FYR MACEDONIA

Highlights

- **Economic growth has slowed down.** Recorded growth in 2016 was well below the levels of the previous two years and performance so far in 2017 has been sluggish, but the political crisis has ended, which should help confidence return to the economy.
- **The new government has announced a detailed development plan.** The plan has a strong emphasis on social inclusion and support for local businesses, as well as on regional integration and advancing the country's European Union (EU) and NATO aspirations.
- **Regional transport links are being enhanced.** The southern section of Corridor X is expected to be finished soon, which will help advance the connectivity agenda.

Key priorities for 2018

- **Economic reforms should be accelerated.** The political crisis of the past two years has hampered reforms. Now that the crisis has been resolved, the new government should focus on areas needing attention such as improved fiscal management and measures to enhance social inclusion and reduce unemployment.
- **Measures to promote private sector involvement in infrastructure should be introduced.** In light of the limited fiscal space, the government should revise legislation on concessions and public-private partnerships (PPPs) to encourage private sector involvement in the transport and energy sectors.
- **Greater access to finance for SMEs is needed to encourage local businesses.** Measures that should be on the agenda to improve access to finance include: the revision of factoring legislation, reforms to improve lending in local currency, and the introduction of covered bonds legislation.

Main macroeconomic indicators %

	2013	2014	2015	2016	2017 proj.
GDP growth	2.9	3.6	3.8	2.4	1.5
Inflation (average)	2.8	-0.3	-0.3	-0.2	0.3
Government balance/GDP	-3.8	-4.2	-3.5	-2.6	-3.5
Current account balance/GDP	-1.6	-0.5	-2.1	-3.1	-2.3
Net FDI/GDP [neg. sign = inflows]	-2.8	-2.3	-2.2	-3.6	-2.8
External debt/GDP	66.1	64.9	68.1	70.0	n.a.
Gross reserves/GDP	25.2	26.4	26.4	21.8	n.a.
Credit to private sector/GDP	46.1	48.2	49.9	46.3	n.a.

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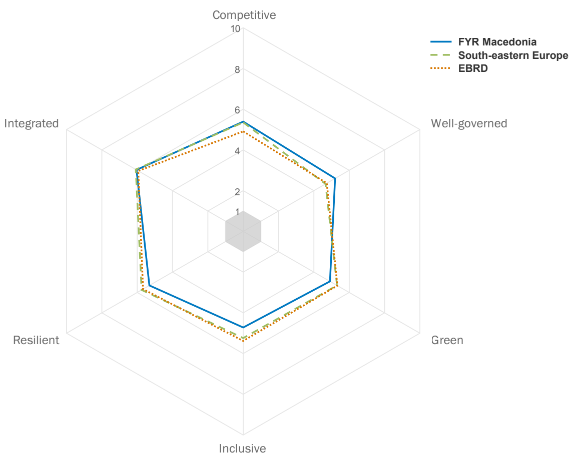
Macroeconomic performance

Growth slowed down in 2016. The robust economic performance of 2014 and 2015, when annual growth was between 3.5 and 4.0 per cent, came to an end in 2016, as the economy grew by just 2.4 per cent. The prolonged political crisis had a measurable negative impact on confidence and thus on economic performance, with a number of construction projects being delayed. The central bank reacted to currency pressures during 2016 by increasing the policy rate to 4.00 per cent, but in February 2017 it cut its long-term rate back to 3.25 per cent. Inflation stayed negative in 2016 for the third year in a row, averaging -0.2 per cent. The economy declined by 0.9 per cent year-on-year in the first half of 2017 as public and private investment levels remained depressed. The resolution of the political crisis and formation of a new government in June 2017 may pave the way for a restoration of confidence.

A slow-down in spending has kept the fiscal balance under control. The fiscal deficit in 2016 was just below 3.0 per cent of GDP, lower than expected. The budget was amended twice in 2016, first in July 2016 raising the planned deficit target to 3.6 per cent of GDP from the previous 3.2 per cent, and the second time in August, raising the expected deficit close to 4.0 per cent of GDP. However, the better-than-expected outcome was driven by a freeze in some spending categories in the period before the parliamentary elections in December 2016. Meanwhile, public debt has been rising steadily from below 30.0 per cent of GDP in 2010 to 46.5 per cent of GDP as of the first quarter of 2017. In August 2017, the parliament approved a 2017 budget revision, planning the budget deficit at 2.9 per cent of GDP, slightly down from the previous 3.0 per cent.

Growth is likely to stay modest in the short term. Both public and private investments have been delayed by uncertainty about the political situation, but short-term prospects are improving. As a result, the 2017 forecast for growth is 1.5 per cent, with a moderate increase to 2.5 per cent growth in 2018 on the assumptions of political stability, the unblocking of further reforms and the arrival of much-needed investments. Downside risks have been mitigated by the improved political situation this year but the country is vulnerable to regional shocks and any resumption of political tensions.

Assessment of transition qualities (1-10)



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Major structural reform developments

The government is advancing reforms in line with EU recommendations. Soon after it took office in June 2017, the government announced a so-called "3-6-9" reform plan. The first part of the plan involves a set of reforms within three months, aimed at advancing reforms in key areas identified by the European Commission as priorities, including in public administration and the judiciary. This three-month package was completed before the October 2017 local elections. The six-month reform package, which should be completed before the December 2017 European Council meeting, aims to convince the EU that the country has improved its position as an EU candidate. The government also plans a third, nine-month reform package, which should be completed before the release of the new European Commission progress report in spring 2018.

The government has presented a development plan for 2017-20. Some of the major development priorities include: (i) acceleration of EU and NATO integrations, including by making institutions more transparent and efficient; (ii) better social protection – by increasing the minimal wage and lowering the poverty rate; (iii) stronger support for local companies – by allowing domestic firms to invest in the country's free industrial zones, which so far have been mostly occupied by foreign investors; and providing a series of employment and other incentives for local firms; (iv) introduction of a more egalitarian tax system; (v) a boost to the country's investments in road and railway infrastructure; and (vi) lower energy imports, by relying on better energy efficiency, and diversifying gas imports by connecting the country to the Trans Adriatic Pipeline (TAP) gas project, as well as to gas connections with Greece and Bulgaria.

FYR Macedonia continues to score exceptionally well in the World Bank's Doing Business report rankings. The country was ranked 11th overall (out of 190 countries) in the World Bank *Doing Business 2018* report, the second-best position among all EBRD countries and far above all other Western Balkans peers. This is one place lower compared with last year. However, corruption perceptions have worsened significantly; according to the latest Transparency International Corruption Perceptions Index, the country is now ranked at 90th position globally (out of 176 countries) compared with 66th in the previous year.

The Energy Community closed a dispute settlement with FYR Macedonia in January 2017. The decision follows successful participation of the country's transmission operator MEPSO in regionally coordinated capacity auctions.

Finalisation of the southern section of the pan-European Corridor X is expected soon. The construction of the Demir Kapija-Smokvica motorway section in the southern part of the country, leading to the Greek border, is expected to be completed by the end of 2017. The pan-European Corridor X runs between central Europe and Greece via Serbia and FYR Macedonia. The project, worth €257 million, is being financed with loans provided by the EBRD and the EIB, and grants from the EU's Instrument for Pre-Accession Assistance funds. It is an important part of FYR Macedonia's integration agenda and should facilitate enhanced cross-border trade.

The new government has cancelled a gasification tender. The tender for the construction of the secondary and tertiary gas network through a PPP valued at around €150 million was called in March 2017 by the previous government. The concession was set for a period of 30 years. However, as only one company submitted documents, the new government has decided to call a fresh tender. With regards to the primary gasification network, so far only the construction of the Klecovce-Stip connection has been completed (August 2016), while works on the Stip-Negotino, Negotino-Bitola and Skopje-Tetovo-Gostivar sections are ongoing. The total investment in the gas network is estimated at €350 million. Around 70 per cent of the gasification process in FYR Macedonia is expected to be completed by 2022.

Non-performing loans have declined to single-digit levels. The non-performing loan (NPL) ratio fell to 6.5 per cent as of June 2017, after stagnating for the past three to four years at around 10.0 to 11.0 per cent of total loans. This reflects recent measures to write off NPLs that are fully provisioned for more than two years. Overall the banking sector is well capitalised, with the capital adequacy ratio at 15.8 per cent.