2.2.3. Widen the offer of public e-services offered through the governmental e-platform and simplify administrative and electronic procedures.

3.1.1. Reinforce the education system to address the skills mismatch, increase access to and quality of VET, and improve access to work-based learning and dual education (including private sector involvement).

3.1.2. Increase participation in adult education and improve recognition of non-formal and informal learning.

4.1.6. Expand the use of E-Customs services for economic operators and reduce the costs and increase the efficiency of customs procedures.

At the same time, taking into account that measures related to energy and human capital belong to the same areas respectively, when evaluating measures 2.1.1.1 and 2.1.3.1, as well as measures 3.1.1 and 3.1.2, the effects are taken as a summary result.

Brief summary of selected reforms from the Reform Agenda and expected potential economic impact

<u>2.1.1.1 Align with electricity integration package to enable electricity market coupling of the EU and North Macedonia: establish the day ahead electricity market, operationalise the package in line with the market coupling operator integration plan by the end of 2025</u>

<u>2.1.3.1 Deployment of renewable energy: Implementation of the Renewable Energy Directive (permitting, guarantees of origin,) and transparent and competitive procedures for the deployment of renewable energy</u>

Renewable energy has multiple benefits for the citizens: contributing to the efforts to deal with climate change, helping to protect our environment, creating growth and jobs as well as contributing to the country's technological and industrial challenges. Deployment pf RES contributes to achieving the country's target of 38% in the gross final energy consumption until 2030. According to the NECP, the fastest growing RES technologies are wind and solar and therefore the deployment of 0.8 GW installed capacities until 2027 is aligned with the NECP projections and current investment plans of private investors.

This reform is expected to generate significant employment opportunities. At the same time, the deployment of renewable energy sources will directly create jobs in construction, operations, and maintenance of renewable energy projects. The jobs generated by the reform will boost the GDP and employment in the country. The reform will support the cross-border electricity trade, reducing fossil fuel consumption and increasing renewable energy capacity.

We assume that 70% of RES investments will be in PV's (photovoltaic power plants) and 30% in wind power plants. The investments needed for construction of 0.8 GW RES will reach EUR 800 million, calculated on the basis of investment cost per kW for these technologies, as reported by IRENA (International Renewable Energy Agency) and estimated in the NECP. Using the multiplier of 1.1[25], this investment would increase the GDP by around 2% on an annual basis in the medium term.

This reform is expected to generate significant employment opportunities, creating jobs in construction, operations and maintenance of renewable energy projects. RES investment is expected to create 6,000 full-time jobs, which was calculated by using results of UN study which estimated that USD 1 million investment creates 7.49 jobs.

<u>2.2.2.3. Widen the offer of public e-services offered through the governmental e-platform and simplify administrative and electronic procedures</u>

The reform aims to increase the availability of government e-services by 50% by 2027. This expansion aims to simplify procedures through automated data exchange and reduced service requirements. The anticipated outcomes include improved efficiency, transparency, and quality of public services, enhancing citizen engagement and supporting business productivity.

This reform is part of broader digitalization efforts aimed at modernizing public administration and enhancing access to services. The focus on automation and reducing administrative burdens is expected to make public sector operations more efficient and reduce potential corruption.

Electronic public services reduce the time, administrative and financial burden for business entities and individuals, which contributes to increasing productivity and improving time efficiency. Overall productivity increases as a result of saving the time required to receive the service. In addition, there are some indirect cost

[25] Nicoletta Batini, Mario Di Serio, Matteo Fragetta, Giovanni Melina, Anthony Waldron, Building back better: How big are green spending multipliers? Ecological Economics, Volume 193, 2022

savings both for the government and the users (businesses and citizens) mainly in the form of commuting, printing materials, staff engagement.

The impact of the reform was measured through saving the time needed to receive a certain service. It was assumed that a user will save up to 2 hours per service application. Using the number of active users and potential service applications due to the introduction of 144 new services, the estimates suggest that the reform will save around 10 million hours per year.

The economic impact of these services is related to the reduction of time and costs for accessing public services, thereby improving productivity. By decreasing the need for physical interactions and paperwork, the reform anticipates direct savings in time and indirect cost savings on commuting and materials, benefiting both users and the government.

Estimates show that this reform will save over 10.2 million hours per year, equivalent to around EUR 58 million per year. This time saving will increase Gross Value Added by 0.46% and GDP by 0.40%, which represents a significant contribution to economic efficiency and productivity.

<u>3.1.1. Reinforce the education system to address the skills mismatch, increase access to and quality of VET, and improve access to work-based learning and dual education (including private sector involvement)</u>

<u>3.1.2. Increase participation in adult education and improve recognition of non-formal and informal learning</u>

Investments in education and skills are the basis for long-term social and economic progress. By strengthening the labor market, enhancing training and professional development possibilities, and enhancing the educational system, the objective is to lay a solid foundation for long-term social and economic growth. Modernizing the educational infrastructure, improving the curriculum and training teachers for green and digital competences are among the priorities that will enable young people to participate effectively in the digital economy.

These initiatives will not only improve the quality of education but will also ensure that North Macedonia remains competitive on the global market, ready for the challenges ahead. The establishment of the Regional VET Centers is a strategic objective in the process of racialization of investments in VET, working on development of the added value for achieving excellence in this field is property in the educational reforms. The new educational laws (Law on Secondary Education and Law on VET) foresee novelties for better harmonization with the world of work, such as introduction of the Career Advisors, Coordinators for VET and the Unique Student Educational Number, additionally, chapters on Regional VET Centers, Dual Education, and Conducting Social Dialog for harmonization of the education with the labor market needs are made. Establishing framework for the process of Validation of Non – Formal and Informal Learning – VNFIL is part of the new Law on Adult Education. The preparation of a VNFIL system is at an advanced stage of development, the main methodological documents are in place and training was organized. The validation process itself covers several steps like submission of documents, advisory meetings, estimation of level of knowledge, and in case something is missing, recommendation for training, and the last step is issuing a certificate. Validation can offer crucial support to the unemployed or those at risk of losing their jobs by enabling citizens to recognize the value of their skills and to present them either to potential employers or when returning to formal education to earn a new qualification.

The reforms outlined in the Growth Plan emphasize transforming the education system through five priority areas, each with defined goals and success indicators. Below is a detailed understanding of each reform, including its context, scope, and strategic objectives.

<u>3.1.1. Reinforce the education system to address the skills mismatch, increase access to and quality of VET, and improve access to work-based learning and dual education (including private sector involvement)</u>

Step: At least one career counselor in 95% of schools (until June 2026).

Improving career guidance will align education with labor market needs, reducing job mismatches and boosting productivity. Students will be better informed about their opportunities, enhancing their satisfaction and motivation. There are currently no career counselors in high schools.

Step:700 private companies involved in dual education (until December 2026)

Increased company participation in education provides practical training, resulting in a better-prepared workforce and reduced unemployment. This collaboration fosters partnerships between schools and the community, promoting inclusive development. There are currently 600 companies involved in dual education.

Step:3,000 students utilized work-based learning opportunities (30% female)

These students will become skilled workers, driving growth in key sectors. Women's inclusion promotes gender balance and economic independence. There are currently 200 students, 75 of whom are female.

Step: Reconstruction and equipping of 4 Regional Vocational Education and Training Centers (RVETCs)

Modern centers will produce highly skilled personnel, enhancing innovative potential. Regional centers contribute to local development and encourage young people to remain in their regions. There are currently 3 RVETC.

Step: 700 students (315 female) enrolled in new educational programs

New programs will provide market-relevant qualifications, increasing employability. Students will gain access to modern education, improving their prospects for a better future. There are currently 300 students, 100 of whom are female.

<u>3.1.2. Increase participation in adult education and improve recognition of non-formal and informal learning</u>

Step: 16 programs for adults (2 for women, including 1 for women’s entrepreneurship)

These programs will offer new qualifications for adults, enhancing productivity. Women’s entrepreneurship fosters economic and social inclusion. There are currently 8 programs, none of which are for women and female entrepreneurship.

Step: 500 adults receive qualifications through validation (of which at least 30% women)

Newly qualified workers will increase labor force participation and reduce the skills gap. The programs will boost participants’ confidence and social mobility. Currently, only 5 adults are validated, none of whom are women.

These reforms will reduce the skills mismatch in the labor market by reducing the gap between labor supply and demand. To measure the impact of the reform on competitiveness, a skills mismatch indicator is calculated, taking into account the data on the working-age population and employment from the State Statistical Office, and using the DG ECFIN document – Skills Mismatches and Productivity in the EU (2019)[26] as a reference.

The measures on skills mismatch and adult education have two targets – 3000 students benefiting from practical knowledge and training and 500 adults having their informal and non-formal education validated. By simulating the Skills mismatch indicator, based on DG ECFIN discussion paper from 2019 – Skills mismatch and productivity in EU that explains linkage between impact of policy change on labor productivity and GDP, it is calculated that the measure improves the productivity by 0,55 leading to similar increase in GDP.

[26] https://economy-finance.ec.europa.eu/system/files/2019-07/dp100_en.pdf

4.1.6. Expand the use of E-Customs services for economic operators and reduce the costs and increase the efficiency of customs procedures

The expansion of E-Customs services aims at more efficient customs procedures, reducing costs for economic operators, and improving transparency and compliance. Full alignment with the Union Customs Law and modernising customs processes through advanced IT systems (such as NCTS phase 6, Automated Export Customs System and Import Control System) will reduce processing times for exports, imports and transit. This creates a more competitive trading environment and increases productivity in import- and export-dependent sectors.

The main economic channels through which the reform will impact the economy are the following:

1. Facilitating trade and increasing trade volume: Reducing customs clearance times by 2-4%, and faster processing of declarations (10% increase in simplified customs declarations) will contribute to increasing trade volume. Faster, more efficient procedures attract more foreign and domestic economic operators, stimulate imports/exports and integrate the country more effectively into the EU market.
2. Productivity and business growth: Reducing administrative and compliance costs for businesses (e.g., fewer delays, faster access to goods) improves profitability, allowing businesses to reinvest in their operations, expand their workforce, and improve technology. By reducing trade barriers, small businesses will particularly benefit from the reform, and will be able to grow and develop faster in an efficient customs environment.
3. Better revenue management and compliance: Enhanced compliance with efficient procedures and risk assessment (e.g. 8% improvement in risk comparison) will lead to higher revenue collection, reduced tax evasion and improved trade transparency. Strengthened risk management systems through ICS2 can more effectively detect irregularities, reduce corruption in customs clearance and increase legitimate trade.
4. Technological progress and digitalization: The development of advanced IT systems (NCTS, AES, ICS) supports digital transformation, which has spillover effects on the broader economy, such as better data management, risk assessment and service delivery across the entire government sector.

6. Institutional issues and stakeholder involvement

The Economic Reform Programme 2025-2027 was prepared by the inter-ministerial working group for the preparation of the ERP, which includes nominated ERP coordinators from relevant ministries and institutions. The whole process is coordinated by the Ministry of Finance - as the National coordinator. In the process of preparing the Programme, the following institutions were involved: National Bank, Ministry of finance, Ministry of Energy, Mining and Mineral Resources, Ministry of Education and Science, Ministry of Digital Transformation, Customs Administration, Ministry for European Affairs. In the preparation process, according to current practice, in addition to the members of the working group, representatives of the sectors in the institutions responsible for policy making, as well as the budget departments were actively involved.

In the process of preparation of the programme, face-to-face and online working meetings, trainings and consultations were oganised with the institutions. Also, electronic communication was used with the aim of the preparation of the ERP moving within the established time dynamics for its delivery to the EC.

On May 14, 2024, the Economic and Financial Dialogue on ministerial level with the EU was held, at which the Joint conclusions with policy guidance were adopted, which were the basis for creating the new ERP 2025-2027.

On July 4, 2024, The EC has published the Guidance for the preparation of the ERP 2025-2027, officially starting a new cycle of the preparation of the ERP. The ERP contains macroeconomic projections, a budget plan for the next three years and a section on the economic impact of chosen measures from the Reform Agenda, as well as an overview of the actions taken in response to the recommendations of the joint conclusions.

In the period October-November 2024, workshops were held organized by CEF Ljubljana, aimed at building the capacities of line ministries involved in the ERP process for assessing the economic impact of their measures from the Reform Agenda.

In December 2024, the competent institutions involved in the process submitted to the Ministry of Finance detailed reports on the implementation of the activities to fulfill the recommendations from the Joint Conclusions of the Economic and Financial Dialogue with the European Union of May 14, 2024, as well as a text on the potential economic impact of the measures from the Reform Agenda.

In December 2024 the macroeconomic and fiscal framework for ERP 2025-2027 was prepared.

The Government adopted the Programme at a session held on the 14th of January, 2025.

7. ANNEXES

Annex 1: Summary data

Table 1a. Macroeconomic prospects

	ESA Code	2023	2023	2024	2025	2026	2027
		bn EUR	Rate of change				
1. Real GDP at market prices	B1g	13.532	2.1	2.1	3.7	4.0	4.4
2. GDP atmarket prices	B1g	14.583	10.0	6.6	6.8	6.7	6.9
Components of real GDP							
3. Private consumption expenditure	P3	9	1.2	2.5	2.7	2.8	2.9
4. Government consumption expenditure	P3	2	-1.8	3.2	1.5	0.4	0.6
5. Gross fixed capital formation[27]	P51	4	-9.6	8.0	8.1	7.4	7.4
6. Changes in inventories and net acquisition of valuables (% of GDP)	P52+P53	:	:	:	:	:	:
7. Exports of goods and services	P6	10	-0.6	-0.6	4.2	5.2	6.0
8. Imports of goods and services	P7	12	-5.8	2.5	4.4	4.5	4.8
Contribution to real GDP growth							
9. Final domestic demand		15.6	-2.9	4.5	4.5	4.2	4.4
10. Change in inventories and net acquisition of valuables	P52+P53	:	:	:	:	:	:
11. External balance of goods/services	B11	-2	5.0	-2.5	-0.8	-0.2	0.1

Source: SSO and calculations of the Ministry of finance

Table 1b. Price developments

		2023	2024	2025	2026	2027
1. GDP deflator	%	7.8	4.5	3.0	2.6	2.3
2. Private consumption deflator	%	7.0	3.2	2.2	2.1	2.0
3. HICP	%	7.8	4.5	3.0	2.6	2.3
4. National CPI	%	9.4	3.5	2.5	2.0	2.0
5. Public consumption deflator	%	11.2	10.0	4.9	2.4	2.3
6. Investment deflator	%	0.1	1.0	3.0	3.0	3.0
7. Export price deflator (goods & services)	%	3.1	0.8	1.3	1.7	1.8
8. Import price deflator (goods & services)	%	1.1	0.1	1.3	1.6	1.9

Source: MoF Calculations and NBRNM

Table 1c. Labour market developments

	ESA code	2023 Level	2023	2024	2025	2026	2027
			Rate of change				
1. Population (thousands)			1,827.8	1,823.0	1,818.8	1,814.3	1,809.3
2. Population (growth rate in %)			-0.2	-0.3	-0.2	-0.3	-0.3
3. Working-age population (persons thousands[28])			1,198	:	:	:	:
4. Participation rate			66.1	:	:	:	:
5. Employment [29](persons. thousands)			688	695	706	717	730
6. Employment[30]. hours worked			:	:	:	:	:
7. Employment (growth rate in %)			-0.5	0.9	1.6	1.6	1.8

[27] Data refers to gross capital formation
[28] Age group of 15-64 years
[29] Occupied population, domestic concept national accounts definition
[30] National accounts definition

8. Public sector employment (persons)			:	:	:	:	:
9. Public sector employment (growth in %)			:	:	:	:	:
10. Unemployment rate[31]			13.1	12.5	11.2	10.1	9.0
11. Labour productivity[32] persons		1,210.2	2.6	1.1	2.1	2.4	2.6
12. Labour productivity[33] hours worked			:	:	:	:	:
13. Compensation of employees	D1	:	:	:	:	:	:

Source: SSO and MoF calculations

Table 1d. Sectoral balance

% of GDP	ESA	2023	2024	2025	2026	2027
1. Net lending/borrowing vis-à-vis the rest of the world	B9	4.4	1.2	-0.7	1.2	0.8
of which:						
- Balance of goods and services		-13.9	-14.1	-13.7	-12.7	-12.4
- Balance of primary incomes and transfers		14.3	12.0	11.4	10.6	10.1
- Capital account		3.7	2.8	1.6	3.4	3.1
2. Net lending/borrowing of the private sector	B9/EDP B9	4.7	2.8	1.7	1.4	0.7
3. Net lending/borrowing of general government		-4.3	-4.9	-4.0	-3.5	-3.0
4. Statistical discrepancy		0.3	0.5	0.0	-0.1	0.0

Source: NBRNM and MoF

Table 1e. GDP. investment and gross value added

	ESA	2023	2024	2025	2026	2027
GDP and investment						
GDP *level* at *current* market prices (in bn Denars)	B1g	897.7	957.2	1,022.5	1,091.3	1,166.5
Investment ratio (% of GDP)		29.6	30.3	31.6	32.8	33.9
Growth of Gross Value Added. percentage changes at constant prices						
1. Agriculture		-3.0	:	:	:	:
2. Industry (excluding construction)		1.4	:	:	:	:
3. Construction		-0.4	:	:	:	:
4. Services		3.6	:	:	:	:

Source: SSO and calculations of the Ministry of Finance

Table 1f. External sector developments

Euro billion, unless otherwise noted	2023	2024	2025	2026	2027
1. Current account balance(% of GDP)	0.4	-2.1	-2.3	-2.2	-2.3
2. Export of goods	7.2	6.9	7.6	7.9	8.1
3. Import of goods	9.8	10.0	10.7	11.1	11.4
4. Trade balance	-2.6	-3.1	-3.1	-3.2	-3.3
5. Export of services	2.6	3.0	3.2	3.3	3.5
6. Import of services	1.9	2.0	2.2	2.2	2.4
7. Service balance	0.7	1.0	1.0	1.1	1.1
8. Net interest payments from abroad	:	:	:	:	:
9. Other net factor income from abroad	-0.7	-0.7	-0.8	-0.9	-1.0
10. Current transfers	2.7	2.5	2.6	2.6	2.7

[31] Harmonised definition, Eurostat
[32] Real GDP per person employed
[33] Real GDP per hour worked

11. Of which from EU	:	:	:	:	:
12. Current account balance	0.0	-0.3	-0.4	-0.4	-0.4
13. Capital and financial account balance	0.5	0.4	0.2	0.6	0.5
14. Foreign direct investment. net	0.5	0.6	0.6	0.7	0.7
15. Foreign reserves	4.5	:	:	:	:
16. Foreign debt	10.9	:	:	:	:
16a. Of which: public	5.2	:	:	:	:
16b. O/w: foreign currency denominated	:	:	:	:	:
16c.O/w: repayments due	:	:	:	:	:
17. Exchange rate vis-à-vis EUR (end-year)	61.5	:	:	:	:
18. Exchange rate vis-à-vis EUR (annual average)	61.6	:	:	:	:
19. Net foreign saving (% of GDP)	:	:	:	:	:
20. Domestic private saving (% of GDP)	:	:	:	:	:
21. Domestic private investment (% of GDP)	:	:	:	:	:
23. Domestic public saving (% of GDP)	:	:	:	:	:
23. Domestic public investment (% of GDP)	:	:	:	:	:

Source: National Bank of the Republic of North Macedonia

Table 1g. Sustainability indicators

		2020	2021	2022	2023	2024
1. Current Account Balance	% of GDP	-2.9	-2.8	-6.1	0.4	-2.1
2. Net International Investment Position	% of GDP	-63.6	-61.2	-61.4	-57.0	
3. Export market share	% growth	1.2	2.9	-1.9	7.4	
4. Real Effective Exchange Rate	% growth	1.9	1.1	2.3	4.9	
5. Nominal Unit Labour Costs	% growth	:	:	:	:	:
6. Private sector credit flow	% of GDP	2.4	4.1	4.5	2.6	
7. Private sector debt	% of GDP	87.2	88.0	89.6	90.6	
8. General Government Debt	% of GDP	50.8	51.4	49.6	49.7	53.5

Source: National Bank of the Republic of North Macedonia and Ministry of Finance

Table 2a. General government budgetary prospects

	ESA	2023	2023	2024	2025	2026	2027
		bn denars	% of GDP				
Net lending (B9) by sub-sectors							
1. General government	S13	-39.03	-4.3	-4.7	-4.0	-3.5	-3.0
2. Central government	S1311	-39.12	-4.4	-4.5	-3.8	-3.5	-3.0
3. State government	S1312	:	:	:	:	:	:
4. Local government	S1313	:	:	:	:	:	:
5. Social security funds	S1314	-2.29	-0.3	-0.1	-0.3	0.0	0.0
General government (S13)							
6. Total revenue	TR	293.13	32.7	35.0	37.0	37.3	37.4
7. Total expenditure[34]	TE	332.16	37.0	39.7	41.1	40.9	40.4
8. Net borrowing/lending	EDP.B9	-39.03	-4.3	-4.7	-4.0	-3.5	-3.0
9. Interest expenditure	EDP.D41	13.01	1.4	1.9	2.0	2.0	2.0
10. Primary balance[35]		-26.03	-2.9	-2.8	-2.0	-1.6	-0.9
11. One-off and other temporary measures[36]		:	:	:	:	:	:

[34] Adjusted for the next flow of swap-related flows so that TR-TE = EDP.B9
[35] The primary balance is calculated as (EDP.B9, item 8) plus (EDP D41 + FISIM recorded as intermediate consumption, item 9)
[36]A plus sign means deficit-reducing one-off measures

Components of revenues							
12. Total taxes (11 = 12a+12b+12c)		169.54	18.9	20.2	21.0	21.4	21.5
12a. Taxes on production and imports	D2	120.20	13.4	14.0	14.7	14.8	15.0
12b. Current taxes on income and wealth	D5	45.10	5.0	5.8	5.9	6.1	6.1
12c. Capital taxes	D91	4.24	0.5	0.5	0.5	0.4	0.4
13. Social contributions	D61	92.62	10.3	11.0	11.5	11.7	11.8
14. Property income	D4	3.98	0.4	0.6	0.6	0.5	0.5
15. Other (15 = 16-(12+13+14))[37]		26.99	3.0	3.3	4.0	3.7	3.6
16 = 6. Total revenue	TR	293.13	32.7	35.0	37.0	37.3	37.4
p.m.: Tax burden (D2+D5+D61+D91-D995)[38]		262.17	29.2	31.2	32.5	33.1	33.3
Selected components of expenditures							
17. Collective consumption	P32	91.38	10.2	11.3	11.3	11.4	11.3
18. Total social transfers	D62 + D63	148.94	16.6	17.7	18.7	18.4	18.0
18a. Social transfers in kind	P31 = D63	:	:	:	:	:	:
18b. Social transfers other than in kind	D62	148.94	16.6	17.7	18.7	18.4	18.0
19 = 9. Interest expenditure	EDP.D41	13.01	1.4	1.9	2.0	2.0	2.0
20. Subsidies	D3	31.00	3.5	3.5	3.6	3.5	3.4
21. Gross fixed capital formation	P51	47.84	5.3	5.3	5.4	5.7	5.7
22. Other (22 = 23-(17+18+19+20+21)[39]		:	:	:	:	:	:
23.=7. Total expenditures	TE[40]	332.16	37.0	39.7	41.1	40.9	40.4
p.m. compensation of public sectoremployees	D1	60.86	6.8	7.5	7.6	7.7	7.7

Source: Ministry of Finance

Table 2b. General government budgetary prospects

	ESA	2023	2024	2025	2026	2027
		bn denars				
Net lending (B9) by sub-sectors						
1. General government	S13	-39.03	-44.67	-41.35	-38.46	-34.56
2. Central government	S1311	-39.12	-43.36	-38.76	-38.46	-34.55
3. State government	S1312	:	:	:	:	:
4. Local government	S1313	:	:	:	:	:
5. Social security funds	S1314	-2.29	-1.31	-2.59	-0.01	-0.01
General government (S13)						
6. Total revenue	TR	293.13	335.40	378.63	407.40	436.56
7. Total expenditure[41]	TE	332.16	380.06	419.98	445.86	471.12
8. Net borrowing/lending	EDP.B9	-39.03	-44.67	-41.35	-38.46	-34.56
9. Interest expenditure	EDP.D41	13.01	17.74	20.95	21.48	23.64
10. Primary balance[42]		-26.03	-26.93	-20.40	-16.99	-10.92
11. One-off and other temporary measures[43]		:	:	:	:	:
Components of revenues						
12. Total taxes (11 = 11a+11b+11c)		169.54	193.74	215.00	233.29	250.89

[37] P.11 + P.12 + P.131 + D.39 + D.7 + D.9 (other than D.91)
[38] Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D995), if appropriate
[39] D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8
[40] Adjusted for the next flow of swap-related flows so that TR-TE = EDP.B9
[41] Adjusted for the next flow of swap-related flows so that TR-TE = EDP.B9
[42] The primary balance is calculated as (EDP.B9, item 8) plus (EDP D41 + FISIM recorded as intermediate consumption, item 9)
[43] A plus sign means deficit-reducing one-off measures

12a. Taxes on production and imports	D2	120.20	133.58	150.34	161.74	174.76
12b. Current taxes on income and wealth	D5	45.10	55.52	59.86	66.65	71.13
12c. Capital taxes	D91	4.24	4.63	4.80	4.90	5.00
13. Social contributions	D61	92.62	105.21	117.10	127.57	137.86
14. Property income	D4	3.98	5.28	5.77	5.77	6.07
15. Other (15 = 16-(12+13+14))[44]		26.99	31.18	40.77	40.77	41.74
16 = 6. Total revenue	TR	293.13	335.40	378.63	407.40	436.56
p.m.: Tax burden (D2+D5+D61+D91-D995)[45]		262.17	298.95	332.09	360.86	388.75
Selected components of expenditures						
17. Collective consumption	P32	91.38	108.03	115.93	123.94	131.69
18. Total social transfers	D62+D63	148.94	169.88	191.14	200.55	209.40
18a. Social transfers in kind	P31=D63	:	:	:	:	:
18b. Social transfers other than in kind	D62	148.94	169.88	191.14	200.55	209.40
19 = 9. Interest expenditure	EDP.D41	13.01	17.74	20.95	21.48	23.64
20. Subsidies	D3	31.00	33.58	37.25	37.86	39.88
21. Gross fixed capital formation	P51	47.84	50.83	54.72	62.03	66.52
22. Other (22 = 23-(17+18+19+20+21)[46]		:	:	:	:	:
23.=7. Total expenditures	TE[47]	332.16	380.06	419.98	445.86	471.12
p.m. compensation of public sectoremployees	D1	60.86	72.01	77.51	83.94	89.33

Source: Ministry of Finance

Table 3. General government expenditure by function

Percentage of GDP	COFOG	2023	2024	2025	2026	2027
1. General public services	1	3.4	3.7	3.6	:	:
2. Defence	2	1.5	1.7	1.8	:	:
3. Public order and safety	3	2.1	2.3	2.3	:	:
4. Economic affairs	4	5.7	5.7	5.8	:	:
5. Environmental protection	5	0.3	0.5	0.6	:	:
6. Housing and community amenities	6	1.6	1.8	1.9	:	:
7. Health	7	5.3	5.6	5.6	:	:
8. Recreation. culture and religion	8	0.6	0.7	0.6	:	:
9. Education	9	4.0	4.3	4.4	:	:
10. Social protection	10	12.6	13.5	14.2	:	:
11. Total expenditure (item 7 = 23 in Table 2)	TE	37.0	39.7	41.1	40.9	40.4

Source: Ministry of Finance

Table 4. General government debt developments

Percentage of GDP	ESA	2023	2024	2025	2026	2027
1. Gross debt[48]		49.7	53.5	53.4	53.6	53.5
2. Change in gross debt ratio		0.1	3.8	0.0	0.1	-0.1
Contributions to change in gross debt						
3. Primary balance[49]		2.9	2.8	2.0	1.6	0.9

44 P.11 + P.12 + P.131 + D.39 + D.7 + D.9 (other than D.91)
45 Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D995), if appropriate
46 D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8
47 Adjusted for the next flow of swap-related flows, so the TR-TE = EDP.B9
48 As defined in Regulation 3605/93 (not an ESA concept)
49Cf item 10 in Table 2a

4. Interest expenditure[50]	EDPD.41	1.4	1.9	2.0	2.0	2.0
5. Real growth effect		-0.9	-1.0	-1.9	-2.0	-2.2
6. Inflation effect		-3.5	-2.1	-1.5	-1.3	-1.2
7. Stock-flow adjustment		0.2	2.2	-0.7	-0.1	0.4
of which:						
- Differences between cash and accruals[51]		:	:	:	:	:
- Net accumulation of financial assets[52]		:	:	:	:	:
of which:						
- Privatisation proceeds		:	:	:	:	:
- Valuation effects and other[53]		:	:	:	:	:
p.m. implicit interest rate on debt [54]		3.2	4.0	4.1	3.9	4.0
Other relevant variables						
8. Liquid financial assets[55]		:	:	:	:	:
9. Net financial debt (9 = 1 - 8)		:	:	:	:	:

Source: Ministry of Finance

Table 5. Cyclical developments

Percentage of GDP	ESA	2023	2024	2025	2026	2027
1. Real GDP growth (%)	B1g	2.1	2.1	3.7	4.0	4.4
2. Net lending of general government *	EDP.B.9	-4.3	-4.9	-4.0	-3.5	-3.0
3. Interest expenditure	EDP.D.41	1.4	1.9	2.0	2.0	2.0
4. One-off and other temporary measures[56]		:	:	:	:	:
5. Potential GDP growth (%)[57]		2.8	3.1	3.3	3.4	3.5
Contributions (percentage points):						
- labour		0.5	0.6	0.6	0.6	0.6
- capital		1.9	1.9	1.9	1.9	1.9
- total factor productivity		0.4	0.6	0.8	0.9	1.0
6. Output gap		-2.6	-3.6	-3.1	-2.5	-1.6
7. Cyclical budgetary component		-0.7	-1.0	-0.8	-0.4	0.0
8. Cyclically-adjusted balance (2-7)		-3.7	-3.9	-3.3	-3.1	-3.0
9. Cyclically-adjusted primary balance (8-3)		-2.2	-2.0	-1.2	-1.1	-0.9
10. Structural balance (8-4)		:	:	:	:	:

* Data pertains to central government budget
Source: Ministry of Finance

[50]Cf item 9 in Table 2a
[51] The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant
[52] Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant
[53] Changes due to exchange rage movement, and operation in secondary market could be distinguished when relevant.
[54]Proxied by interest expenditure divided by the debt level of the previous year
[55] AF1, AF2, AF3 (consolidated at market value, AF5 (if quoted in stock exchange; including mutual fund shares).
[56] A plus sign means deficit-reducing one-off measures
[57] Until an agreement on the Production Function Method is reached, countries can use their own figures (SP).

Table 6. Divergence from previous programme

	2023	2024	2025	2026	2027
1. GDP growth					
Previous programme	2.3	3.4	4.8	5.5	:
Latest programme	2.1	2.1	3.7	4.0	4.4
Difference (p.p.)	-0.2	-1.3	-1.1	-1.5	:
2. General government net lending (% of GDP)					
Previous programme	-4.8	-3.4	-3.0	-3.0	:
Latest programme	-4.3	-4.9	-4.0	-3.5	-3.0
Difference (p.p.)	0.5	-1.5	-1.0	-0.5	:
3. General government gross debt (% of GDP)					
Previous programme	50.2	52.0	50.3	50.2	:
Latest programme	49.7	53.5	53.4	53.6	53.5
Difference (p.p.)	-0.5	1.5	3.1	3.4	:

Source: Calculations of the Ministry of Finance

Table 7. Long-term sustainability of public finances

Percentage of GDP	2007	2010	2020	2030	2040	2050	2060
Total expenditure	:	34.8	38.1	40.4	39.4	39.4	38.9
of which:		:	:	:	:	:	:
- Age-related expenditures	:	:	:	:	:	:	:
- Pension expenditure	:	8.6	10.3	12.2	11.4	11.6	11.3
- Social security pension	:	:	:	:	:	:	:
- Old-age and early pensions	:	:	:	:	:	:	:
- Other pensions (disability. survivors)	:	:	:	:	:	:	:
- Occupational pensions (if in general government)	:	:	:	:	:	:	:
- Health care	:	4.5	6.1	7.0	6.7	6.8	6.7
- Long-term care *(this was earlier included in the health*	:	:	:	:	:	:	:
Education expenditure	:	4.0	3.9	4.3	4.5	4.7	5.0
Other age-related expenditures	:	:	:	:	:	:	:
Interest expenditure	:	0.7	1.2	2.4	2.3	1.8	1.5
Total revenues	:	32.4	29.9	36.7	36.7	36.7	36.7
of which: property income	:	:	:	:	:	:	:
of which: trade-related revenue	:	6.0	6.7	7.6	6.7	5.8	5.1
of which: royalties. concessions etc.	:	:	:	:	:	:	:
of which: from pensions contributions (or social	:	:	:	:	:	:	:
Pension reserve fund assets	:	34.8	38.1	40.4	39.4	39.4	38.9
of which: consolidated public pension fund assets	:	:	:	:	:	:	:
Assumptions*							
Labour productivity growth	2.9	2.2	-4.2	2.6	4.5	4.7	4.5
Real GDP growth	6.5	3.4	-4.7	3.9	4.4	3.7	3.5
Participation rate males (aged 20-64)[58]	:	:	:	83.7	83.4	78.9	74.4
Participation rate females (aged 20-64)	:	:	:	58.4	63.1	67.9	72.6

[58]Labour market calculation refer to the age group of 15-64 years old.

Total participation rate (20-64)	:	:	:	71.3	73.5	73.5	73.5
Unemployment rate	:	:	:	:	:	:	:
Population aged 65+ over total population	11.6	12.5	16.7	20.6	23.8	27.3	30.2

* Labour market data refer to the age group 15-64
Source: Calculations of the Ministry of Finance

Table 7a. Contingent liabilities

Measures		Maximum amount of contingent liabilities[59] (% of GDP)	Estimated take-up (% of GDP)
In response to COVID-19	Subtotal		
Others	Subtotal		
Total			

Source: Ministry of Finance

Table 8. Basic assumptions on the external economic environment underlying the programme framework

		2023	2024	2025	2026	2027
Short-term interest rate	Annual average	:	:	:	:	:
Long-term interest rate	Annual average	:	:	:	:	:
USD/EUR exchange	Annual average	1.08	1.09	1.08	1.08	:
Nominal effective exchange rate	Annual average	7.02	3.22	0.17	0	:
Exchange rate vis-à-vis the EUR	Annual average	61.62	61.56	:	:	:
Global GDP growth. excluding EU	Annual average	3.7	3.5	3.6	3.6	:
EU GDP growth	Annual average	0.4	0.9	1.5	1.8	:
Growth of relevant foreign markets	Annual average	:	:	:	:	:
World import volumes. excluding EU (y-o-y)	Annual average	1.3	3.2	3.3	3.3	:
Oil prices (Brent. USD/barrel)	Annual average	82.5	80.7	73.1	71.5	:

Source: European Commission. Economic Forecast Autumn 2023

Table 9a: Social scoreboard indicators

	Data source	2018	2019	2020	2021	2022	2023
Equal opportunities							
1. Adult participation in learning during the last 12 months, age 25-64	Eurostat	2.4%	2.8%	2.6%	N/A	N/A	N/A
2. Share of early leavers from education and training, age **18-24**	Eurostat	7.1%	7.1%	5.7%	N/A	N/A	N/A
3. Share of population with basic overall digital skills or above, age **16-74**	Eurostat	N/A	32.0%	N/A	34.6%	N/A	N/A
4. Young people neither in employment nor in education or training (NEET rate), age **15-29**	Eurostat	29.8%	24.5%	26.2%	N/A	N/A	N/A
5. Gender gap in employment rate, age **20-64**	Eurostat	21.4 pps.	21.3 pps.	19.9 pps.	N/A	N/A	N/A
6. Income quintile share ratio - S80/S20	Eurostat	6.2	5.6	5.9	N/A	N/A	N/A
Working conditions							

[59]Any possible budgetary impact related to the call of those guarantees should be provided in the table on the discretionary measures in the ERP.

7. Employment rate, age **20-64**	Eurostat	56.1%	59.2%	59.1%	N/A	N/A	N/A
8. Unemployment rate, age **15-74**	Eurostat	20.8%	17.3%	16.4%	N/A	N/A	N/A
9. Long-term unemployment rate, age **15-74**	Eurostat	15.5%	12.4%	12.4%	N/A	N/A	N/A
10. Gross disposable income of households in real terms, per capita	Eurostat	N/A	N/A	N/A	N/A	N/A	N/A
Social protection and inclusion							
11. At-risk-of-poverty or social exclusion rate (AROPE)	Eurostat	41.1%	39.9%	39.8%	N/A	N/A	N/A
12. At-risk-of-poverty or social exclusion rate (AROPE) for children (0-17)	Eurostat	45.9%	44.0%	46.3%	N/A	N/A	N/A
13. Impact of social transfers (other than pensions) on poverty reduction	Eurostat	14.8%	15.0%	15.2%	N/A	N/A	N/A
14. Disability employment gap, age **20-64**	Eurostat	27.1%	28.6%	33.7%	N/A	N/A	N/A
15. Housing cost overburden rate	Eurostat	10.2%	9.9%	8.5%	N/A	N/A	N/A
16. Children aged less than 3 years in formal childcare	Eurostat	8.8%	13.0%	6.3%	N/A	N/A	N/A
17. Self-reported unmet needs for medical care	Eurostat	2.3%	2.5%	1.7%	N/A	N/A	N/A

Source:Eurostat
N/A:(not avaliable)

Table 9b: Other selected indicators

	Data source	2018	2019	2020	2021	2022	2023
Other social and healthcare indicators							
1.Public social protection expenditure in % of GDP	MF	11.5	11.9	2.4	12.5	12.3	12.6
2.Public healthcare expenditure in % of GDP	MF	4.9	5.0	6.3	6.4	5.5	5.3
3.Household out-of-pocket payments as a % of total health expenditure	Eurostat	42.1	40.4	38.9	N/A	N/A	N/A
4.Percentage of population not covered by health insurance (Health Insurance Fund data)	HIF	10.0	9.7	10.1	N/A	N/A	N/A
5.Ratio of doctors per 1000 inhabitants	Eurostat	6.4	6.5	N/A	N/A	N/A	N/A
6.Ratio of nurses per 1000 inhabitants	Eurostat	N/A	N/A	N/A	N/A	N/A	N/A
Environment							

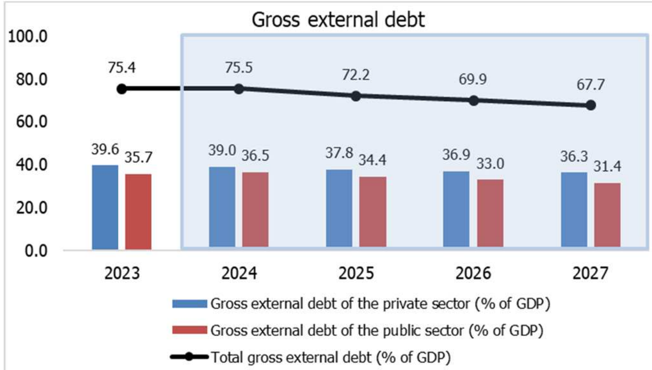
7.Total environmental tax revenues as a share of total revenues from taxes and social contributions	SSO	N/A	N/A	N/A	N/A	N/A	N/A
8.Greenhouse gas emissions per capita	SSO	0.004 CO2-eq. [kt]	0.006 CO2-eq. [kt]	N/A CO2-eq. [kt]	N/A CO2-eq. [kt]	N/A	N/A
9.Generation of waste excluding major mineral wastes	Eurostat	458 kg per cap.	N/A	437 kg per cap.	N/A	712 kg per cap.	N/A
Digital economy							
10.Percentage of households with broadband access (mobile and fixed)	SSO	79.3%	81.8%	79.9%	83.7%	86.6%	88.0%
11.Share of total population using internet [NB: population 16-74]	SSO	79.2%	81.4%	81.4%	86.4%	88.3%	85.3%
Energy							
12.Energy imports dependency (%)	Eurostat	58.4%	58.1%	63.5%	68.1%	63.0%	N/A
13.Energy intensity: Kilograms of oil equivalent (KGOE) per thousand Euro	Eurostat	302.13 kg/EUR	321.03 kg/EUR	305.67 kg/EUR	301.45 kg/EUR	302.00 kg/EUR	N/A
14.Share of renewable energy sources (RES) in final energy consumption (%)	Eurostat	18.2%	17.5%	19.2%	17.8%	19.2%	20.2%
Transport							
15.Railway Network Density (meters of line per km2 of land area)	UNECE	26.6	26.6	26.6	26.6	26.6	N/A
16.Motorisation rate (Passenger cars per 1000 inhabitants)	Eurostat	200	205	207	260(b)	264	N/A
Agriculture							
17.Share of gross value added (Agriculture, Forestry and Fishing)	Eurostat	8.5%	8.1%	8.6%	7.1%	7.3%	6.6%(p)
18.Share of employment (Agriculture, Forestry and Fishing)	SSO	13.5%	12.9%	13.0%	11.8%	10.0%	7.8%
19.Utilised agricultural area (% of total land area)	Eurostat	49.7%	49.7%	49.7%	49.7%	N/A	N/A
Industry (except construction)							

20.Share of gross value added	Eurostat	18.6%	18.1%	17.4%	17.0%	17.0%	17.2%(p)
21.Contribution to employment (% of total employment)	SSO	24.8%	24.3%	23.2%	23.0%	23.8%	23.7%
Services							
22.Share of gross value added	SSO	62.6%	63.3%	64.4%	65.6%	65.0%	67.3%
23.Contribution to employment (% of total employment)	SSO	54.7%	55.8%	57.1%	58.4%	59.5%	61.0%
Business Environment							
24.Rank in Global Competitiveness Index (Source: World Economic Forum)	WEF	84	82	N/A	N/A	N/A	N/A
25.Estimated share of informal economy in GDP (as % of GDP) (Source: IMF)	IMF	N/A	N/A	N/A	N/A	N/A	N/A
Research, Development and Innovation							
26.R&D intensity of GDP (R&D expenditure as % of GDP)	Eurostat	0.4%	0.4%	0.4%	N/A	0.4%	N/A
27.R&D expenditure – EUR per inhabitant	Eurostat	18.8%	19.9%	19.5%	N/A	26.9%	N/A
Trade							
28.Export of goods and services (as % of GDP)	NBRNM	60.2%	61.9%	57.7%	65.8%	72.8%	67.8%
29.Import of goods and services (as % of GDP)	NBRNM	72.9%	76.2%	70.5%	81.3%	93.4%	80.8%
30.Trade balance (as % of GDP)	NBRNM	-12.7%	-14.3%	-12.7%	-15.5%	-20.6%	-13.0%

Source: SSO, Eurostat,IMF,MF,WEF,UNECE,HIF,WB
N/A:(not available)
b:break in time series
e:estimated
p:provisional

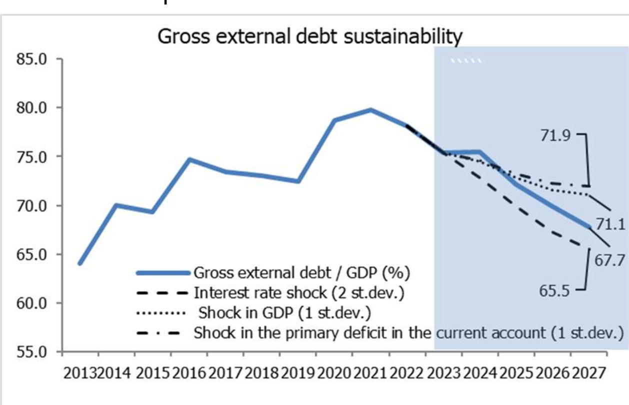
Annex 2: External debt sustainability analysis

According to the analysis of the external debt sustainability [60], the gross external debt at the end of 2024 is estimated at 75.5% of GDP, which indicates a small increase of 0.2 p.p. of GDP relative to the previous year. The estimated increase of the external debt in 2024 reflects the assessment for higher public debt by 0.8 p.p. of GDP, mainly due to the increase in the central government debt, as well as a slightly lower external debt of the public enterprises. On the other hand, the private component of the external debt is expected to decline by 0.6 p.p. of GDP compared to the end of 2023, mostly due the lower debt related to the currency and deposits of the deposit-taking corporations, as well as the slightly lower debt related to the intercompany debt and financial loans, while an increase is expected in trade credits related debt. In the remaining analyzed period (2025 - 2027), continuous fall in external debt is expected, in conditions of more pronounced decrease in the public debt, than the decrease in the debt of the private sector. Thus, the reduction of the public debt is expected in all sectors, with a more pronounces decrease in the central government and public enterprises debt, while in the private external debt the adjustment reflects the lower trade credit related debt. As a result of such developments, at the end of the analyzed period, in 2027, the external debt is estimated at 67.7% of GDP. Compared to the developments in 2023, the level of external debt in 2027 is expected to be lower by 7.6 p.p., due to the expected decrease in the public sector debt by 4.3 p.p., and the decrease in the private sector debt by 3.3 p.p.



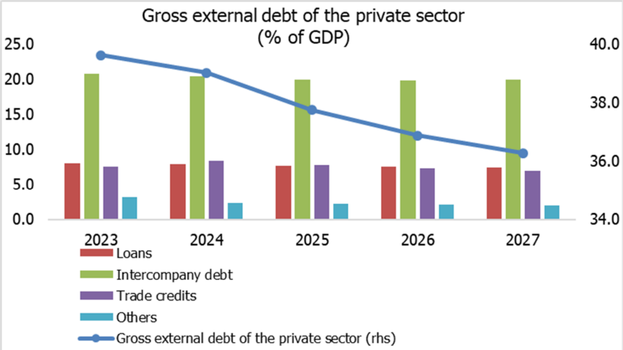
Source: Forecast for the period 2024-2027; External debt sustainability analysis, NBRNM.

On average within the analyzed period (2024 – 2027), the primary current account (current account excluding interest payments) has neutral effect on the external debt dynamics. On the other hand, the non-debt creating capital flows and the automatic debt dynamics (which includes the effects of the real GDP growth and the changes in the prices and nominal effective interest rate) act favorably by reducing the debt on cumulative bases. It should be noted that during the analyzed period, 2024-2027, an increase in the foreign exchange reserves is expected as well as their maintenance at the adequate level.

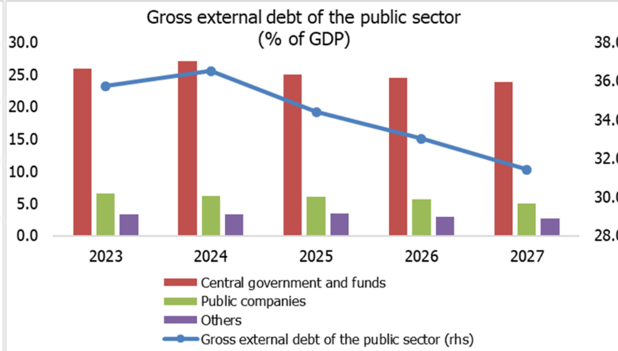


The structure of the external public debt in 2027 compared to the end of 2023, points to decrease of the external debt of the central government (by 2.1 p.p.), public enterprises (by 1.5 p.p.) and a decrease in external debt of the item "others" (by 0.7 p.p.). Within the private sector external debt, the lower share in GDP in 2027 compared to share in GDP at the end of 2023 is predominantly driven by the lower debt related to the currency and deposits, intercompany debt, while the rest of the components are expected to register moderate decline in the external debt.

[60] Source: Calculations and analysis of NBRNM, based on the IMF approach. The basic scenario assumes average GDP growth in the period 2023-2026 of 3.2% and it is based on NBRNM October 2023 medium term projections for the period 2023-2026 and the presented balance of payments forecast (October, 2023), projection that incorporate the Budget for 2023, and for the period 2024-2026 the Fiscal strategy 2024-2028, having in mind that the balance of payment statistics does not fully align with the external debt statistics.



Source: Forecast for the period 2024-2027; External debt sustainability analysis, NBRNM.



Source: Forecast for the period 2024-2027; External debt sustainability analysis, NBRNM.

The stress tests indicate that the expected debt dynamics on a medium run is particularly sensitive to shocks in the primary current account as well as in economic activity. However, the structure of the external debt is in favor of lower vulnerability, considering relatively high share of intercompany debt and trade credits, averaging at 38.8% during the overall forecasting horizon of, as more flexible and less risky types of debt.

Annex 3: Institutions involved in the preparation of ERP 2025-2027

The Economic Peform Programme 2025-2027 is a joint result of several institutions, and the overall preparation is coordinated by the Ministry of Finance.

Content of the Economic Reform Programme	Participants in the preparation of the Programme	
	Institution	Person in charge
1. Overall Policy Framework and Objectives	Ministry of Finance	Vesna Cvetanova
2. Implementation of the policy guidance	All institutions in charge	Vesna Cvetanova, MoF
3. Macroeconomic framework		
3.1. Recent economic developments	Ministry of Finance National Bank	Alen Kalac Irena Rashovikj Ana Nikolova Aneta Krstevska
3.2. Medium-term macroeconomic scenario	Ministry of Finance National Bank	Gjoko Gjorgjeski Alen Kalac Irena Rashovikj Ana Nikolova Ornela Trajkoska Pendevska Aneta Krstevska
3.3. Alternative scenario and risks	Ministry of Finance National Bank	Alen Kalac Aneta Krstevska
4. Fiscal framework		
4.1. Fiscal strategy and medium-term objectives	Ministry of Finance	Tanja Kostovska Anica Ivanoska Aleksandra Altievska Lidija Gjozinska Aleksandra Petkanovska Alen Kalac Irena Rashovikj Ana Nikolova
4.2. Budget execution in 2024	Ministry of Finance	Edmir Kamberi Alen Kalac Irena Rashovikj
4.3 Budget plan for 2025	Ministry of Finance	Tanja Kostovska Anica Ivanoska Aleksandra Altievska Lidija Gjozinska Aleksandra Petkanovska
4.4. Medium-term budgetary outlook	Ministry of Finance	Tanja Kostovska Anica Ivanoska Aleksandra Altievska Lidija Gjozinska Aleksandra Petkanovska
4.5. Structural deficit	Ministry of Finance	Gjoko Gjorgjeski Alen Kalac Irena Rashovikj
4.6. Public debt management, stock and projections of public debt trends	Ministry of Finance	Renata Davitkova Panceva Sanja M. Mancheva

4.7. Sensitivity analysis and comparison with the previous programme	Ministry of Finance	Gjoko Gjorgjeski Alen Kalac Irena Rashovikj Renata Davitkova Panceva Sanja M. Mancheva
4.8 Quality of public finances	Ministry of Finance	Tanja Kostovska Anica Ivanoska Aleksandra Altievska Lidija Gjozinska Aleksandra Petkanovska
4.9. Fiscal governance and budgetary frameworks	Ministry of Finance	Tanja Kostovska Anica Ivanoska Aleksandra Altievska Lidija Gjozinska Aleksandra Petkanovska
4.10. Sustainability of public finances	Ministry of Finance	Gjoko Gjorgjeski Alen Kalac Irena Rashovikj Ana Nikolova
5A. CONSISTENCY OF THE REFORM AGENDA WITH THE ERP'S MACRO-FISCAL FRAMEWORK		
POLICY AREA 2: ENERGY/DIGITAL TRANSITION		
2.1.1.1 Align with electricity integration package to enable electricity market coupling of the EU and North Macedonia: establish the day ahead electricity market, operationalise the package in line with the market coupling operator integration plan by the end of 2025, and 2.1.3.1 Deployment of renewable energy: Implementation of the Renewable Energy Directive (permitting, guarantees of origin,) and transparent and competitive procedures for the deployment of renewable energy	Ministry of Energy, Mining and Mineral Resources	Magdalena Daskalova
		Alketa Bugaj and Janez Janša, CEF experts, for the section on assessing the economic impact of reforms
		Vesna Cvetanova, MoF Andria Aleksoski, MoF Desanka Zdravkovska, MoF
SUB-AREA 2.2.2. Digitalization		
2.2.2.3. Widen the offer of public e-services offered through the governmental e-platform and simplify administrative and electronic procedures	Ministry of Digital Transformation	Hava Huseni Nora Muamedi
		Alketa Bugaj and Janez Janša, CEF experts, for the section on assessing the economic impact of reforms
		Vesna Cvetanova, MoF Andria Aleksoski, MoF Desanka Zdravkovska, MoF
POLICY AREA 3: HUMAN CAPITAL **SUB-AREA 3.1. Education Skills**		
3.1.1. Reinforce the education system to address the skills mismatch, increase access to and quality of VET, and improve access to work-based learning and dual education (including private sector involvement), and 3.1.2. Increase participation in adult education and improve	Ministry of Education and Science	Natalija Kizevska Nadica Kostoska
		Alketa Bugaj and Janez Janša, CEF experts, for the section on assessing the economic impact of reforms
		Vesna Cvetanova, MoF Andria Aleksoski, MoF

recognition of non-formal and informal learning		Desanka Zdravkovska, MoF
POLICY AREA 4: PRIVATE SECTOR DEVELOPMENT AND BUSINESS ENVIRONMENT SUB-AREA: 4.1 Business Environment		
4.1.6. Expand the use of E-Customs services for economic operators and reduce the costs and increase the efficiency of customs procedures	Customs Administration of the Republic of North Macedonia	Maja Barikj
		Alketa Bugaj and Janez Janša, CEF experts, for the section on assessing the economic impact of reforms
		Vesna Cvetanova, MoF Andria Aleksoski, MoF Desanka Zdravkovska, MoF
6. Institutional issues and stakeholder involvement	Ministry of Finance	Desanka Zdravkovska
7. Annexes		
Annex 1: Summary data	Ministry of Finance National Bank	Aneta Krstevska, NBRNM Gjoko Gjorgjeski, MoF Alen Kalac, MoF Irena Rashovikj, MoF Ana Nikolova, MoF Renata Davitkova Panceva, MoF Sanja M. Mancheva, MoF Edmir Kamberi, MoF Tanja Kostovska, MoF Anica Ivanoska, MoF
Annex 2: External debt sustainability analysis	National Bank	Aneta Krstevska