FYR MACEDONIA

Highlights

- **Economic growth in 2016 has slowed amid political uncertainty.** Growth was robust in 2015 but a slow-down has been evident in the first half of 2016. The central bank has raised its key policy rate to counter higher demand for foreign currency.
- **Energy sector reform is lagging.** The EU Energy Community has referred FYR Macedonia for failing to adopt renewable action plans, a requirement under the EU Renewable Energy Directive, as well as for missing deadlines to meet the so-called energy soft measures under the EU's Third Energy Package.
- **FYR Macedonia is hosting a new regional capital market platform.** The SEE Link platform links the stock exchanges from the region and is intended to increase liquidity and improve access for investors and local brokers, by creating a regional infrastructure for trading securities listed on the national bourses.

Key priorities for 2017

- **A re-energising of reforms is needed once the political situation is clarified.** The political crisis in 2016 risks the gains made over the years in terms of macroeconomic stability and investment-friendly reforms. A new national consensus would help reforms get back on track.
- **Fiscal stability should be preserved.** The government's announced intention to keep the fiscal deficit under 3 per cent of GDP is commendable, and efforts to keep to this target should be strengthened in order to gain macroeconomic credibility.
- **Energy sector reforms should be resumed.** Key steps to take in the short term are to reduce cross-subsidies and move further towards cost-reflective tariffs.

Main macroeconomic indicators %

	2012	2013	2014	2015	2016 proj.
GDP growth	-0.5	2.9	3.6	3.8	2.1
Inflation (average)	3.3	2.8	-0.1	-0.2	0.1
Government balance/GDP	-3.8	-3.8	-4.2	-3.5	-4.0
Current account balance/GDP	-3.2	-1.6	-0.8	-1.4	-1.8
Net FDI/GDP [neg. sign = inflows]	-1.7	-2.8	-2.3	-1.9	-1.7
External debt/GDP	69.6	66.1	65.2	68.5	n.a.
Gross reserves/GDP	29.5	25.2	26.5	24.4	n.a.
Credit to private sector/GDP	46.6	46.1	48.4	49.7	n.a.

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Macroeconomic performance

Growth has remained strong in 2015. The robust economic performance of 2014 continued into 2015, as the economy grew by 3.8 per cent, helped by household spending, public investment and a strong export performance, especially of products associated with some of the large foreign investments in the car and car components sector. Inflation stayed negative in 2015, averaging -0.2 per cent. The political crisis in 2016 has had some impact on economic growth, which slowed to 2.1 per cent in the first half of 2016. On 4 May 2016, the central bank raised its key policy rate from 3.25 to 4 per cent due to pressures on the deposit base and higher demand for foreign currency as a consequence of the political situation.

Fiscal policy has loosened in recent years. The central government budget deficit has hovered at around 4 per cent of GDP over the past four years, with current expenditure accounting for 90 per cent of total spending. As a result, public debt, while still relatively moderate by regional standards, has risen by 14 percentage points in the past five years, from 32.0 per cent of GDP in 2011 to 46.5 per cent of GDP by the end of 2015. An amendment to the constitution, proposed in 2015 but not yet adopted, would set the government debt and deficit at 60 per cent and 3 per cent of GDP, respectively. However, in July 2016 the parliament adopted revisions to the 2016 budget raising the deficit target to 3.6 per cent of projected GDP from the previous 3.2 per cent of GDP, while a second supplementary budget in August is expected to bring the deficit close to 4.0 per cent of GDP. In September, the government adopted the budget for 2017, setting the target for the deficit at 3.0 per cent of projected GDP.

FYR Macedonia placed a €450 million seven-year Eurobond in July 2016 with a coupon rate of 5.625 per cent. The funds have ensured that international reserve coverage remains adequate and will be used for financing budget gaps in 2016 and 2017 as well as for repaying maturing debts. This was the second time in the last year that the country tapped international debt markets; in November 2015 it raised €270 million through the sale of a five-year Eurobond at a yield of 5.125 per cent.

Growth is likely to remain limited in the short term. Recent economic trends suggest that growth in 2016 will remain lower than in recent years, at around 2.1 per cent. However, a rebound to 3 per cent is expected in 2017 on the back of robust consumption and investment. However, downside risks have increased as a result of the political crisis, while the sharp increase in public debt in recent years is another source of risk.

Major structural reform developments

EU approximation remains stalled. No progress has occurred in the past year, and prospects of any meaningful dialogue on approximation have been harmed in 2016 by the political crisis in the country. Although FYR Macedonia has been an EU candidate since 2005, the opening of accession talks continues to be blocked by the name dispute with Greece.

Business environment reforms continue to advance. FYR Macedonia continues to score exceptionally well in the World Bank's *Doing Business* report rankings. The country was ranked 10th overall (out of 190 countries) in the 2017 report (published in late October 2016), up from 16th position the previous year. The report noted particular improvements in the ease of getting credit, where FYR Macedonia rose 26 places globally, and in getting electricity (up 15 places). At the same time, the European Commission, in its 2016 assessment of the economic reform programmes of candidate and potential candidate countries, noted that the private sector in FYR Macedonia is still held back by weak access to finance for small and medium-sized enterprises (SMEs), an unpredictable regulatory framework and insufficient law enforcement.

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Energy sector reform is lagging. In February 2016 the EU Energy Community referred FYR Macedonia for failing to adopt renewable action plans, a requirement under the EU Renewable Energy Directive. Also, the Energy Community announced that FYR Macedonia has missed two deadlines to meet the so-called energy soft measures under the Third Energy Package. First, the transmission system operator MEPSO failed to sign an agreement with the Coordinated Auction Office in South East Europe (SEE CAO) on coordinated allocation. However, in June 2016 MEPSO signed an agreement to become a shareholder of SEE CAO. Second, FYR Macedonia failed to amend its energy law to comply with the obligation to grant eligibility to all electricity consumers. Tariffs are not yet cost-reflective and cross-subsidies are still present in the market.

Construction of the first section of the Macedonian gas transportation system was completed in August 2016. This is the 61-kilometre long gas pipeline section Klecovce-Stip in eastern Macedonia, a project worth US$ 75 million. The construction was started in March 2015 by Russian company Stroytransgaz. The construction of the gas pipelines from Skopje to Gostivar via Tetovo (in western Macedonia) and from Stip to Negotino (in eastern Macedonia) is expected to start in the second half of 2016, as part of a national natural gas transportation system.

The SEE Link platform linking the Macedonian, Bulgarian and Croatian stock exchanges has become operational. The platform was unveiled in March 2016 at the annual conference of the Macedonian Stock Exchange in Skopje, when its order-routing system was launched. The system is intended to increase liquidity and improve access for investors and local brokers, by creating a regional infrastructure for trading securities listed on the three bourses. The joint stock company is seated in FYR Macedonia, with the three exchanges holding an equal share in its ownership. The project is envisioned to attract other national stock exchanges from the region and will contribute to the further development of local capital markets.

Financial sector stability has been preserved. The banking sector posted a combined net profit of €75.4 million in 2015, up by 47.3 per cent from the previous year, according to central bank data. The profitability measured by return on assets (RoA) reached 10.4 per cent at the end of 2015 and was the highest rate since 2008. The bulk of the profit was made by the four biggest banks in FYR Macedonia, which account for 80 per cent of total assets. The non-performing loan ratio fell to 7.2 per cent as of June 2016 (after being sticky for the past three to four years at around 10.0 to 11.0 per cent of total loans), reflecting recent measures to write off non-performing loans (NPLs) that are fully provisioned for more than two years. Other financial services such as insurance and leasing remain less developed relative to EU standards.