North Macedonia

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This report does not constitute a rating action.

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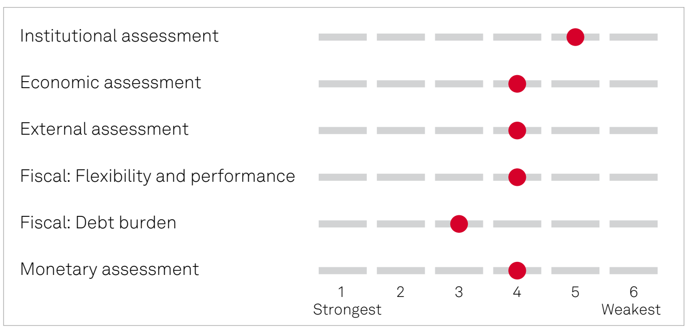
Ratings Score Snapshot



Sovereign credit rating
Foreign currency
BB-/Stable/B
Local currency
BB-/Stable/B

Credit Highlights

Overview

Institutional and economic profile	Flexibility and performance profile
Parliamentary elections were held with the VMRO-DPMNE party winning the largest share of seats.	Public debt remains moderate but will rise to about 57% of GDP from 2024-2027.
-- S&P Global Ratings expects GDP growth to slightly accelerate to 2.5% in 2024 and remain at around 3.0% in the long-term.	-- The general government deficit has been revised up to 4.9% of GDP for 2024, up from 3.4%, signaling a slower pace of fiscal consolidation.
-- North Macedonia approved a new nationalist-led government under Prime Minister Hristijan Mickoski, with his VMRO-DPMNE party forming a coalition with the Albanian alliance VLEN/VREDI and ZNAM.	-- We anticipate the current account deficit will remain around 2% of GDP during 2024–2027, in line with the trend in the previous decade.
-- The new administration will likely take a different approach compared with the previous government regarding EU accession.	-- We anticipate the current account deficit will stay around 2% of GDP during 2024-2027, consistent with the trend of the previous decade.

Economic momentum in North Macedonia remains weak. Among the five Western Balkans countries aspiring to join the EU, North Macedonia posted the lowest growth rate, at 1% in 2023, extending a trend observed over the last two years, primarily due to a mix of weak external demand and investments. We expect growth to remain moderate at around 2.5% this year.

In the May 2024 parliamentary elections, North Macedonia approved a new nationalist-led government under Prime Minister Hristijan Mickoski, with his VMRO-DPMNE party forming a coalition with the Albanian alliance VLEN/VREDI and ZNAM. This shift reflects widespread voter dissatisfaction with a slow EU integration progress, rising living costs, and persistent corruption. The new administration aims to implement comprehensive reforms, prioritize economic growth, and address EU integration issues, but it faces challenges, particularly with Bulgaria's demands for constitutional changes, potentially stalling North Macedonia's EU accession unless a compromise is reached.

The government has revised the budget deficit forecast to 4.9% of GDP, up from the previous 3.4%. The revised budget will prioritize increases in pensions, salaries, and municipal development funds, which will be financed through cuts in other expenditure. This shift indicates a slower pace of fiscal consolidation. With the new administration just being formed, the longer-term fiscal outlook remains unclear.

Outlook

The stable outlook echoes our view that, despite North Macedonia facing economic challenges such as subdued growth in its trading partners and the effects of the war in Ukraine, these factors are counterbalanced by the country's moderate government debt levels, and controlled interest expenses.

Downside scenario

We could consider lowering the ratings if North Macedonia's fiscal or external metrics significantly deteriorate, or if there is a depletion of its foreign currency reserves, putting pressure on the de facto peg to the euro. Additionally, the ratings would face downward pressure if budget deficits worsened substantially beyond our medium-term projections, particularly in the event of a sharp increase in government debt.

Upside scenario

We could consider raising the ratings if North Macedonia demonstrates significant progress in implementing structural reforms, resulting in a strengthened institutional framework. Additionally, positive factors that could trigger an upgrade include improved fiscal performance characterized by a declining trend in net general government debt and robust economic growth.

Rationale

Our ratings on North Macedonia are constrained by a weak but gradually improving institutional framework, somewhat wide and persistent budget deficits, high levels of government foreign currency debt, and limited monetary flexibility due to the denar's de facto peg to the euro. Despite these constraints, the ratings are bolstered by moderate net government and external debt levels, strong net inflows of foreign direct investment (FDI), and a stable banking sector.

Institutional and economic profile: The country's growth prospects remain the weakest among the Western Balkan nations

Economic momentum in North Macedonia remains weak. Among the five Western Balkans countries aspiring to join the EU, North Macedonia posted the lowest growth rate, at 1% in 2023, extending a trend observed over the last two years, primarily due to anemic external demand

and investment. This pattern continued into the first quarter of this year, with the economy expanding by just 1.2% year on year. Growth during this period was predominantly driven by investments (a volatile component of GDP), due to increased investment in fixed assets and rise in inventories. In light of this persistent sluggish growth, we have revised our growth forecast for this year downward to 2.5% from 2.9%. We anticipate that consumption and investments will continue to be the primary drivers of growth for the remainder of the year. However, the risks to the growth outlook are skewed to the downside, given the uncertain economic environment within the EU and the potential for rising commodity prices driven by global geopolitical tensions. Looking ahead, we anticipate growth to recover to approximately 3% by 2027, driven by an expected increase in external demand and a boost in credit activity.

Despite experiencing sluggish economic growth in recent years, North Macedonia has achieved a significant reduction in its unemployment rate, which fell to 12.9% in the first quarter of the year. This is a notable improvement from the roughly 28% rate recorded a decade ago. A key driver behind this reduction has been the influx of FDI, particularly into the country's economic development zones. We anticipate the unemployment rate will continue to decline, supported by sustained FDI inflows, especially from EU countries encouraging nearshoring strategies. However, the labor market still faces several challenges, including high levels of emigration, a sizable informal sector, and a shortage of skilled labor. The lack of high-quality job opportunities within North Macedonia prompts many citizens to seek employment in Western European countries, such as Germany, where wages and working opportunities are more attractive.

Parliamentary elections were held in May 2024, resulting in North Macedonia's electorate approving a new government led by Prime Minister Hristijan Mickoski, marking a shift toward a nationalist-dominated administration. Mickoski's VMRO-DPMNE party emerged as the biggest winner, forming a coalition with the Albanian alliance VLEN/VREDI and ZNAM, a faction that broke away from the previous ruling party, the Social Democrats (SDSM). Consequently, the coalition secured 77 votes in the 120-seat parliament. This significant shift reflects widespread voter dissatisfaction with the sluggish progress on EU integration, rising cost of living, and ongoing issues with corruption.

On the policymaking front, the new administration's primary agenda includes comprehensive reforms aimed at revitalizing state institutions, eradicating corruption, and upholding the rule of law. Economic growth is a pivotal goal, with the government setting a target of up to 5% growth, driven by major infrastructure projects. Additionally, the government aims to attract new investments, widen the tax base, and increase pensions and wages. However, it is too early to determine whether these policies will result in economic headwinds or tailwinds, given that the new administration was just recently sworn in and there is limited fiscal headroom without resorting to additional borrowing.

The new government has committed to continuing on the path of EU integration, but it has taken a firm stance against Bulgaria's demand for constitutional changes to recognize a Bulgarian minority in North Macedonia. This contrasts with the previous administration, which had agreed to these changes as part of the 2022 deal to further EU accession talks. Instead, the new administration has called for a revision of the 2017 treaty with Bulgaria to better define and protect North Macedonian national identity and interests, as well as the interests of Bulgarian citizens with North Macedonian national identity. However, the EU has stressed that the treaties and the framework for EU accession talks are non-negotiable. Given the current government's stance and the EU's firm position, North Macedonia's accession bid is likely to remain stalled unless a compromise is reached. This impasse is expected to persist at least for the next year. However, pressure could build on the government to reach a compromise if neighboring countries such as Albania and Montenegro continue to progress in their own respective membership bids.

Flexibility and performance profile: Budgetary and external pressures will ease throughout 2024-2027

The government has made a large upward revision to the budget deficit target for this year from 3.4% of GDP to 4.9%. The revised budget reflects weaker economic growth prospects for this year and focuses on increasing pensions, salaries, and servicing international financial institution (IFI) debts while cutting other expenditure. The funds for any additional outlays will be financed through domestic debt issuance.

In line with previous years, the budget deficit will be financed through a combination of domestic and foreign borrowing. External borrowing sources include loans from the ongoing IMF Precautionary and Liquidity Line (PLL) program and various IFIs such as KfW, World Bank, OPEC fund for international development, and the World Bank. The new administration has secured a €500 million loan from Hungary, which carries a much lower interest rate than those offered by IFIs.

The long-term fiscal outlook remains unclear until a new fiscal strategy is published, we anticipate a slower pace of fiscal consolidation from the new administration. Nevertheless, the budget deficit is projected to average 3.5% of GDP over 2024-2027. Key challenges include managing the sizable informal sector and potential cost overruns associated with infrastructure projects. Despite these challenges, we expect net general government debt to inch up toward about 57% of GDP in the coming years.

Approximately 70% of government debt is denominated in foreign currency, presenting potential risks, particularly if the de-facto currency peg comes under pressure. However, we currently do not foresee this occurring. Adhering strictly to the Organic Budget Law, which is set for implementation in 2025, will be pivotal for further fiscal consolidation. This law establishes fiscal rules similar to the eurozone's Maastricht criteria and mandates the formation of an independent fiscal council, which was established in 2023 and should enhance North Macedonia's efforts to reduce its budget deficit. Despite tight financial conditions, debt-servicing costs remain manageable. Over the next four years, interest payments are expected to average around 5% of government revenue, a figure comparatively lower than many of North Macedonia's peers with similar credit ratings.

We anticipate the current account deficit will widen to 2.6% of GDP in 2024, up from a surplus of 0.7% in 2023, driven by increased domestic demand and weaker external demand, particularly from key trading partners such as Germany. We expect North Macedonia's current account deficit to revert to its pre-pandemic trend of roughly 2% of GDP. The 2024 deficit will be financed through a combination of net FDI inflows and external government borrowing.

The central bank's foreign reserves have continued their upward trajectory, increasing by 3.5% year on year to reach €4.3 billion in June, equivalent to approximately four months' worth of imports. This growth is primarily attributed to net purchases of foreign currency by the central bank in the currency market. Looking ahead, we expect foreign reserves to remain stable, underpinned by sustained FDI inflows and external government borrowing.

Inflation decelerated sharply to 3.2% in June 2024, driven by base effects, easing price pressures, and tight monetary policy. We project inflation to average 3.5% for the year, supported by these factors. However, potential inflationary pressures could emerge from a tight labor market or adverse geopolitical developments. Given the de-facto currency peg, the timing of the central bank's easing cycle is closely aligned with the European Central Bank's (ECB's) monetary policy actions. Notably, the central bank refrained from lowering the policy rate alongside the ECB in June to ensure that inflation and inflation expectations remain stable. However, we expect the central bank to ease the policy rate this year, although this remains dependent on the materialization of risks.

The banking sector in North Macedonia remains stable and profitable, with nonperforming loans (NPLs) low at 3.1% of total loans and a stable capital adequacy ratio of 18.9% in the first quarter of this year, a historical high. The recent slight increase in the NPL ratio is attributed to the adoption of a new methodology that aligns with EU standards. Moreover, to help bolster financial stability, the central bank has increased the counter cyclical buffer once again and increased foreign currency reserve requirements. Despite these adjustments, the near-term likelihood of contingent liabilities for the government arising from the financial sector remains reasonably low. This reflects the sector's resilience and the effectiveness of regulatory measures in maintaining financial stability

North Macedonia--Selected Indicators

	2018	2019	2020	2021	2022	2023	2024bc	2025bc	2026bc	2027bc
Economic indicators (%)										
Nominal GDP (bil. MKD)	660.9	692.7	669.3	729.4	803.1	840.6	891.8	940.6	994.0	1,049.4
Nominal GDP (bil. $)	12.7	12.6	12.4	14.0	13.7	14.8	15.6	16.7	18.7	20.0
GDP per capita (000s $)	6.1	6.1	6.0	6.8	7.5	8.1	8.5	9.1	10.2	11.0
Real GDP growth	2.9	3.9	(4.7)	4.5	2.2	1.0	2.5	3.1	3.1	3.1
Real GDP per capita growth	2.8	3.8	(4.7)	4.9	15.1	1.4	2.6	3.2	3.2	3.2
Real investment growth	1.7	9.5	(15.1)	2.9	9.4	(16.7)	6.3	4.0	3.9	4.2
Investment/GDP	32.3	34.3	29.9	32.2	36.0	23.9	25.0	25.1	25.2	25.5
Savings/GDP	32.5	31.3	27.0	29.5	29.7	24.5	22.4	22.7	22.9	23.2
Exports/GDP	60.4	62.4	57.8	65.4	74.0	72.8	71.9	72.6	73.2	74.1
Real exports growth	12.8	8.9	(10.9)	14.3	11.4	(0.1)	3.8	3.4	3.2	3.3
Unemployment rate	20.7	17.3	16.4	15.7	14.4	13.1	12.7	12.3	12.0	11.8
External indicators (%)										
Current account balance/GDP	0.1	(3.0)	(2.9)	(2.7)	(6.3)	0.7	(2.6)	(2.4)	(2.3)	(2.3)
Current account balance/CARs	0.2	(3.7)	(3.9)	(3.1)	(6.6)	0.7	(2.8)	(2.6)	(2.5)	(2.5)
CARs/GDP	79.8	80.4	74.3	85.2	95.2	95.3	93.3	93.2	92.8	93.3
Trade balance/GDP	(16.2)	(17.3)	(16.7)	(19.7)	(26.8)	(18.9)	(21.1)	(21.2)	(21.3)	(21.5)
Net FDI/GDP	5.6	3.2	1.4	3.2	5.0	3.8	3.5	3.5	3.5	3.5
Net portfolio equity inflow/GDP	(0.8)	(0.0)	(0.5)	(0.4)	(0.8)	(0.4)	(0.3)	(0.3)	(0.3)	(0.3)
Gross external financing needs/CARs plus usable reserves	109.1	111.7	113.8	112.7	115.4	111.3	114.0	113.3	113.5	114.4
Narrow net external debt/CARs	24.3	23.0	33.4	26.2	26.8	23.7	24.8	24.4	22.3	21.0
Narrow net external debt/CAPs	24.3	22.2	32.1	25.4	25.2	23.9	24.2	23.7	21.7	20.5
Net external liabilities/CARs	68.4	71.3	92.2	68.8	66.6	66.8	68.2	67.5	62.9	60.4
Net external liabilities/CAPs	68.5	68.7	88.8	66.7	62.5	67.3	66.4	65.8	61.3	59.0
Short-term external debt by remaining maturity/CARs	20.2	20.7	24.0	20.5	19.9	22.3	22.7	22.3	20.6	20.0

North Macedonia--Selected Indicators										
Usable reserves/CAPs (months)	1.2	1.3	1.4	1.1	1.1	1.1	1.2	1.2	1.0	0.8
Usable reserves (Mil. $)	1,152.5	1,137.3	1,153.1	1,267.0	1,297.2	1,473.5	1,583.8	1,459.6	1,300.6	1,368.4
Fiscal indicators (general government %)										
Balance/GDP	(1.1)	(2.1)	(8.2)	(5.4)	(4.4)	(4.9)	(4.9)	(3.2)	(3.0)	(2.8)
Change in net debt/GDP	1.6	3.5	7.5	5.3	4.7	4.9	5.4	3.6	3.3	3.1
Primary balance/GDP	0.1	(1.0)	(7.0)	(4.1)	(3.3)	(3.4)	(3.1)	(1.5)	(1.4)	(1.2)
Revenue/GDP	30.4	31.4	29.9	32.0	32.1	34.9	32.5	32.0	32.0	32.0
Expenditures/GDP	31.5	33.5	38.1	37.4	36.5	39.8	37.4	35.2	35.0	34.8
Interest/revenues	3.9	3.8	4.0	3.9	3.6	4.5	5.5	5.4	5.1	4.9
Debt/GDP	45.8	46.5	57.0	57.8	56.3	58.8	60.8	61.3	61.3	61.1
Debt/revenues	150.8	148.3	190.5	180.4	175.5	168.5	187.1	191.4	191.5	191.0
Net debt/GDP	39.3	41.0	50.0	51.1	51.1	53.7	56.0	56.7	57.0	57.1
Liquid assets/GDP	6.5	5.5	7.1	6.6	5.2	5.1	4.8	4.5	4.3	4.1
Monetary indicators (%)										
CPI growth	1.5	0.8	1.2	3.2	14.2	9.4	3.5	2.3	2.0	2.2
GDP deflator growth	3.9	0.9	1.4	4.3	7.7	3.6	3.5	2.3	2.5	2.4
Exchange rate, year-end (MKD/$)	53.7	55.0	50.2	54.4	57.7	55.7	57.2	54.8	52.3	52.9
Banks' claims on resident non-gov't sector growth	7.3	6.4	4.8	8.3	9.3	5.2	6.0	7.0	7.0	7.0
Banks' claims on resident non-gov't sector/GDP	49.0	49.7	53.9	53.5	53.1	53.4	53.4	54.1	54.8	55.5
Foreign currency share of claims by banks on residents	40.3	41.2	41.2	40.3	42.2	41.7	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	40.0	38.4	39.7	42.8	44.4	42.9	N/A	N/A	N/A	N/A
Real effective exchange rate growth	1.4	(1.7)	1.9	1.1	2.3	4.9	N/A	N/A	N/A	N/A

Sources: National Bank of the Republic of North Macedonia,International Monetary Fund, Eurostat, State Statistical Office of Republic of North Macedonia (Economic Indicators); National Bank of the Republic of North Macedonia,International Monetary Fund (Monetary Indicators); Ministry of Finance, National Bank of the Republic of North Macedonia (Fiscal and Debt Indicators); National Bank of the Republic of North Macedonia (External Indicators).

Adjustments: We adjust usable reserves by subtracting monetary base and required bank reserves on resident foreign-currency deposits from the reported international reserves. Government debt is adjusted by including the debt of Public Enterprise for State Roads.

Definitions: Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid claims on nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. N/A- Not applicable. MKD--Macedonian denar. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

North Macedonia--Rating Component Scores

Key rating factors	Score	Explanation
Institutional assessment	5	Policy choices may weaken capability and willingness to maintain sustainable public finances. Transparency is impaired owing to high levels of perceived corruption.
Economic assessment	4	Based on GDP per capita (US$) and growth trends as per Selected Indicators in table 1.

North Macedonia--Rating Component Scores

Key rating factors	Score	Explanation
External assessment	4	Based on narrow net external debt and gross external financing needs/(current account receipts (CAR) plus usable reserves) as per Selected Indicators in table 1.
		There is a risk of marked deterioration in cost of financing given elevated rates and sizable upcoming Eurobond redemptions in the next few years.
Fiscal assessment: flexibility and performance	4	Based on the change in net general government debt (% of GDP) as per Selected Indicators in table 1.
Fiscal assessment: debt burden	3	Based on net general government debt (% of GDP) and general government interest expenditures (% of general government revenues) as per Selected Indicators in table 1.
		Over 70% of gross government debt is denominated in foreign currency.
Monetary assessment	4	The North Macedonian denar is pegged to the euro. Furthermore, the National Bank of the Republic of North Macedonia benefits from a degree of operational independence; it uses market-based monetary instruments and has some ability to act as a lender of last resort for the financial system. Annual consumer price index is generally low and in line with that of its peers.
Indicative rating	bb-	As per Table 1 of “Sovereign Rating Methodology
Notches of supplemental adjustments and flexibility	0	None.
Final rating		
Foreign currency	BB-	Default risks do not apply differently to foreign-and local-currency debt.
Notches of uplift	0	
Local currency	BB-	

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

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Sovereign Ratings List, July 10, 2023
- Sovereign Ratings History, July 10, 2023
- Sovereign Risk Indicators, July 10, 2023. A free interactive version is available at http://www.spratings.com/sri
- Sovereign Ratings Score Snapshot, July 7, 2023

- Global Sovereign Rating Trends Midyear 2023: Fragile Stability, July 5, 2023
- 2022 Annual Global Sovereign Default And Rating Transition Study, April 28, 2023

Ratings Detail (as of July 22, 2024)*

North Macedonia		
Sovereign Credit Rating		BB-/Stable/B
Transfer & Convertibility Assessment		BB
Senior Unsecured		BB-
Sovereign Credit Ratings History		
24-May-2013	*Foreign Currency*	BB-/Stable/B
21-Sep-2009		BB/Stable/B
30-Apr-2009		BB/Negative/B
24-May-2013	*Local Currency*	BB-/Stable/B
24-Aug-2011		BB/Stable/B
21-Sep-2009		BB+/Stable/B

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