



Executive Board Minutes 22/15-2

February 14, 2022–2:45 p.m.

Republic of North Macedonia—2021 Article IV Consultation

Documents: SM/22/20, and Cor. 1, and Sup. 1; SM/22/22, and Cor. 1

Staff: Barkbu, EUR; Tamirisa, SPR

Length: 45 minutes

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CEDA OGADA
Secretary

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¹ Minutes are the official record of a formal Board meeting in which the Board may adopt decisions and reach understandings related to the business of the Fund. Staff background documents issued before the meeting are the principal basis for the meeting. Preliminary “gray” or “buff” statements by Executive Directors and staff’s responses to Directors’ technical questions are circulated prior to the meeting. Adopted decisions and/or summings up—the Chair’s “sense of the meeting” or policy conclusions/recommendations—are issued after the meeting. The minutes include all these elements, as well as the discussion record (a verbatim transcript of the discussion lightly edited for clarity). Minutes are made public consistent with the IMF’s Open Archives Policy.

THE ACTING CHAIR'S SUMMING UP

Executive Directors agreed with the thrust of the staff appraisal. They welcomed the rebound in the economy reflecting improved mobility and continued policy support. Looking ahead, Directors stressed the importance of increasing vaccine coverage and limiting scarring from the pandemic while making progress on long-standing reform priorities.

Directors agreed that fiscal support should be targeted and gradually scaled down while maintaining its flexibility given still high pandemic-related uncertainty. They emphasized that a credible medium-term fiscal strategy will help anchor efforts to rebuild buffers and create room for more priority investment. In this context, they recommended focusing consolidation on tax policy and revenue administration. Further improvement in public financial management is also needed to support the authorities' investment plan and limit fiscal risks. Directors looked forward to the adoption of the Organic Budget Law and further progress in strengthening the transparency and accountability of public spending.

Directors noted that the de facto exchange rate peg has served the country well. They encouraged the central bank to stand ready to tighten monetary policy if inflation is expected to become persistently higher than in the euro area, or sustained pressures on foreign currency reserves materialize. Directors underscored the importance of preserving the operational autonomy of the central bank.

Directors noted that the banking system is well-capitalized but emphasized the need for continued vigilance. They welcomed the authorities' efforts to ensure that banks recognize problem assets in a timely manner. The growth in foreign currency lending should also be closely monitored. Directors highlighted the need to continue strengthening the macroprudential policy framework and the financial safety net, including the bank resolution framework and deposit insurance. Completing the legislative process is important in this regard.

Directors encouraged policies to facilitate resource reallocation, improve education outcomes, and strengthen the social safety net. Efforts to reduce informality and raise labor participation of women and youth are also important. To preserve employment and competitiveness, Directors considered that minimum wage increases should also be guided by productivity trends. They welcomed the Growth Acceleration Plan, noting that its implementation can boost growth and spur a green and digital transformation.

It is expected that the next Article IV consultation with the Republic of North Macedonia will be held on the standard 12-month cycle.

EXECUTIVE BOARD ATTENDANCE²

B. Li, Acting Chair

Executive Directors

A. Buisse (FF)

S. Bhalla (IN)

M. Mahmoud (MI)

A. Mozhin (RU)

A. BinZarah (SA)

Alternate Executive Directors

W. Nakunyada (AE)

M. Bangrim Kibassim (AF), Temporary

J. Corvalan (AG), Temporary

C. Becker (AP), Temporary

F. Fuentes (BR)

Z. Zhang (CC)

F. Lopez (CE), Temporary

P. Mooney (CO), Temporary

H. Azal (EC)

A. Rieck (GR)

M. Massourakis (IT)

M. Kashima (JA)

S. Belhaj (MD), Temporary

L. Dresse (NE)

A. Marcussen (NO)

F. Mochtar (ST)

A. Tola (SZ), Temporary

D. Andreicut (UK), Temporary

S. Senich (US), Temporary

O. Vongthieres, Acting Secretary

J. Morco / M. Guerra Bradford, Summing Up Officers

C. Milambo, Board Operations Officer

L. Nagy-Baker, Verbatim Reporting Officer

Also Present

Communications Department: M. Louis. European Central Bank: R. Rueffer, S. Tordoir.

European Department: B. Barkbu, J. Decressin, S. Eble, T. Gade, A. Mangov, F. Roldan.

Legal Department: C. DeLong, L. Pedersen, J. Swanepoel. Monetary and Capital Markets

² For countries in each constituency, please see the Constituency Codes in the annex.

Department: U. Das. Strategy, Policy, and Review Department: N. Tamirisa. World Bank Group: S. Madzarevic-Sujster. Executive Directors: A. Andrianarivelo (AF), P. Jennings (CO), R. Lim (ST), P. Moreno (CE). Alternate Executive Directors: A. Alhosani (MI), C. Amarasekara (IN), M. El Qorchi (MD), A. Guerra (CE), C. Just (EC), R. N'Sonde (AF), F. O'Brolchain (CO), L. Palei (RU), O. Parkyn (AP), C. Roman (FF), J. Romero (CE), F. Sylla (AF). Senior Advisors to Executive Directors: W. Abdelati (MI), H. Andrianometiana (AF), E. Cartagena (CE), M. Choueiri (MI), O. Hendrick (AG), B. Jappah (AE), R. Mahabir (BR), J. Rojas (CE), C. Sassanpour (MD), S. Spurga (NO), N. Thiruvankadam (IN). Advisors to Executive Directors: T. Abdygulov (SZ), F. Al-Kohlany (MI), P. Al-Riffai (MI), A. Arevalo Arroyo (CE), Bah, R. (AF), Dennis Bautista (ST), B. Boostani (MD), M. Damane (AE), F. Dogan (EC), D. Fadhel (MI), D. Hamzah (MI), A. Korinthios (IT), V. Lankester Campos (CE), M. Merhi (MI), R. Moral Betere (CE), I. Ogihara (JA), A. Olhaye (AF), B. Piasecki (SZ), D. Shestakov (RU), D. Tevdovski (NE), C. Westphal (US), Y. Zhao (CC), B. Stahlhofen (GR), L. Albisson (FF).

DISCUSSION RECORD³

The Acting Chair (Mr. Li):

From the staff report, we can see that the authorities of North Macedonia have taken forceful action to cushion the impact of the pandemic, initially helped by the Rapid Financing Instrument (RFI) and more recently by the SDR allocation. In line with global developments, the economy is now recovering, and policy support is being phased out.

Looking ahead, a credible medium-term fiscal plan will help the country rebuild buffers and create room for more investment. Continued improvement of public financial management (PFM) is important to achieve these objectives. In addition, completing the legislative agenda to strengthen the framework for macroprudential policy and bolster the financial safety net is also a priority. I look forward to hearing Directors' views on how the authorities can meet the challenges ahead and how the Fund can help.

Mr. Dresse:

We appreciate the Board's broad support for North Macedonia and constructive comments expressed in their gray statements. I issued a comprehensive buff statement, so I will focus on four key issues.

First, the authorities are firmly committed to credible policies, economic stability and sustainability. While North Macedonia has been hit hard by the pandemic and some targeted support may be necessary to further consolidate the recovery, fiscal policy already contributes to a gradual consolidation. The monetary policy stance currently supports economic recovery and keeps inflation in line with the Euro Area. However, the central bank concurs with staff's recommendation to continue closely monitoring inflation developments and is prepared to act as soon as needed. As a pathway out of the pandemic, the authorities are committed to further increase the vaccination rate despite the difficulties mentioned by staff in their written response.

Second, the institutions and governance are improving steadily in North Macedonia, as recognized in two recent documents. In October 2021, the European Commission stated the supervisory and regulatory requirements of credit institutions in North Macedonia are equivalent to those applied in the

³ Edited for clarity.

European Union, and two weeks ago the Fund's Central Bank Transparency Code Assessment concluded that the National Bank of the Republic of North Macedonia is transparent and accountable.

However, this is not the end of the journey. The central bank and fiscal authority are committed to tackle the remaining FSAP recommendations and to resume progress in the denarization strategy. More in general, the authorities want to continue the path of progress supported by the highly valued technical assistance from the Fund and the World Bank.

Third, the authorities are mindful of the remarks made by many Directors that structural reforms are key to achieve higher productivity growth and speed up the country's income convergence. The government's ambitious Growth Acceleration Plan 2022-2026 will increase public investment and facilitate green and digital transitions. The country's favorable business environment is expected to attract more foreign investment and increasing women's labor force participation and reducing informality are also necessary to boost potential output.

Finally, as highlighted by Mr. Moreno and Mr. Massourakis, in the start of the EU accession negotiation can provide an additional impetus for the authorities' reform agenda. North Macedonia has made important steps forward and remains devoted to continuing the EU integration path. The first positive European Commission recommendation for start of the negotiation has been received by the country in 2009, while in 2019 changed of the country's name for integration purposes. Due to opposition by Bulgaria, no specific date has been set yet for the start of the negotiations. However, we take note of positive signs shown both by the new prime ministers of Bulgaria and North Macedonia.

The staff representative from the European Department (Ms. Barkbu):

I would just like to make a few comments to follow up. The authorities' response, as we heard, to the pandemic has been strong, and the economy is recovering. However, vaccine coverage remains low. The latest observation is around 40 percent of the population. While there were some supply shortages in 2021, that is no longer an issue. There is supply of vaccines, and the problem seems to be vaccine hesitancy. Accelerating the rollout of vaccines, as many Directors highlighted, is important to contain downside risks.

On fiscal policies, the authorities are scaling down fiscal support, using more targeted measures as recommended by staff; and given the uncertainty, it is important going forward to keep policies flexible. Over the medium-term, we see a need for consolidation. We estimate that need at around 1-3/4 percent of GDP. This will help rebuild space to address future shocks. We see substantial scope for revenue mobilization, as well as some scope for expenditure rationalization. These measures together would give a larger reduction in the deficit than the 1-3/4 percent that we consider should be targeted, so there is room to increase public investment while reducing the fiscal deficit at the same time.

Let me note that the authorities' Growth Acceleration Plan aims to scale up public investment, which is supported by staff; but as many Directors highlighted, it is important that this comes together with further improvements in public financial management.

The final point, many Directors emphasized the need to implement the 2018 Financial Sector Assessment Program (FSAP) recommendations. There has been considerable progress on drafting legislation on the financial safety net and on the macroprudential oversight. Some of these laws are now in Parliament, but others are still at the later stages of drafting. We consider it very important to make sure that these frameworks will soon be in place to prevent buildup of vulnerabilities and to mitigate any negative future shocks.

Ms. Senich:

We did not issue a gray statement, so I want to comment on a few points in the report.

First, we welcome that North Macedonia's economy is expected to continue to recover in 2022, though we note that the uncertainty around the pandemic remains elevated, especially given the country's low vaccine rates. We would continue to find it helpful for staff to consider whether there are economic policies that have worked well in different countries to overcome vaccine hesitancy. We agree with staff's assessment that the authorities should gradually pursue fiscal consolidation while remaining flexible as the pandemic evolves. We urge the authorities to implement the needed public financial and investment management reforms to raise additional revenue, rebuild fiscal space, and support more inclusive, sustainable growth.

We also support the authorities' planned investments under the Growth Acceleration Plan. We welcome the authorities' intention to improve

the under execution of infrastructure investment. We also agree that investments in green and digital infrastructure in particular, if executed well, could help North Macedonia address these emerging issues. We echo staff's concern about the plan's complicated governance structure and ambitious assumptions about the outcomes for productivity growth. We would welcome any insights from staff about whether the authorities seem to internalize their concerns.

We agree that monetary policy is appropriately accommodative and that higher inflation likely reflects mostly global factors. That said, we also echo staff that the central bank should stand ready to tighten policies if a large and persistent inflation differential with the Euro Area is expected or if there are sustained pressures on foreign exchange reserves. We also echo staff and the ECB representative in urging the authorities to follow through on steps to preserve central bank independence, including by taking supervisory decisions at the Executive Council level and preserving independence in the central bank's personnel matters. We encourage the authorities to continue pursuing policies to support the reskilling and retraining of the labor force to increase labor force participation and boost labor productivity. These efforts would help to limit economic scarring from the pandemic, as well as accelerate the pace of income convergence. We strongly agree that a minimum wage increase should be guided by productivity developments and to limit upside risks to inflation and preserve competitiveness.

Finally, we welcome that the banking sector has remained resilient. We commend staff for working with the authorities to strengthen the central bank's stress testing capacity. We encourage staff to work with the authorities to address shortcomings in North Macedonia's AML/CFT framework, including around cryptocurrencies. We look forward to MONEYVAL's upcoming assessment of the country's AML/CFT framework in 2022.

Mr. Fuentes:

Despite the slower start of 2022 due to the rise in Omicron cases, the economy of North Macedonia remains on a firm path towards recovery. The authorities' ambitious Growth Acceleration Plan is expected to boost investment and speed up economic activity, improving growth prospects in a slightly more favorable external environment. That said, lingering structural vulnerabilities warrant a steadfast implementation of key reforms to boost potential growth, improve labor market, and social policies outcomes. We issued a gray statement in which we broadly agree with the thrust of the staff appraisal, and I will use this intervention to make two additional points.

First, regarding the labor market, efforts to address the stubbornly high unemployment and the size of the informal sector are critical to support a more inclusive growth strategy. The low labor market dynamics, particularly during the pandemic, has led to high levels of long-term unemployment, primarily affecting low-skilled workers and the youth. Furthermore, additional measures are needed to effectively remove the underlying causes of informality and the persistent emigration trends. In addition, a comprehensive reform of the education system is crucial to increase productivity, improve labor market outcomes, and ensure the youth population have the skills needed for the post-pandemic economy.

Finally, we welcome the progress made by North Macedonia towards EU accession and its potential impact on reform implementation. With NATO membership now achieved, making progress with the EU accession negotiations will have a positive spillover effect in the economy. It will provide a policy anchor to advance in the structural reform agenda and become a critical component of the government's foreign policy that will enable greater international corporation and bolster the country's development strategy. Considering the potential socioeconomic benefits for North Macedonia, we hope the current impasse with Bulgaria could be resolved in a timely manner.

Before concluding with these remarks, we want to wish the authorities and the people of North Macedonia success as they continue to deal with the recovery and the COVID crisis.

Ms. Rieck:

The authorities have shown decisive and effective action to contain the economic impact of the pandemic. It is good to see that the economy is set for solid growth in the medium term. At the same time, important downside risks remain, such as inflationary pressures, relatively low vaccination rates, as well as high unemployment and stagnant productivity. We agree with the staff appraisal, and we want to highlight a few points mainly for emphasis.

First, we welcome the improvements on transparency and governance related to public spending, to pandemic-related expenses. We very much appreciate that the authorities have broadly followed Fund recommendations, such as setting up an online portal to track payments. Still, some issues do remain, and we would welcome continued efforts in this regard. Not least

because the authorities are envisaging large-scale investments, transparent use of public resources, and proper procurement is ever more important.

Second, growth-enhancing structural reforms and well-executed investment projects should be key priorities for the authorities. We think a broad-based Growth Acceleration Plan sets the right focus on infrastructure development while also considering the need for a green and digital transformation.

Finally, we support the call by staff and several Directors, including Mr. Buisse, Ms. Marcussen, Mr. O’Brolchain, and Mr. Fuentes just now, to strengthen the formal sector of the economy. Relatively high unemployment and a large informal sector remain an issue which needs to be tackled through labor market reforms. Key issues are to promote inclusive labor participation in the formal sector to reduce job mismatches and to increase labor productivity. The authorities should also carefully consider the impact of the minimum wage on these issues when setting the new level. A more inclusive and flexible labor market would offer opportunities and could alleviate the trend of youth emigration. In this regard, it would be interesting to learn about staff’s perspective on advisable structural reforms to tackle this issue.

Mr. Massourakis:

We have issued a joint gray statement with Mr. Moreno, so today I would like to focus on just a few additional points.

The first point, we thank staff for the update on the recent agreement achieved with trade unions and employers on an ad hoc increase in the minimum wage. We understand that the authorities considered a higher minimum wage to support living standards following the pandemic crisis impact on lower income segments. We urge the authorities to complement the income’s policies with substantive measures to reduce informal employment and strengthen tax compliance.

Second, we regret that North Macedonia lags regional peers in human capital development mainly because of inadequate quality and quantity of schooling. Therefore, investing more on the educational system will be of the utmost importance. Given the significant impact of the pandemic on women and youth employment, stronger policies to increase labor force participation and support reskilling should focus particularly in these categories.

Third point, with regards to the authorities' plans to increase public investment, we note that many of the country's policies and procedures governing public investment are not aligned or partially aligned with best practice. Addressing governance weaknesses therefore can raise the efficiency of public investment and thus ensure the success of the authorities' plans.

Mr. Nakunyada:

The COVID-19 pandemic disrupted sustained growth performance attained over the years in North Macedonia. We commend the authorities for the effective policy responses that cushioned the most vulnerable and set the stage for the economic rebound. We did not issue a statement and would like to highlight a few points.

First, we welcome the authorities' plans to rebuild fiscal buffers by scaling down pandemic-related spending while providing targeted support. We also welcome the priority accorded to spending on education, health, and vaccine acquisition in the 2022 budget while allowing for an agile response to pandemic-related spending needs.

Further, we agree that normalizing VAT on electricity and the rollback of energy subsidies would be essential to create the much-needed fiscal space and mitigate fiscal vulnerabilities. We also welcome the authorities' commitment to transparency in the use of public resources, including additional measures on pandemic spending.

Second, we are encouraged by the authorities' initiatives to improve bank stress testing frameworks, intensify supervisory efforts, while strengthening macroprudential policies and the financial safety net. The National Bank of the Republic of North Macedonia (NBRNM) should, however, continue to maintain a carefully calibrated approach to limiting foreign exchange lending, especially to households. That said, we positively note progress in implementing the 2018 FSAP recommendations and encourage further efforts to address the remaining issues.

Finally, structural reforms remain essential to support investment, limit scarring, and unlock the economy's growth potential. To this end, we view ongoing efforts to improve the business climate as important to enhance the country's investment appeal. Further efforts are required to boost productivity, reduce informality, and improve female labor force participation. We also look forward to the commencement of accession negotiations, which would be

critical to cement the country's EU integration path and provide strong impetus to reform implementation.

Mr. Azal:

As we issued a gray statement, I will only highlight a few points for emphasis.

First, we note that North Macedonia has one of the highest mortality rates from the pandemic in the world, which calls for the authorities' firm action to address vaccine hesitancy and issue a speedy vaccination, which would also help strengthen the economic recovery.

Second, on the financial sector, we welcome the new law on financial stability to enhance the macroprudential framework for the central bank to address risks that may arise from the banking system's high euroization and public debt's denomination in foreign currency.

Third, while we welcome the Growth Acceleration Plan, which will support economic growth, we reiterate the importance of stronger public financial management to increase the efficiency and reduce fiscal risks to the economy.

Finally, on the structural reforms front, we reiterate that wage hikes should be in line with labor productivity and encourage the authorities to put more emphasis on increasing labor force participation, particularly of the youth and women. Furthermore, increased attention should be given to green and digital transition and investment plans to ensure sustainable and inclusive growth.

Mr. Bangrim Kibassim:

The COVID-19 has severely impacted North Macedonia and led to a deterioration of macroeconomic conditions and long-lasting economic scars. Considering elevated uncertainties, the authorities should focus their efforts toward containing inflation, building fiscal buffers, and advancing longstanding reforms. These steps would help to improve North Macedonia's macroeconomic outlook and growth and enhance EU accession prospects.

As the recovery takes hold, the fiscal policy should remain supportive and address resource allocation. The effective implementation of the authorities' Growth Acceleration Plan and Organic Budget Law (OBL),

complemented by public financial management reforms, will be critical for increasing efficiency, fiscal sustainability, public investment, and economic growth. We have not issued a gray statement and would like to offer the additional following comments.

First, we concur with Mr. Moreno and Mr. Massourakis in stressing that enhancing vaccination coverage should be high priority. Given the risk posed to the outlook by potential disruption in supply chains, the low rate of vaccination in North Macedonia associated to an elevated mortality rate is a source of concern that requires an appropriate response.

Second, monetary policy should remain accommodative while containing inflation. We positively note that the levels of international reserves and credit to the economy are appropriate. However, to strengthen the monetary policy framework, the autonomy of the central bank should be reinforced. In addition, the authorities should stand ready to address higher inflation if predictions materialize considering the need to address inefficiency in policy transmission, as highlighted by Mr. Zhang.

Lastly, progress on structural reforms should support economic transformation and the achievement of inclusive growth. Reducing informality and increasing productivity and women and youth labor participation should rank high on the reform agenda. Likewise, addressing barriers to the digital economy would increase the efficiency of the authorities' Growth Acceleration Plan and support their transformation program.

Mr. Shestakov:

We have not issued a gray statement and would like to make several brief remarks.

On fiscal policy, we know that staff propose a structured fiscal consolidation which is more ambitious than the government's fiscal transition. We would like to support the authorities and underline the merits in more gradual fiscal consolidation, especially given the fact that the health crisis is not over yet. Of course, here we echo remarks made by many Directors about the need to accelerate vaccination.

We welcome the authorities' plans outlined in the draft Organic Budget Law to advance fiscal governance with numerical caps on overall deficit and public debt, as well as the establishment of independent fiscal council. We also encourage the authorities to address remaining shortcomings

in the accountability of the pandemic-related spending and publicly disclose the official ownership of government contractors.

On monetary policy, we know that despite the rebound in economic activity, inflation currently is less than in the Euro Area with the de facto peg serving as an anchor of stability. The staff report mentioned that the rate cuts undertaken during the pandemic have not passed through to market and lending rates. We are doubtful of staff comments that the rate hikes might have a signaling effect since the economic magnitude of that effect is likely not large. In this regard, we would like to know more about the measures undertaken by NBRNM to strengthen the monetary transmission mechanism, and maybe there will be some Fund TA in this area.

On structural issues, we agree with staff that the potential growth of North Macedonia can be accelerated with an appropriately designed public investment plan, which would leverage the recommendation from the IMF 2020 PIMA and align procedures governing public investment with best practices.

We also agree with staff that minimum wage increases which are decoupled from the productivity developments might not be the ideal way to reduce poverty among the working population. If the authorities believe that minimum wage increases are an important part of their desired policy package, they may be complemented with different measures which might increase labor market flexibility and labor force participation, especially among women.

Ms. Marcussen:

Having already issued a gray statement, I would like to emphasize two points.

First, we agree with others that the current upswing provides a window of opportunity to rebuild fiscal buffers. In particular, new revenue measures including carbon pricing and unified VAT rates would create fiscal space for the much-needed public investment. It would also create more room to maneuver to ensure an appropriately countercyclical economic policy stance. Here, we would just note that, as elaborated by staff in their technical responses, inflation of consumer services was 5.3 percent year-on-year in December 2021, which was higher than the headline inflation. This may be significant in just stressing the need for the policy stance to be prepared to address potential inflationary pressures on the domestic side.

Our second point is we would encourage staff to continue following up on transparency and accountability of COVID-related emergency spending, including by addressing some of the shortcomings that the staff paper also commented on in the audited pandemic-related contracts. It is very important that applied governance standards are strong, even for emergency financing, which is approved under pressing circumstances.

The staff representative from the European Department (Ms. Barkbu):

I will try to address the questions and comments. The first one I would talk about would be about the vaccine hesitancy that appears to be an issue behind the low vaccination rate, so we focused on the situation in North Macedonia. We think the main reason for hesitancy is concerns about the safety of vaccines and doubts about the efficacy of vaccines, and many countries share similar challenges. A typical response has been to step up public campaigns to provide better information and raise awareness, and this has also been done in North Macedonia. Going forward, perhaps the authorities could explore more targeted campaigns aimed at those groups with low coverage or also those vulnerable groups. Many countries, including in Europe, have implemented vaccine mandates for access to services such as restaurants or for vulnerable parts of the population, but those need to be enforced. This is something that we could look more into and see what would be relevant for North Macedonia.

There was a question on the government's growth acceleration plans and the importance of governance and good assumptions on productivity, so clearly we have discussed regarding the public financial management, the authorities had a PIMA assessment in 2020, and they now have an action plan in terms of the following up on the PIMA recommendations; there is very careful discussion between the Fund and the authorities in this area, and we are certain that they are committed to implementing this, which is very important for the success of the investment plan.

We have also discussed productivity and growth assumptions; how much will scaled-up investment imply in terms of growth dividend. There is a Selected Issues Paper on that where we have used models and benchmarks from other studies, and we have discussed this in detail with the authorities; but there is still some disagreement on the expected effect. The authorities are clearly aware of the need to raise productivity, and that is a priority for them going forward.

There were some questions, many focused on the challenges that need to be addressed in terms of the large informal sector and large emigration. This is linked to productivity, and the efforts need to continue here, both to reduce the informal sector and to ensure that the labor force stays in the country. In terms of informality, there has been a decline, from what we can see from different statistical sources, in the size of the informal sector. Partly this is related to registration measures that were taken as part of the COVID response. Also, measures to enforce revenue administration will help in this regard.

I think the final question that I will talk about is the monetary policy transmission. In the staff report, we discussed that there was very limited transmission from policy rates to lending rates during the pandemic, but the authorities also used other tools. They used central bank bills. In terms of when the authorities would need to tighten monetary policy in addition to the policy rate, they also can use the central bank bills. They can also use reserve requirements. We see the concern regarding the transmission, at least in the long-term.

In terms of the signaling, what we see as very important and where the central bank agrees is in terms of very clear communication, a very clear assessment of inflation trends, and very clear assessment, or very clear communication of actions taken by the central bank would probably be the best way to ensure that there is transmission on monetary policy.

Mr. Dresse:

Let me close by expressing the authorities' appreciation of Ms. Barkbu and her team for the constructive dialogue and valuable policy advice. I would like to thank Directors for the support, constructive comments, and useful suggestions. We will faithfully convey these messages to the authorities of North Macedonia.

The Acting Chair (Mr. Li) noted that the Republic of North Macedonia is an Article VIII member, and no decision is proposed.

The Acting Chair (Mr. Li) adjourned the discussion.

ANNEX

- Staff's Statement
- Gray Statements
- European Central Bank Statement
- Staff's Responses to Executive Directors' Technical Questions
- Constituency Codes

BUFF/22/3

February 9, 2022

**Statement by the Staff Representative on the Republic of North Macedonia
Executive Board Meeting
February 14, 2022**

This statement provides information that has become available since the issuance of the Staff Report. The thrust of the staff appraisal remains unchanged.

1. On February 8, the government announced that it had reached an agreement with the trade unions and employers on an ad-hoc increase in the statutory net minimum wage to 18,000 denars paid from April 2022. This represents an increase of about 18.5 percent relative to the current level, in line with the potential increase in the minimum wage outlined in the staff report.
2. Future statutory minimum wage increases will be based on an amended mechanism as the average of the annual growth in the cost of living and the growth rate of the average wage, provided that the minimum wage is not less than 57 percent of the average wage.
3. The agreement will need to be adopted by law to become effective.
4. The minimum wage increase was discussed during the mission, as laid out in the staff report. Staff project that the net minimum wage would reach 60 percent of the net average wage in 2022, which is high by regional standards. Staff's view continues to be that minimum wage increases should also consider productivity developments, to preserve competitiveness and employment.

DOCUMENT OF INTERNATIONAL MONETARY FUND AND FOR OFFICIAL USE ONLY

BUFF/ED/22/22

February 9, 2022

**Statement by Mr. Dresse and Mr. Tevdovski on Republic of North Macedonia
Executive Board Meeting
February 14, 2022**

On behalf of the authorities of North Macedonia, we would like to thank the staff team, led by Ms. Barkbu, for the report and constructive discussions during the mission. We highly value the Fund's engagement, particularly in this difficult environment due to the pandemic and we thank staff for the broad range of technical assistance provided to North Macedonia over the years.

The authorities consent to the publication of the Article-IV report. They broadly agree with the staff appraisal and will take staff's recommendations into consideration when designing and implementing future reforms to address the challenges faced by the economy.

The authorities' policy response to the COVID-19 crisis

North Macedonia entered the pandemic with solid macroeconomic fundamentals. In the past decade, the country maintained a track record of low inflation, moderate fiscal deficit, and a stable financial sector. The unemployment rate declined from 32.1 percent in 2010 to 17.3 percent in 2019. Supported by crucial institutional and governance reforms, the economy grew at a strong pace before it was hit by the COVID-19 crisis, 3.9 percent in 2019. These solid macroeconomic fundamentals provided room for adequate policy response to the shock.

Effective policy support helped cushion the economic and social impact of the COVID-19 crisis. Supported by the Rapid Financing Instrument and the use of SDR allocation, the government implemented six packages of fiscal measures to help address firms' liquidity problems, protect jobs, and support the most vulnerable through wage subsidies, tax deferrals, subsidized loans and loan guarantees for firms, sector-specific support, investment incentives and financial support for low-income households. The National Bank of the Republic of North Macedonia (NBRNM) cut its policy rate three times during the crisis, by a cumulative 75 basis points to 1.25 percent. The central bank bills have been reduced by 60 percent, thus providing additional liquidity to the economy. On financial sector measures, the NBRNM successfully used the regulatory flexibility to support

temporary banks loans restructuring, the temporary relaxation of non-performing loan criteria and a deduction in the reserve requirement. As a result, the decline of real GDP in 2020 was cushioned to 6 percent. In 2021, more targeted policy support has helped the economy rebound to 4.6 percent up to third quarter of the year and prevented job losses. The unemployment rate declined further to 15.7 percent in the third quarter of 2021.

Fiscal stability and sustainability

The 2022 budget aligns with the authorities' medium-term fiscal strategy that targets gradual fiscal consolidation while supporting the recovery and accelerating growth rates. The scaling back of fiscal support started in 2021, when the headline deficit decreased to 5.4 percent of GDP from 8.2 percent of GDP in 2020. The 2022 budget further provides consolidation with headline deficit target of 4.3 percent of GDP, while aiming to accelerate growth, intensifies public investment and maintains health spending at a sufficiently high level. The additional funds for health and vaccine-related spending are foreseen in the budget and the government is committed to further increase the vaccination rate. The focus in the budget is on cutting nonessential costs, and better supporting the private sector, innovation and competitiveness.

The authorities are fully committed to public financial management (PFM) reforms, aiming at improving domestic revenue mobilization and expenditure efficiency. Since the first PFM reform program in 2017, designed in line with recommendations of the Fund, World Bank and European Union, the authorities are improving all elements of the system, ranging from improved transparency to digitalizing the processes in Customs administration and Public Revenue Office. Central in the PFM reforms is the new Organic Budget Law (OBL) which is expected to be adopted in 2022. The OBL brings significant changes to fiscal policymaking, budget preparation and execution, and fiscal reporting. In line with the EU framework, it introduces numerical rules for the overall fiscal deficit and public debt, capped at respectively 3 and 60 percent of GDP. Additionally, an independent fiscal council is tasked with assessing the government's macroeconomic and budgetary projections and monitoring the fulfillment of the rules. Moreover, the authorities are committed to fully implement the action plan from the Fund's Public Investment Management (PIM) assessment by the middle of this year which, in combination with recently introduced central government incentive-based mechanism ("CAPEF"), would scale up investment and limit fiscal risks.

Transparency and accountability of public related spending are a high priority. The Fund's Fiscal Transparency Evaluation provided a solid basis for the reform activities. Since 2019, a web portal called "Open finance" is in function which allows the public to track all data for budget transactions by users of the Budget of the Republic of North Macedonia, disbursed by the treasury of the Ministry of Finance. In addition, public procurement contracts must be made publicly available on the dedicated electronic portal. This also includes crisis-related spending, for which additional transparency measures were implemented. The authorities stress that emergency health procurements awarded without

public calls, including for vaccines, are in line with the domestic public procurement law, EU directives and practice of other European countries during the pandemic.

Credible monetary policy and stable financial sector

The accommodative monetary policy is appropriate, with international reserves kept at adequate level. The policy stance supports economic recovery and keeps inflation in line with the euro area. The recent surge in inflation is driven by global supply side factors and are expected to ease during 2022. Given the uncertainty regarding the future path of inflation, the NBRNM concurs with staff's recommendation to continue closely monitoring developments and potential risks, and emphasizes its preparedness to act as needed. The de facto fixed exchange rate with the euro, that has served the country well for decades, is supported by an adequate level of international reserves according to the ARA metric threshold. Both staff and the NBRNM consider the external position to be in equilibrium.

The banking system remains well capitalized and liquid, owing to sound prudential policies. The total capital adequacy ratio exceeds 17 percent at end-September 2021, while the overall NPL level is around 3.5 percent. The NBRNM regular stress tests found that the banking system's capital levels would remain above the minimum requirements through 2022 in a stressed scenario.

The recent IMF's Central Bank Transparency Code Assessment found the NBRNM transparent and accountable. Maintaining central bank operational independence, along with transparency and accountability, is critical to supervisory decision-making. Additionally, in line with the 2018 FSAP recommendations, NBRNM staff should be excluded from the law on administrative staff.

The authorities are committed to complete the implementation of the 2018 FSAP recommendations. Important steps have already been taken: the adoption of a new regulation on liquidity risk management, which closely follows Basel III and EU requirements; the NBRNM altered its organizational structure by dividing the Department on Financial Stability, Banking Regulation, and Bank Resolution in two separate departments to further enhance systemic risk monitoring framework; full-scope inspections started in domestic systematically important banks; and bank resolution activities have been delegated to the newly created Banking Regulation and Bank Resolution Department. Regarding the remaining issues, the new Bank Resolution Law, the new Insolvency Law, and the new Law on Deposit Insurance are expected to be submitted to parliament this year, while the new Financial Stability Law is submitted to parliament for adoption at this time. In this light, the European Commission passed in October 2021 the Decision on the equivalence of the supervisory and regulatory requirements for North Macedonia, confirming that the prudential, supervisory, and regulatory requirements applied in North Macedonia are equivalent to those applied in the European Union.

Macro-critical Structural Reforms

The authorities appreciate staff's in-depth analysis of structural policies, which can facilitate reallocation and transformation. This crisis created the opportunity to prepare the next generation of structural reforms.

The authorities concur with staff's analysis that successfully up scaling investments can boost the economy's growth potential and limit scarring from the pandemic. While the country's per capita stock of public capital nearly has a 50 percent gap with new EU member countries, the government's ambitious Growth Acceleration plan will increase public investment and facilitate green- and digital transitions. Moreover, the country's favorable easing of the doing business environment is expected to accelerate private capital formation, mainly through foreign investment.

Increase in labor force participation is another channel to boost potential output and accelerate the country's income convergence. The authorities acknowledge the potential of informal economy reduction and the increase of women participation in the labor force. Various policies have been implemented with mixed effects and staff's recommendations are welcomed. The authorities reiterate the importance and their commitment to maintain youth and skilled labor in the domestic labor market, prevent a continuation of emigration trends, and improve the quality of education.

EU Integration

North Macedonia has made important steps and remains devoted to continue on the EU integration path. After the Prespa agreement with Greece, the country achieved two major milestones at the start of the pandemic: the country joined NATO as its 30th member country, and the EU Council agreed to start accession negotiations. However, no specific date has been set yet, as noted in the staff report. EU membership is strongly supported by the country's population and accession prospects have helped spur important reforms in past. The authorities expect that the start of the accession negotiations can revive reform momentum. They regard international cooperation as a crucial driver for economic development.

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GRAY/22/455

February 10, 2022

**Joint Statement by Mr. Moreno, Mr. Massourakis, Ms. Korinthios, and Mr. Lopez on
Republic of North Macedonia
(Preliminary)
Executive Board Meeting
February 14, 2022**

We thank staff for the informative set of reports and Mr. Dresse and Mr. Tevdovski for the helpful Buff statement. Going forward, the top priority should be to limit economic scarring from the Covid-19 crisis and support resource reallocation while making progress on long-standing reform priorities. We broadly agree with the thrust of the staff report and offer the following comments for emphasis:

- **We are pleased that, after GDP dropping by 6 percent in 2020, the economy is rebounding.** Although growth is expected to remain solid, we encourage the authorities to remain vigilant given the risks from possible adverse pandemic developments and more protracted supply-side disruptions. With only 39 percent of the population fully vaccinated against Covid-19 and with one of the highest mortality rates in the world, speeding up the vaccination campaign is of the utmost importance.
- **We regret that EU accession negotiations have stalled.** Improved EU accession prospects would have provided an additional impetus for the authorities' reforms agenda. Nevertheless, we are encouraged by the government's Growth Acceleration Plan, which could play a significant role in the post-pandemic recovery, by spurring investment and boosting potential growth. Moving forward with well implemented infrastructure and green projects could pave the way towards the green and digital transformation of the economy, lifting output and speeding up income convergence. However, the government's plan to scale up investment should be complemented by further improvements in public financial management.
- **We share staff's view that fiscal support for pandemic relief should become more targeted and gradually scaled down, depending on the evolution of the pandemic.** We also emphasize the need for a credible medium-term fiscal strategy, focused on revenue mobilization, which will help create fiscal space to address much needed investment needs and mitigate risks related to increasing debt levels.

Combating tax evasion and corruption, improving debt management, as well as reducing informality will be key in this regard. We strongly support staff's recommendation to ensure the operational independence of the fiscal council.

- **Rising energy and food prices have pushed up inflation, which has increased to 4.9 percent and is expected to remain higher for longer than previously thought.** As higher inflation reflects mostly global factors, we share staff's view that the current monetary policy stance remains appropriate, although the National Bank of the Republic of North Macedonia (NBRNM) should stand ready to tighten policies if inflation developments so require. In this context, given recent developments in the labor market, second-round effects due to wage pressures should be carefully monitored.

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GRAY/22/462

February 10, 2022

**Statement by Mr. Hendrick and Mr. Corvalan Mendoza on Republic of North
Macedonia
(Preliminary)
Executive Board Meeting
February 14, 2022**

We thank staff for the informative set of reports including the selected issues paper, and Mr. Dresse and Mr. Tevdovski for their comprehensive Buff statement.

North Macedonia entered the pandemic with solid macroeconomic fundamentals, which allowed the authorities to take bold and decisive actions to mitigate scarring effects of the COVID-19 pandemic on its population and the economy. Fiscal, monetary, and financial policies were supportive to cushion the shock, coupled with automatic stabilizers that pushed the fiscal position to run a deficit of 8 percent of GDP in 2020 and around 5.5 percent of GDP in 2021. A Rapid Financing Instrument with the Fund and later an SDR allocation were used to cover spending on pandemic-related subsidies, protect the most vulnerable, and buttress firms. However, we learned from the report that despite the country's mortality rate since the beginning of the pandemic, which was among the highest in the world, today its population has a low vaccination rate. Only 39 percent are fully vaccinated. *We would like to hear more details form staff on whether this is due to lack of financing to buy vaccines, lack of supply from donors or major producers, or any other reason that better explains the situation.*

On a more positive note, the economy strongly recovered in 2021. Growth rebound was 4 percent last year and projected to remain at this level in 2022, thanks to supportive macroeconomic measures put in place during the crisis. Prospects to become a member of the EU might play a positive role and accelerate the legislative agenda to implement reforms in the coming years. Under this scenario the new government could have a window of opportunity to move ahead a reform agenda that would speed up the income convergence of North Macedonia with other European countries. Important policy tools under consideration like the new Organic Budget Law (OBL), the growth acceleration plan, or the forthcoming amendments to the Financial Stability Law could buttress a more sustainable and inclusive economic growth going forward.

The economy's quick rebound and gradual reduction of pandemic-related measures creates a window of opportunity to rebuild fiscal buffers and focus once again on public investments and debt sustainability. The theme presented in the selected issues paper (SIP) "Boosting revenue collections to create fiscal space and invest in post-pandemic growth" is timely at this juncture. We found the SIP interesting to better capture the fiscal position and its trend. As we see it, the SIP presents a good case analysis to find possible scenarios to tackle deep development challenges the country faces (investment in physical and human capital). We also note the sensible discussion among staff and the authorities on how fast and how big the fiscal balance should remain in the coming years. For the former, an overall fiscal deficit closer to 1 percent of GDP is advisable for the medium term, whereas for the latter, a deficit of 2 percent of GDP becomes more appropriate. Nevertheless, both agree the consolidation efforts would come from a tax policy reform and administrative measures and not so much from the expenditure side. *Assuming the new OBL is approved this year, which is in line with the EU framework, which limits an overall fiscal deficit of 3 percent of GDP and public debt is capped at 60 percent of GDP, we wonder how these limits relate to staff's proposal of a fiscal deficit of 1 percent of GDP in a country that requires public investments?*

Inflation pressures are broad-based but is expected to converge to 2 percent over the medium term. The operational independence of the National Bank of the Republic of North Macedonia (NBRNM) should be preserved at all times to support the monetary and financial framework and make it more resilient. The de facto exchange rate peg with the euro has served the economy well for many years, and the levels of reserves are appropriate to maintain the peg.

The financial sector remains well capitalized during the pandemic; the regulatory forbearance and the liquidity injection from NBRNM to the financial system could bring unintended consequences in the future. Therefore, we go along with staff's assessment to modernize the bank resolution framework and boost the deposit insurance mechanism to buttress the financial safety net of the financial system. We welcome the steps taken by the authorities in line with the 2018 FSAP report, and we encourage them to complete the implementation of the recommendations to enhance financial integrity. Preparing the country for the MONEYVAL evaluation this year will be an additional important step.

With these comments, we wish the authorities and people of North Macedonia all the best in these challenging times.

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GRAY/22/464

February 10, 2022

**Statement by Mr. Alhosani and Ms. Hamzah on Republic of North Macedonia
(Preliminary)
Executive Board Meeting
February 14, 2022**

Statement on North Macedonia

2021 Article IV Consultation

(Preliminary)

Executive Board Meeting

February 14, 2022

We thank staff for the well written report, we also thank Mr. Dresse and Mr. Tevdovski for their useful buff statement. We are in broad agreement with staff’s policy recommendations and appraisal. We are pleased to see the rebound in the economy after GDP dropped by 6 percent in 2020. We also commend the authorities for the effective policy support that helped cushion the economic and social impact of the pandemic through the Rapid Financing Instrument (RFI) and the use of SDR allocations.

Protecting the lives and livelihoods of the population is a key priority especially since the COVID-19 pandemic has become a polyandemic that is confronting the world with more than just a health emergency. Given that North Macedonia had one of the highest mortality rates in the world since the start of the pandemic, we are concerned by the low vaccine coverage with only 39 percent of the population being fully vaccinated as of December 2021. *Can staff clarify on the reasons behind the low rates and what the authorities’ vaccination target is for 2022?*

Strengthening public financial management is key to limit economic scarring from the pandemic and upscale investments. We encourage the authorities to fully implement the action plan formulated in response to the Public Investment Management (PIM) Assessment and operationalize the PIM unit in the Ministry of Finance while ensuring full integration of PPPs into the PIM framework. We also take note of the Organic Budget Law (OBL) which is expected to be adopted during 2022 as this could reduce fiscal risks and improve public finances.

We are pleased that the financial sector remained well capitalized and liquid during the pandemic however macroprudential policy frameworks and financial safety nets should be strengthened. We take note of the authorities' commitment to the implementation of the FSAP recommendations. We welcome that the National Bank of the Republic of North Macedonia (NBRNM) was found to be transparent and accountable under the IMF's Central Bank Transparency Code. We are also pleased by the decision passed by the European Commission in October 2021 on the equivalence of the supervisory and regulatory requirements for North Macedonia. However, we agree with staff that priorities should be given to improving macroprudential oversight and coordination across institutions to ensure that macroprudential instruments are available. Additionally, a modernized framework for bank resolution and deposit insurance will be crucial to strengthen financial safety nets.

Structural reforms are key to boosting potential output and accelerating economic growth. We welcome the authorities' commitment to improving education quality and maintaining youth and skilled labor in the labor market. We agree with staff that a reduction in the informal economy and increasing the participation of women in the labor force is key. We encourage the authorities to focus on ensuring that education and training are in line with current labor market needs. Digitalization can also have a catalytical role to enhance the overall business climate in North Macedonia. We take note of the Growth Acceleration Plan which can provide financing that targets green and digital transitions.

Finally, we hope that the authorities are successful in achieving a timely roll-out of vaccines, which will lead to an expedited resumption of normal economic and social activities.

With these remarks, we wish the people of North Macedonia all the best and the North Macedonian authorities success in their future endeavors.

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GRAY/22/465

February 10, 2022

**Statement by Mr. O'Brolchain and Mr. Mooney on Republic of North Macedonia
(Preliminary)
Executive Board Meeting
February 14, 2022**

We thank staff for the comprehensive report and Mr. Dresse and Mr. Tevdovski for their helpful Buff statement. The economy entered the crisis on a sound economic footing, and GDP is expected to grow by 4 percent in 2021 and 2022 due to forceful policy support. However, the pandemic has had a severe effect on North Macedonia, with one of the highest per capita COVID-19 mortality rates and low vaccine coverage. We agree with the thrust of the report and add the following remarks for emphasis.

Fiscal policy should be implemented flexibly as the pandemic evolves, targeting the most vulnerable. A robust medium-term fiscal strategy, focused on revenue mobilization, can help anchor the fiscal consolidation, with tax policy focusing on progressivity and improved revenue collection measures. We agree with staff that the disclosure of the beneficial ownership of entities contracting with the government should be required, to enhance transparency. We welcome the recent adoption of a Public Investment Management (PIM) action plan, and the associated establishment of a PIM unit in the Ministry of Finance.

Structural policies are critical to support future growth and convergence. In particular, measures to reduce the size of the informal economy, increase labour force participation, and boost productivity should be pursued. Minimum wage increases should be guided by productivity developments to help preserve competitiveness.

We positively note that the banking sector remains well capitalized and profitable, with low NPL levels. On the issue of depositor preference, we agree with staff's recommendation, as outlined in Annex II, that depositor preference should be considered as part of the financial legislative package, to bring it in line with EU law. We welcome the findings of the pilot review under the IMF's Central Bank Transparency code that the NBRNM is transparent and accountable. We note the recent efforts to upgrade the AML/CFT framework, and encourage the authorities to swiftly implement the recommendations from the upcoming MONEYVAL assessment.

We welcome the Government's "Growth Acceleration Plan", as outlined in the Selected Issues Paper, which aims to make more efficient use of publicly funded investment in the amount of 4 billion euros over the period 2022-2026. The governance structure for the Plan requires transparency and independent assessments to avoid political interference. We positively note the authorities' focus on reducing informality in the labour market, and the ongoing efforts to increase female labour force participation. We agree with staff that public investment and economic policies should support the green and digital transformation. Finally, we welcome the authorities' commitment to continue on the EU integration path, as outlined in the Buff.

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GRAY/22/467

February 10, 2022

**Statement by Mr. Fuentes and Ms. Mahabir on Republic of North Macedonia
(Preliminary)
Executive Board Meeting
February 14, 2022**

Thanks to staff for the report and to Mr. Dresse and Mr. Tevdovski for their useful statement. The economy of the Republic of North Macedonia has begun to emerge from the pandemic on the back of a strong policy support. That said, it is paramount that authorities accelerate the vaccination rollout to support the surge in economic activity, particularly considering the recent spike in COVID cases. The government have laid out an ambitious Growth Acceleration Plan (GAP) to support the recovery and boost medium-term growth. Yet, for a successful implementation of this plan, the authorities must address lingering structural bottlenecks and intensify their focus to strengthen governance and transparency.

Scarring from the pandemic is likely to be large. Mortality rates remain among the highest mortality in the world, with a sizeable cumulative output loss reflecting the sharp contraction in some high-contact sectors, and a drop in labor participation rates. In this regard, we take note of the GAP objective to accelerate growth by bolstering public and private sector investment to create jobs, while fostering a fiscal consolidation process to stabilize the public debt. *Could staff share their thoughts on the feasibility of achieving these objectives?* Considering the role of infrastructure investment as a key driver of this plan, staff notes that governance weaknesses may hamper the efficiency of public investment. In this regard, we encourage authorities to fully implement the action plan formulated in response to the Public Investment Management (PIM) Assessment and operationalize the PIM unit in the Ministry of Finance.

Sustained policy support, including resources from the RFI and their SDR allocation, helped mitigate the economic impact of the pandemic. We support the authorities' approach of a gradual unwinding of fiscal support and fine-tuning the scope of these measures as the recovery becomes entrenched. We noticed, however, that the state audit office found that most of the audited pandemic-related contracts had been awarded without public calls. Against this background, we would urge the authorities to strengthen the procurement process, including the collection and publication of beneficiary ownership information.

The banking system has remained resilient during the pandemic. We are reassured by staff's comment that the sector is well-capitalized, profitable, and adequately positioned to address any potential increase in NPLs. Moreover, we welcome the Fund's continued provision of technical assistance (TA) to the central bank in the area of stress-testing and bolstering supervisory capacity. In addition, the formal adoption of the macroprudential mandate by the central bank is likely to increase the need for TA to support fulfilling this new role. In addition, steadfast commitment to strengthen the AML/CFT framework, including addressing lingering deficiencies previously identified, is warranted for the upcoming MONEYVAL evaluation, especially now that the authorities have expressed their plans to formalize cryptocurrency trading.

With these remarks we wish the authorities and the people of North Macedonia all the success in their recovery efforts.

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GRAY/22/469

February 10, 2022

**Statement by Mr. Azal and Mr. Dogan on Republic of North Macedonia
(Preliminary)
Executive Board Meeting
February 14, 2022**

We thank staff for the comprehensive set of reports, and Messrs. Dresse and Tevdovski for their helpful Buff statement. The authorities' strong policy response, with six policy packages, helped mitigate the pandemic's negative impact on economic activity and vulnerable households. Nevertheless, the pandemic has taken a heavy economic and human toll, with a high number of deaths. The uneven spread of new variants and low vaccination rate remain concerning. The economic recovery is encouraging and should be bolstered by the successful implementation of fiscal and financial sector reforms.

Medium-term fiscal targets require rigorous efforts. We support the authorities' medium-term fiscal strategy, which entails rebuilding sufficient fiscal space to address investment needs and safeguard fiscal resilience. These objectives can be achieved through stronger revenue mobilization and by strengthening fiscal management tools, in particular, improving revenue administration and enhancing the risk management capacity. In this context, we expect that the new Organic Budget Law will improve the overall fiscal policymaking framework.

The authorities' plan to substantially increase public investments is noteworthy. We agree that boosting long-term growth by addressing high unemployment and increasing private sector participation would help accelerate North Macedonia's convergence to EU income levels on average, and close the per capita gap in public capital stock with the new EU members. However, strengthening the legislative and public investment management frameworks within a more flexible and proactive approach, as well as contingency planning, are crucial to achieve expected objectives and safeguard the economy against potential fiscal risks from the unsuccessful implementation of investment projects. We note that the authorities plan to finance the Growth Acceleration Plan through diversified tools, especially green financing for the green transition. *Could staff elaborate on whether the authorities have a thoroughly assessed financing strategy for these projects and how they will manage fiscal risks in case of inadequate financing? We also wonder staff's own estimation about the planned total investments' impact on GDP growth by 2026.*

Monetary policy should remain focused on the objective of subdued and stable inflation. Considering that food and energy price hikes and an acceleration in the wage bill are fueling inflationary pressures, we agree with staff that the authorities should carefully communicate its evaluation of the main drivers of inflation and stand ready to adjust the monetary policy stance if inflation becomes more persistent. The remaining concerns from the last safeguards assessment of the National Bank of the Republic of North Macedonia (NBRNM) should be addressed to improve the central bank's autonomy. *We would appreciate staff's comments on enhancing the NBRNM's internal audit and risk management functions.*

We welcome that the banking system has remained well-capitalized and profitable owing to the implementation of prudent measures. Loan restructuring and a cleanup of problem assets from the balance sheets, as well as increased bank supervision to detect early signs of distress in the system, would help strengthen the banking sector against financial sector shocks and bolster financial confidence. In this context, unhedged FX lending, heightened euroization in banks' deposits, and rising private sector debt and mortgage lending require close consideration. *Could staff expand on the large share of unhedged FX or FX-linked loans, and assess the progress so far in the denarization strategy to better discern financial sector stability?* To strengthen financial sector stability, we note that a legislative package is expected to be submitted to parliament in 2022. *Could staff comment on the possible risks that could arise from delays in the legislation? We also wonder about staff's comment on the banking sector's stress testing capacity regarding the Fund's ongoing technical assistance.*

With pandemic-induced hardships fading, structural reforms should focus on reinforcing macroeconomic stability. The authorities should prioritize reducing informality to ensure inclusive growth, as well as increasing female and youth labor force participation to limit scarring. The minimum wage should be set, considering labor productivity, to maintain competitiveness. To enhance transparency in the public procurement framework, we call on the authorities to publish the beneficial ownership of pandemic-related spending in line with the state audit office's findings.

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GRAY/22/470

February 10, 2022

**Statement by Ms. Marcussen and Mr. Spurga on Republic of North Macedonia
(Preliminary)
Executive Board Meeting
February 14, 2022**

We thank staff for the informative set of reports and Mr. Dresse and Mr. Tevdovski for the useful Buff statement. We commend the authorities for the timely and strong policy response to the pandemic crisis, supported by the April 2020 RFI disbursement and the SDR allocation. Growth is expected to remain solid this year. However, we note that the long-term economic scarring is likely to be sizeable. Reflecting a higher post-crisis debt stock and only gradually narrowing fiscal deficits, public gross financing needs are set to remain high at around the 15 percent of GDP benchmark in the baseline scenario, limiting fiscal space to counter potential future shocks. Upside risks to inflation are building up, and the ad-hoc 18.5 percent increase in the statutory net minimum wage agreed on February 8 may add to the inflationary pressures. In this context, we broadly share staff's assessment and would like to add the following remarks:

We agree with staff that a credible medium-term fiscal strategy, foreseeing additional tightening and larger cumulative consolidation by 2026, is key to rebuilding buffers and ensuring an appropriately counter-cyclical fiscal stance. The medium-term fiscal consolidation strategy should focus on tax policy and revenue administration measures, given the limited spending reduction opportunities and the high investment needs with regard to both human and physical capital. As environmental taxation is relatively low and below most regional peers and the EU countries, we see sufficient room for the introduction of carbon taxes. We also call on the authorities to reduce the VAT preferential treatments by increasing and unifying the rates to strengthen VAT revenues. We welcome the ongoing discussions on the draft Organic Budget Law, which introduces new numerical rules in line with the EU framework and establishes an independent fiscal council. We agree with staff that the scope

for temporary deviations from the rules should be limited and well specified to bolster the credibility of fiscal policy and ring-fence long-term growth-enhancing expenditures.

The central bank should stand ready to tighten monetary policy should a large and persistent inflation differential with the euro area begin to materialize. We note that real wages continue to outpace trend productivity, core measures suggest that inflation is becoming more broad-based and inflation expectations have shifted upward, while the real interest rate has been decreasing. *Does staff agree with the authorities that high wage growth is not currently driving price setting?*

We take positive note that the regulatory flexibility provided during the pandemic had a large uptake and helped borrowers and banks. Flexibility measures should be phased out in line with the economic recovery. *Can staff elaborate on the status of the regulatory support measures, such as the relaxation of the NPL criteria, and the progress in phasing them out?*

We call on the central bank to maintain carefully calibrated measures to limit FX lending and implement its 2018 denarization strategy. A large share of FX loans remains a key risk. We welcome that the recently introduced more stringent reporting requirements of liquidity risks enable closer monitoring of FX liquidity buffers. *Would staff recommend the authorities to impose a separate minimum liquidity ratio for FX positions?*

An ambitious structural reform agenda is needed to reduce the size of the shadow economy, address the very high rates of youth unemployment, and boost labor productivity that could sustain high wage growth. Policies to support reskilling and retraining of the labor force, strengthen educational outcomes, and increase competition in the product markets are critical.

Transparency and accountability of Covid-19-related emergency spending needs to be ensured, including the disclosure and publication of the beneficial ownership of entities contracting with the government. We also call on the implementation of corrective measures to address irregularities found in the audited pandemic-related contracts.

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GRAY/22/471

February 10, 2022

**Joint Statement by Ms. Kashima, Mr. Mochtar, Mr. Parkyn, Mr. Bautista, Mr. Becker,
and Ms. Ogihara on Republic of North Macedonia
(Preliminary)
Executive Board Meeting
February 14, 2022**

We thank staff for the informative report and Mr. Dresse and Mr. Tevdovski for their insightful buff statement.

We welcome that North Macedonia's economy is recovering supported by the authorities' decisive policy support. However, we note that the high mortality rate and low vaccine coverage are causing additional uncertainty and hindering the recovery. *Could staff elaborate on what hampers the vaccine rollout in North Macedonia?* Further efforts for calibrated policies and enhancing structural reforms are needed to ensure strong recovery and lift potential growth. **As we broadly concur with the thrust of the staff's appraisal and policy advice, we would like to offer the following comments for emphasis.**

Fiscal Policy

We agree with staff on the need for flexible and targeted fiscal policies allowing contingencies in pandemic-related spending needs, while improving the mid-term fiscal position and transparency. We also support staff's view that labor-resource reallocation policies should be focused on as a next step to exit the pandemic, which will provide a degree of economic resilience to current and future COVID-19 outbreaks. In the medium-term, we underscore the importance of fiscal consolidation with realistic assumptions and an appropriate normalization path, where we see different views between the authorities and staff. Also, as we learned from the excellent selected issues paper that more progressivity in the tax system and improving the public revenue office (PRO)'s capacity with modernized IT would support a credible medium-term fiscal plan. Reducing the informal economy is another challenge to tackle for better tax integrity. In addition, we support the staff recommendations on strengthening fiscal transparency and accountability, such as disclosing the beneficial ownership of entities involved in pandemic-related spending. Ensuring the independence of the fiscal council for the framework of the new organic budget law (OBL) would also enhance the efficiency and credibility of policymaking.

Monetary and Financial Policy

We encourage the authorities to closely monitor the financial risks and vulnerabilities, fostering the transition to a more robust financial system. We welcome that monetary policy is sufficiently accommodative and international reserves remain appropriate to support the exchange rate peg. Given the high uncertainty about global financial conditions, the authorities should stay vigilant in monitoring developments and emerging risks. We are also pleased that staff judge the banking system to be well-capitalized and profitable, and concur with staff that assessing and recognizing its problem assets would build stronger confidence. Unhedged FX or FX-linked loans amid slow denarization and rising debt in the private sector might put the financial sector at risk. In this regard, we positively note that the NBRNM will be granted a more formal macroprudential mandate. Also, it is essential to enhance AML/CFT framework and address deficiencies and we encourage timely development for the upcoming MONEYVAL assessment. We welcome the substantive agenda of legislative changes in line with FSAP recommendations and international standards. *Is the IMF involved in CD activities related to the 2018 FSAP recommendations? Can staff also elaborate on the deficiencies identified in the 2020 safeguards assessment regarding the central bank's autonomy?*

Structural Reforms

Improving labor market rigidities and advancing green and digital reforms will be essential to achieve sustainable and inclusive growth. Increase and reallocation of the labor force are urgent tasks, and we support the staff view that reskilling and retraining of the labor force and strengthening education are essential for a transition to a robust post-pandemic economy. Minimum wage increases of 18.5 percent, which has recently been debated, would be disproportionate to weak productivity growth and the authorities should examine the potential negative impact on productivity and inequality, as discussed in Annex III. Also, lack of progress with EU accession may negatively impact future capital inflows and momentum on advancing legislative agenda. In this regard, strengthening the fiscal and financial sector would raise investor confidence. Addressing disparities with the EU regarding the quantity and quality of infrastructure is vital, and we expect that the Growth Acceleration Plan will narrow the gap, with further efforts for good governance. Green and digital transformations also need to be accelerated to catch up to EU peers, and we expect the Fund to provide support on this front.

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GRAY/22/473

February 10, 2022

**Statement by Mr. Buissé, Mr. Roman, and Mr. Albisson on Republic of North Macedonia
(Preliminary)
Executive Board Meeting
February 14, 2022**

We thank staff for their insightful report and Mr. Dresse and Mr. Tevdovski for their helpful Buff Statement. We welcome the recovery underway in North Macedonia, thanks to well-targeted policy responses. We encourage the authorities to increase the vaccination rollout and to continue making timely progress on the implementation of long-standing reforms.

Economic developments and outlook

We welcome the economy's rebound, but risks are tilted to the downside. We welcome the growth forecasts in 2021 and 2022 at 4 percent driven mainly by household consumption and investment. Maintaining supporting policies are recommended to heal the scars from the pandemic and preserve stability, alongside with the rise of the fully vaccinated population, in a context where the country is facing one of the highest mortality rates from Covid-19 in the world. While North Macedonia is facing supply-chain disruptions, rising energy and foods prices, but also geopolitical tensions, the authorities should remain flexible to adapt their strategy in case of a slower than anticipated recovery. Going forward, growth assumptions should remain realistic.

Fiscal policy

We support staff's recommendation to a gradual fiscal consolidation, so as to rebuild fiscal buffers and create space for investment. We encourage the authorities to maintain efforts to broaden revenue mobilization and improve the accountability and transparency in public spending and tax system. A comprehensive tax policy reform, a credible medium-term revenue strategy, and an improved revenue administration are crucial to achieve sustainable growth, as well detailed in the selected issues' paper. Unifying all the revenues and expenses in a single budget will also be key. We encourage the authorities to strengthen direct taxation, especially through the personal income tax reform, and to improve indirect taxation, mostly by reducing the large combination of preferential treatments in the value added tax (reduced rates and exemptions). We also support staff's recommendations to improve property and environmental taxations. *Could staff develop on the authorities' willingness and their schedule to i. implement the OECD's pillar two model rules on large multinational enterprises taxation as well as ii. to introduce carbon taxation?*

Monetary and financial sector policies

Monetary policy should continue to support the recovery, while closely monitoring inflation. We welcome staff's diagnostic that the *de facto* peg has served as an anchor of stability over the past decades. The level of international reserves is appropriate to support the peg, and we note that the banking system is overall well capitalized and profitable. North Macedonia remains nonetheless exposed to FX variations with almost 80% of public debt denominated in foreign currency and most of the bank deposits and credits in euros. NPLs are currently very low, but they could increase after the end of supporting policies, requiring careful monitoring. We therefore support the forthcoming amendments to the financial stability law to grant the NBRNM a more formal macroprudential mandate. We encourage the authorities to modernize the bank resolution framework and strengthen deposit insurance, in line with EU law. We welcome the authorities' commitment to implement the 2018 FSAP recommendations as well as the new bankruptcy law, planned in the first half of 2022.

Structural reforms

Accelerating the structural reforms to improve public governance remains decisive. We encourage the authorities to accelerate the implementation of a comprehensive set of measures to reduce informality, improve SOE's governance, strengthen tax compliance and fight corruption. We also welcome the authorities' intention expressed in the Buff to maintain youth and skilled labor in the domestic labor market and to increase women participation in the labor force. We note the recent agreement announced on net minimum wage: while we are hoping that this reform could reduce poverty among the working population, we share staff's view that wage increases should consider productivity developments to preserve competitiveness and employment. Finally, we encourage the authorities to strengthen their AML-CFT framework, in particular in terms of financial transparency and sanctions' effectiveness.

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GRAY/22/474

February 10, 2022

**Statement by Mr. Zhang and Ms. Zhao on Republic of North Macedonia
(Preliminary)
Executive Board Meeting
February 14, 2022**

We thank staff for the helpful reports and Mr. Dresse and Mr. Tevdovski for their informative Buff statement. We take positive note that the economy is expected to rebound on a solid basis thanks to improved mobility, a return of the diaspora, and the ambitious public investment plan. Going forward, it is essential to implement medium-term fiscal strategy to rebuild buffers and create space for investment, to strengthen macroprudential policy to safeguard the financial system, and to combat informality and support reallocation to achieve a sustainable and inclusive growth. We broadly agree with the staff's appraisal and would like to offer the following points for emphasis.

On the fiscal front, we take positive note that the 2022 budget still emphasized the health and vaccine-related spending but scaled back overall pandemic-related spending. While the overall public debt level is well-managed, we see the need for a gradual fiscal consolidation in the medium term, in line with the counter-cyclical nature of fiscal policy, to build fiscal buffer and create space for investment. The focus should be on the revenue side through tax reforms with an aim to reduce preferential tax treatments and improve revenue collection. On the expenditure side, given the country's lagging capital infrastructure compared to its peers, we welcome the authorities' investment plan to accelerate growth. At the same time, we see the need to improve public financial management and enhance accountability and transparency in public spending. We welcome the planned adoption of the A new Organic Budget Law to enhance the credibility of fiscal policy.

On the monetary and financial front, we take positive note that the international reserves have been replenished thanks to foreign capital inflows, a large Eurobond placement, and the SDR allocation. We note that the rate cuts undertaken during the pandemic have not passed through to market and lending rates, which is understandable given the *de facto* pegged exchange rate regime. We take note of staff's suggestion to tighten monetary policy in case

of persistently high inflation or severe pressures of foreign currency reserves. *Given the de facto peg and the ineffectiveness of monetary policy transmission, could staff elaborate on how effective the policy tightening would be in case these conditions materialize?* On the financial side, it is encouraging that the banking system remains well capitalized and profitable. We welcome the forthcoming amendments to the Financial Stability Law to grant the NBRNM a more formal macroprudential mandate. Meanwhile, we take note of the high external debt from Table 1, and agree with staff that possible unhedged FX loans remain a key risk. *We welcome staff's comments on what should be done to bring down unhedged external debt and further cultivate domestic debt market.* We encourage the authorities to further strengthen macro-prudential policy framework and financial safety net to safeguard the financial system.

On the structural front, it is important for the authorities to pursue structural reforms to support reallocation and raise potential growth. Given the large percentage of informal economy, the government's efforts in reducing the size of the informality is a step in the right direction. We agree with staff that minimum wage increases should be guided by productivity developments. Efforts to increase labor force participation are essential to boost labor productivity and limit the economic scars. We also encourage the authorities to support the green and digital transformation in their public investment and economic policies.

With these remarks, we wish the authorities all the best in these challenging times.

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GRAY/22/477

February 10, 2022

**Statement by Mr. Peter and Mr. Tola on Republic of North Macedonia
(Preliminary)
Executive Board Meeting
February 14, 2022**

The authorities' strong policy response—in conjunction with the Fund support under the Rapid Financing Instrument and the SDR allocation—has cushioned the economic and social impact of the pandemic crisis and set the basis for economic recovery. At the same time, the country is exposed to downside risks stemming from the impact of the omicron wave, tightened global financial conditions, and higher energy prices.

The authorities should be ready to move on a more pronounced fiscal consolidation path, once the impact of the omicron wave abates. Strong revenue performance has helped the authorities lower fiscal deficit but increasing public debt levels and large gross financing needs leave the country vulnerable to a tightening of the global financing conditions. We agree with staff that additional fiscal tightening for the period 2023 to 2026 would ensure that fiscal policy is counter-cyclical and consistent with a to debt-stabilizing primary balance. Measures to increase revenue mobilization and improve public financial management would not only help fiscal consolidation, but they would also create the necessary space to boost capital spending. The integration of public-private partnerships (PPPs) in the Public Investment Management (PIM) framework, as recommended by staff, would help to better manage fiscal risks from PPPs. The expected approval of a new Organic Budget Law is a welcome step toward stronger fiscal policy credibility.

We support staff's call for faster progress in the implementation of the 2018 FSAP recommendations. We note with concern that many of the 2018 FSAP recommendations have not been addressed. Delays in adopting the Bank Resolution Law is particularly worrying, considering the experience with the Eurostandard bank failure. *Could staff comment on the reasons for such delays?* We also call on the authorities to ensure the effective implementation of the new AML/CFT law also in the context of the planned formalization of cryptocurrency trading.

Supply-side reforms are necessary to unlock the economy's growth potential. Staff rightly underscore the importance of structural policies in facilitating economic transformation. It will be important to reduce the reliance of growth on domestic demand and break the trend of negative contributions of net exports to growth. This calls for measures to increase productivity, including by increasing labor force participation and supporting reskilling and retraining. Staff stresses that minimum wage increases should follow productivity developments and caution that a higher minimum wage may lead to more informal employment and hurt competitiveness. However, it could also be argued that the introduction of a higher minimum wage could potentially enhance the attractiveness of formal employments, increase labor force participation, and reduce the dependency on social assistance if accompanied with measures to fight informality. *Staff comments are welcome.*

Investment in digital and green transformation are key to bridging the infrastructure gap with the EU. The authorities' Growth Acceleration Plan is an important step toward improving the efficiency of public investment and upgrading economic and social infrastructure. Boosting human capital is a key element to meeting the objectives. This calls for measures to improve education and address the emigration of youth and skilled labor. The PIM framework could play an important role in aligning policies and procedures, guiding public investment with good practices.

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GRAY/22/481

February 10, 2022

**Statement by Mr. Bhalla and Mr. Natarajan on Republic of North Macedonia
(Preliminary)
Executive Board Meeting
February 14, 2022**

1. We thank the staff for the detailed report and Mr. Dresse and Mr. Tevdovski for the informative Buff. The economic recovery in North Macedonia is expected to continue amidst the omicron uncertainties. Supply chain disruptions have affected the industrial sector and exports. Growth momentum is driven by higher disposable income due to strong remittances and an increase in household consumption and investment. Higher inflation is likely to linger for longer due to an increase in global food and energy prices.

2. The economy is estimated to grow at about 4 percent in 2021 after dipping by around 6 percent in 2020. The economy is witnessing strong domestic demand and growth in public as well as private investment which will help in achieving robust medium-term growth. Scaling up public investment by way of the Growth Acceleration Plan should boost the growth prospects. Strengthening public investment management is essential to enhance the efficiency and productivity of public investment. *Can the staff provide an assessment of private sector investment, particularly foreign direct investment, in the country?*

3. Fiscal policy needs to remain flexible and adapt to the different stages of economic recovery and pandemic dynamics. The broad direction is to have a more targeted approach in the allocation of resources. The medium-term fiscal strategy should aim at gradual fiscal consolidation and create fiscal buffers. We welcome authorities' focus on cutting non-essential costs while ensuring sufficient funds for social transfers. The measures to increase local governments' fiscal capacity and incentivize revenue collections are expected to strengthen the additional revenue.

4. Monetary policy remains accommodative even as the National Bank of the Republic of North Macedonia (NBRNM) is watchful of the developments and potential risks. The banking sector has remained stable helped by adequate capital levels and temporary restrictions. Monitoring and recognizing problem assets will help to keep the balance sheet clean and strong. We encourage the strengthening of the AML/CFT framework and welcome the initiatives in this respect.

5. We recognize the importance of increasing the labor force participation with a focus on women. We encourage policies for reskilling and retraining to facilitate a faster economic transition and welcome the authorities' efforts to strengthen education and internships. Formalizing the huge informal sector will require policies to incentivize more formal sector job opportunities and supportive governance measures.

6. Finally, we wish the authorities success in their endeavors.

**Statement by Rasmus Rueffer (ECB Representative) and Sander Tordo (Advisor) on
North Macedonia – 2021 Article IV Consultation
(Preliminary)**

IMF Executive Board Meeting

14 February 2022

We would like to thank Mr. Dresse and Mr. Tevdovski for their informative Staff statement and Staff for their Report. We would like to highlight the following issues:

We commend the authorities for their forceful and timely policy support that cushioned the crisis impact and provided welcome tailwind for the economic recovery. Coordinated fiscal, monetary and financial sector policies cushioned the adverse impact on people, businesses and the financial sector, and supported economic activities to rebound. There were also notable efforts to increase targeting of the measures over time. After a contraction of 6% in 2020, real GDP grew by 4% in 2021 and is projected to reach its pre-crisis level in 2022. Nevertheless, the new wave of infections amid the still low COVID-19 vaccination rate suggest that continued vigilance is needed. As the economic recovery takes hold, medium-term policies should reorient toward rebuilding policy buffers against future risks.

Turning to fiscal policy, we support Staff’s recommendations for a credible medium-term consolidation plan with lower medium-term deficit targets to rebuild buffers. In the short-term, given the uncertain pandemic evolution and the energy crisis that the authorities declared, fiscal policy should still preserve the flexibility to address contingencies and, at the same time, substantially increase targeting to protect the most vulnerable groups and raise the efficiency of spending. In the medium term, it is important to anchor sustainability and confidence in a credible consolidation path and rebuild buffers that are critical for North Macedonia, a small open economy, to respond to future shocks. As such, the Staff recommendation of a lower deficit of about 1% of GDP has strong merits. In addition, we concur with Staff that concrete revenue measures are essential to support a durable consolidation while advancing the authorities’ developmental objectives. Adopting the new Organic Budget Law, that would make fiscal management consistent with the EU fiscal framework, would also lend credibility to the medium-term plan.

We support Staff’s view that the National Bank of the Republic of North Macedonia (NBRNM) should closely monitor inflation developments, strengthen communication with the public, and stand ready to tighten monetary policies if needed. We note that headline inflation continued to increase in the second half of 2021, accelerating to 4.9% in December despite the price caps on basic food items. Globally, food and energy prices may remain higher for longer. In addition, analysis by IMF Staff showed continued domestic price pressures with potential second-round effects in North Macedonia. Several measures, including the phasing out of the VAT cut on electricity tariffs, suggest that inflation is becoming more broad-based. Inflation expectations have increased significantly and could feed into wage- and price-setting processes. Even though, according to IMF Staff analysis, wage

growth (at 5.6% in November 2021) has outpaced productivity growth, the minimum wage, which is already high relative to regional peers, is scheduled to be increased further (Annex I & III of the Staff Report). These developments require close monitoring so that elevated inflation does not become entrenched. Like Staff, we encourage the NBRNM to improve communication with the public on inflation so as to help shape expectations and minimize second-round effects.

We concur with Staff that while the banking system remains stable, intensified efforts are needed to monitor the high risks and strengthen the financial safety net. While the non-performing loan (NPL) ratio edged up only marginally to 3.5% in September 2021, some delayed effects on asset quality from expired crisis support could still materialize in early 2022. Furthermore, the sharp rise of energy prices could create an additional source of stress on businesses and asset quality that warrants reflection in forward-looking stress tests and close monitoring. Finally, we underscore the priority to accelerate critical financial sector legislations, including the financial stability law and the banking law that provides deposit insurance consistent with the EU law.

To rebuild financial buffers and enhance stability, there is indeed scope for selective tightening of macroprudential measures while improving the macroprudential framework. Credit growth has remained strong at about 8% in 2021, above its pre-crisis level and outpacing the recovery. Mortgage lending and real estate prices have also increased significantly, with a large share of FX mortgage loans potentially being unhedged. These developments suggest that there is scope to introduce borrower-based measures to reduce risks. In addition, given bank's robust capitalization and profitability, consideration could be given to raising capital buffers. Finally, the declining euroization of bank deposits has reversed in recent years, and this could warrant raising risk weights to help reduce FX deposits in line with the authorities' 2018 denarization strategy.

Finally, we also strongly echo Staff's call for preserving the operational independence of NBRNM. This would include Staff's recommendation that supervisory decisions should be taken by the executive part of the NBRNM council instead of the full Council. In addition, protecting the NBRNM's independence in personnel matters would underpin these broader efforts, including by appropriate exclusion from the law on administrative servants and the law on public sector employees.

Republic of North Macedonia—2021 Article IV Consultation

Responses to Technical Questions Posed by Executive Directors in Advance of
EBM/22/15—February 14, 2022 ¹

Outlook / Risks

1. **Could staff elaborate on what hampers the vaccine rollout in North Macedonia?**
2. **We would like to hear more details from staff on whether this is due to lack of financing to buy vaccines, lack of supply from donors or major producers, or any other reason that better explains the situation.**
3. **Can staff clarify on the reasons behind the low rates and what the authorities' vaccination target is for 2022?**

Despite some early setbacks in 2021 due to lack of supply, the main factor behind the current low vaccination rate, which has increased only marginally since end-December, appears to be vaccine hesitancy. This should also be seen in a regional context, with other Balkan countries (e.g., Albania, Bosnia and Herzegovina, Bulgaria, Kosovo) displaying similar if not lower vaccination rates. In addition, according to the authorities, the actual share of vaccinated is somewhat higher when using the (still to be released) results of the recently conducted census, which will result in a lower population size. Staff are not aware of an official target for vaccination coverage, but some official statements refer to an 80 percent coverage as needed to prevent the spread of the virus.

4. **We also wonder staff's own estimation about the planned total investments' impact on GDP growth by 2026.**

Staff are using the framework described in Box 1 and the Selected Issues Paper to assess the growth impact of a scale-up of public investments. However, we are not incorporating the full amount of government projected capital expenditure given historical under-execution of public investments and uncertain investment project maturity, especially for the outer years of the projection horizon, and therefore project a moderate impact on growth. Full implementation of the Growth Acceleration Plan, accompanied by a stronger public investment management framework, could further boost growth.

5. **We take note of the GAP objective to accelerate growth by bolstering public and private sector investment to create jobs, while fostering a fiscal consolidation process to stabilize the public debt. Could staff share their thoughts on the feasibility of achieving these objectives?**

¹ EDs have requested that staff indicate those areas for which responses will be provided during staff's oral intervention at the Board. This avoids the need for EDs to repeat their questions during the discussion.

Staff expect the planned scaling-up of investment to lead to higher growth, see the answer to question 4. This will improve revenue collections. However, staff consider that a fiscal consolidation based on tax policy reform and better revenue administration is needed to bring down the deficit to 1 percent of GDP and place debt firmly on a downward path (see answer to question 9).

6. Does staff agree with the authorities that high wage growth is not currently driving price setting?

The rise in inflation is driven mainly by global factors such as food and energy prices. These two price categories alone make up 50 percent of the CPI basket in North Macedonia.

However, as highlighted in the Staff Report, inflation is becoming more broad-based which is reflected in the rise in core inflation. Staff estimate that inflation on consumer services was 5.3 percent y/y in December 2021. However, this aggregated index, which is less than 20 percent of the weight of the CPI basket, is also impacted by the volatile price dynamics during the pandemic, including higher input costs from energy and food prices for some of the services categories.

Staff see high wage growth as an upside risk to inflation going forward.

7. Can the staff provide an assessment of private sector investment, particularly foreign direct investment, in the country?

Following an immediate partial rebound in total investment, private investment has been lagging through the pandemic. Private investment is one of the main factors behind the substantial economic scarring thus far through the pandemic. Staff estimate that total investment in 2022 on average will be 5 percent below the pre-pandemic level in 2019, and close to 15 percent below pre-pandemic trends. While foreign direct investment is quite volatile in North Macedonia, staff's estimations suggest that it has recovered its pre-pandemic level as a share of GDP in 2021.

Structural Policy

8. Staff stresses that minimum wage increases should follow productivity developments and caution that a higher minimum wage may lead to more informal employment and hurt competitiveness. However, it could also be argued that the introduction of a higher minimum wage could potentially enhance the attractiveness of formal employments, increase labor force participation, and reduce the dependency on social assistance if accompanied with measures to fight informality. Staff comments are welcome.

A higher minimum wage could indeed enhance the attractiveness of formal employment, increase labor force participation, and reduce dependency on social assistance for employees. However, it also provides an incentive for employers to increase informal employment. Staff agree that a rise in the minimum wage should be accompanied by measures to reduce informality.

A main concern is that the statutory minimum wage will reach a high level relative to average wage (60 percent) and the median wage (80 percent), which is becoming increasingly binding on the wage distribution, impacting a larger share of the work force. At this level, a negative effect on employment and competitiveness is a larger risk than when the minimum wage was raised with large ad hoc hikes in the past (2017 and 2019).

Fiscal Policy

9. Assuming the new OBL is approved this year, which is line with the EU framework, which limits an overall fiscal deficit of 3 percent of GDP and public debt is capped at 60 percent of GDP, we wonder how these limits relate to staff's proposal of a fiscal deficit of 1 percent of GDP in a country that requires public investments?

Staff consider that the government should stay clear of the 3 percent deficit ceiling in normal times, which is also in line with the spirit of the EU fiscal framework. A 1 percent of GDP deficit, as recommended by staff for the medium term, would place debt firmly on a downward path, provide scope for countercyclical fiscal policy, and ensure that in a downturn, public investment can be protected, while complying with the deficit and debt limits.

The staff recommendation to move to a 1 percent of GDP fiscal deficit in the medium term is consistent with a scaling-up of investment. The proposed menu of measures (page 16 of the Staff Report) would create space for additional investment in physical and human capital.

10. Could staff develop on the authorities' willingness and their schedule to i. implement the OECD's pillar two model rules on large multinational enterprises taxation as well as ii. to introduce carbon taxation?

North Macedonia is a member of the Inclusive Framework on BEPS. It has joined the Statement establishing a new framework for international tax reform and committed to its implementation. With this commitment, the country has shown its willingness to implement the agreed two-pillar solution. The pillar 2 model rules for domestic implementation of a 15 percent global minimum tax were published at the end of December 2021. The authorities are currently reviewing the model rules and have therefore not yet decided on a specific timeline for implementation, nor have they made any public statement. They intend to request technical assistance from the OECD on all aspects of its implementation.

North Macedonia does not currently impose a dedicated carbon tax, nor does it have an equivalent cap-and-trade system.² However, the authorities are committed to reducing emissions by over 50 percent by 2030 relative to 1990 and have adopted a tax system

² Although it does apply excise duty rates on fuel and an emission based motor vehicle tax that impose a price on some carbon emissions, the cost of these duties in units of CO₂ is too heterogenous across fuels and cars to be considered a formal carbon price.

reform strategy aiming among others at introducing a “green” taxation framework. Recent Fund work has identified capacity development needs related to tax analysis and formulated recommendations which, if implemented, could help design a carbon tax that achieves environmental objectives while at the same time addressing competitiveness and distributional concerns.

11. Could staff elaborate on whether the authorities have a thoroughly assessed financing strategy for these projects and how they will manage fiscal risks in case of inadequate financing?

According to the authorities’ Growth Acceleration Plan, possible financing instruments include development bonds, project bonds, green bonds, public-private partnerships (PPPs), privatization of non-essential public assets, as well as through the use of several state funds and development of more innovative instruments such as fund of funds, venture capital, and crowdfunding. Some of these will be implemented within the existing legal framework while other will require legislative changes, for which the Plan establishes specific timeframes as well as responsible agencies. To mitigate related risks, the authorities should develop a risk management function to minimize the probability that risks materialize, assess their fiscal impact, and better cope with risks which nevertheless materialize. More broadly, the authorities should aim at continued improvement of the public investment management framework.

Financial Sector Policy

12. Can staff elaborate on the status of the regulatory support measures, such as the relaxation of the NPL criteria, and the progress in phasing them out?

All regulatory support measures have been unwound. In particular, the relaxation of the NPL criteria was phased out in September 2020 and the remaining regulatory support measures by March 2021.

13. Would staff recommend the authorities to impose a separate minimum liquidity ratio for FX positions?

The 2018 FSAP recommended to monitor and gradually strengthen banks’ FX liquidity buffers (see Annex VII of the Staff Report).

The Liquidity Coverage Ratio (LCR), implemented from early 2021, introduced more stringent monitoring and reporting requirements for FX liquidity risks, including calculating, monitoring and reporting LCRs by significant currency. However, it does not prescribe a separate minimum liquidity coverage ratio by currency. The NBRNM has stated its readiness to use its regulatory power to limit excessive currency mismatches, if observed, but it does not plan to impose a separate minimum liquidity ratio for FX positions. Staff did not discuss a separate minimum FX liquidity coverage ratio with the NBRNM, and as such are not recommending it at this stage. From a currency risk exposure perspective, the banking system’s FX position is well within the 30 percent of own funds required by law.

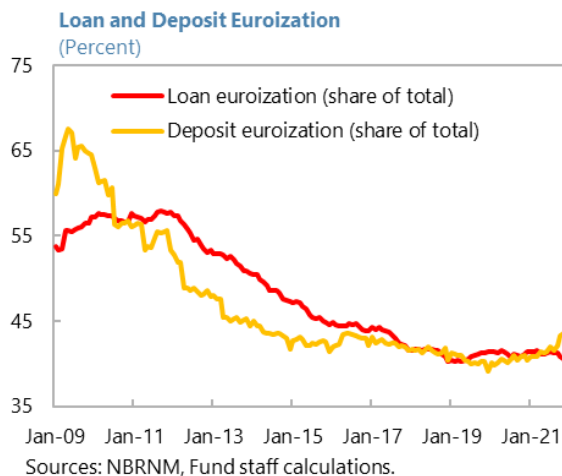
14. Is the IMF involved in CD activities related to the 2018 FSAP recommendations?

The Fund has been and is involved in several CD activities to assist the authorities with progressing with the 2018 FSAP recommendations, related to amendments to the national bank law, central bank governance, emergency liquidity assistance, and stress testing of the banking sector, c.f. Informational Annex. In addition, Fund staff has provided input and comments, in collaboration with the World Bank and other IFIs, to financial sector legislation and financial sector policies, when requested.

15. Could staff expand on the large share of unhedged FX or FX-linked loans, and assess the progress so far in the denarization strategy to better discern financial sector stability?

There has been a decline overall in euroization over the past decade (see chart). However, during the pandemic, the decline stalled, and there has been a small uptick over the past year in deposit euroization.

Staff's concern mainly relates to potentially unhedged FX or FX linked loans to household. The share of FX or FX linked loans out of total loans to households was 43.5 percent by end-September 2021. The coverage ratio of FX or FX-linked loans to FX deposits was close to 60 percent on an aggregate basis. However, pockets of vulnerabilities can exist on a disaggregate basis.



16. We note with concern that many of the 2018 FSAP recommendations have not been addressed. Delays in adopting the Bank Resolution Law is particularly worrying, considering the experience with the Eurostandard bank failure. Could staff comment on the reasons for such delays?

17. To strengthen financial sector stability, we note that a legislative package is expected to be submitted to parliament in 2022. Could staff comment on the possible risks that could arise from delays in the legislation?

The financial legislative package has been delayed, partly due to political and administrative focus on mitigating the impact of the pandemic, in addition to existing political instability.

While staff see no immediate financial stability risks from the delays in finalizing the financial legislative agenda, completing the agenda remains important to modernize the resolution framework and strengthen the financial safety net, and to bolster trust in the system.

18. We also wonder about staff's comment on the banking sector's stress testing capacity regarding the Fund's ongoing technical assistance.

At the request of the NBRNM, the Fund provided during 2021 Capacity Development (CD) to strengthen the framework for stress-testing of banks. The scope of the CD included an assessment of both the top-down (TD) and the bottom-up (BU) stress testing framework of the NBRNM. Since the 2018 FSAP, the NBRNM has made significant progress on developing a TD stress testing framework, while the BU stress testing framework is at an earlier stage of development. The mission made several recommendations to strengthen the stress-testing framework, which may be followed up by additional CD if requested.

Monetary Policy

19. Given the de facto peg and the ineffectiveness of monetary policy transmission, could staff elaborate on how effective the policy tightening would be in case these conditions materialize?

During the pandemic, there has been limited pass-through of policy rate cuts to lending rates. However, there is some evidence that over a longer horizon, policy rate changes are passed on to lending rates. Moreover, the NBRNM has used other tools such as reducing the amount of Central Bank bills, which has boosted liquidity in the system. With respect to the de facto peg, the imperfect capital mobility can also provide the NBRNM with some degree of autonomy. If the NBRNM needs to tighten monetary policy, it could use policy rate hikes (which also have a signaling effect), increase the amount of Central Bank bills and also use reserve requirements.

20. We welcome staff's comments on what should be done to bring down unhedged external debt and further cultivate domestic debt market.

Implementation of the denarization strategy should continue. This strategy includes among others differential reserve requirements for domestic-currency, FX-linked, and FX denominated contracts. The authorities also have a strategy in place to strengthen the domestic debt market, using debt issuances at different maturities across the yield curve, while at the same time being gradual and careful that each issuance has appropriate levels of liquidity. We also note that the authorities are considering a potential issuance of new debt instruments such as inflation-linked bonds or green bonds as part of the financing options for the Growth Acceleration Plan, further diversifying investment opportunities.

Safeguards assessment

21. Can staff also elaborate on the deficiencies identified in the 2020 safeguards assessment regarding the central bank's autonomy?

On the NBRNM's autonomy, the 2020 safeguards assessment found that the existing NBRNM Law is already largely based on Fund advice and broadly in line with international best practices. Even so, a provision subjecting NBRNM staff to the Law on Administrative Servants limits the NBRNM's functional autonomy as it limits its ability to select suitable professionals to fill NBRNM positions. Also, while already good, the dismissal criteria need to be clarified. Finally, the financial autonomy of the NBRNM would benefit from a strengthening of the profit retention provisions in the NBRNM Law. IMF staff have provided CD on these points, as well as a few minor points regarding the NBRNM's governance and mandate. Legislative amendments are underway that will fully address all the issues.

22. The remaining concerns from the last safeguards assessment of the National Bank of the Republic of North Macedonia (NBRNM) should be addressed to improve the central bank's autonomy. We would appreciate staff's comments on enhancing the NBRNM's internal audit and risk management functions.

The 2020 safeguards assessment concluded that the NBRNM's internal audit function was already well established, with adequate capacity to fulfill its mandate. Two areas recommended for improvement related to the proper delineation of the reporting lines of the function and finalizing and implementing the recommendations of an external quality assessment (EQA). Since the safeguards assessment, the internal audit charter has been amended to explicitly provide for the function's dual reporting line: administratively to the Governor and functionally to the Audit Committee. At the same time, the EQA has been concluded with no significant negative findings.

Regarding risk management, the Operational Risk Management (ORM) Policy has been updated and the implementation framework strengthened. A requirement for semi-annual reporting to the ORM Committee and the Council on operational risk issues was introduced and, where necessary, the ORM Committee is required to submit more frequent reports to the Council on significant operational risks exposures. These reporting arrangements aim to ensure that significant unexpected operational risk exposures are signaled to the Council and addressed on a more frequent basis.

CONSTITUENCY CODES

OEDAE

Angola, Botswana, Burundi, Eritrea, Eswatini, Ethiopia, The Gambia, Kenya, Lesotho, Liberia, Malawi, Mozambique, Namibia, Nigeria, Sierra Leone, Somalia, South Africa, South Sudan, Sudan, Tanzania, Uganda, Zambia, and Zimbabwe

OEDAF

Benin, Burkina Faso, Cameroon, Central African Republic, Chad, Comoros, Democratic Republic of Congo, Republic of Congo, Côte d'Ivoire, Djibouti, Equatorial Guinea, Gabon, Guinea, Guinea Bissau, Madagascar, Mali, Mauritania, Mauritius, Niger, Rwanda, São Tomé & Príncipe, Senegal, Togo

OEDAG

Argentina, Bolivia, Chile, Paraguay, Peru, and Uruguay

OEDAP

Australia, Kiribati, Korea, Marshall Islands, Federated States of Micronesia, Mongolia, Nauru, New Zealand, Palau, Papua New Guinea, Samoa, Seychelles, Solomon Islands, Tuvalu, and Vanuatu

OEDBR

Brazil, Cabo Verde, Dominican Republic, Ecuador, Guyana, Haiti, Nicaragua, Panama, Suriname, Timor-Leste, and Trinidad and Tobago

OEDCC

China

OEDCE

Colombia, Costa Rica, El Salvador, Guatemala, Honduras, Mexico, and Spain

OEDCO

Antigua and Barbuda, The Bahamas, Barbados, Belize, Canada, Dominica, Grenada, Ireland, Jamaica, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines

OEDEC

Austria, Belarus, Czech Republic, Hungary, Kosovo, Slovak Republic, Slovenia, and Turkey

OEDFF

France

OEDGR

Germany

OEDIN

Bangladesh, Bhutan, India, and Sri Lanka

OEDIT

Albania, Greece, Italy, Malta, Portugal, and San Marino

OEDJA

Japan

OEDMD

Afghanistan, Algeria, Ghana, Islamic Republic of Iran, Libya, Morocco, Pakistan, and Tunisia

OEDMI

Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Maldives, Oman, Qatar, United Arab Emirates, and Yemen

OEDNE

Andorra, Armenia, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Georgia, Israel, Luxembourg, Moldova, Montenegro, Netherlands, Republic of North Macedonia, Romania, and Ukraine

OEDNO

Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway, and Sweden

OEDRU

Russian Federation and Syrian Arab Republic

OEDSA

Saudi Arabia

OEDST

Brunei Darussalam, Cambodia, Fiji, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Nepal, Philippines, Singapore, Thailand, Tonga, and Vietnam

OEDSZ

Azerbaijan, Kazakhstan, Kyrgyz Republic, Poland, Serbia, Switzerland, Tajikistan, Turkmenistan, and Uzbekistan

OEDUK

United Kingdom

OEDUS

United States