Statement by Mr. Luc Dresse, Alternate Executive Director for North Macedonia and Mr. Stijn Verhelst, Advisor to Executive Director
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The authorities of the Republic of North Macedonia wish to express their deep appreciation to Ms. Barkbu, Mission Chief, Ms. Eble, Resident Representative, and their teams for the close and constructive engagement under the difficult circumstances created by the severe fallout from Russia's war against Ukraine and the sharp tightening of the global financial conditions. The authorities have requested a 24-month arrangement under the Precautionary and Liquidity Line (PLL) to support their policies to address these shocks and to replenish macroeconomic buffers. The authorities subscribe to the thrust of the staff report and express their strong commitment to sound policies that meet the objectives of the PLL arrangement.

Hit by global external shocks, North Macedonia faces actual and potential balance of payments needs

While North Macedonia was still recovering from the pandemic, external shocks, mainly resulting from Russia's war against Ukraine, put significant pressure on the balance of payments starting in early 2022. Compared to other countries in the Western Balkans, the impact of soaring energy prices and weakening external demand was exacerbated by North Macedonia's heavy dependence on energy imports and its greater trade openness, which amounts to about 140 percent of GDP. In addition, global financial conditions have significantly tightened, with repercussions for North Macedonia.

Against this backdrop, the National Bank of the Republic of North Macedonia (NBRNM) had to intervene in the foreign exchange market to support the de-facto exchange rate peg to the euro, which served as a crucial anchor for 25 years. The foreign exchange reserves level declined in the first quarter of 2022, lowering reserve coverage from 110 percent of the Assessing Reserve Adequacy (ARA) metric at the end-2021 to 90 percent in early April. Foreign reserves recovered during the summer thanks to significant remittances and external government financing. However, with the reserve coverage at about 100 percent of the ARA metric by end-October 2022, additional buffers are needed heading into a season with increased energy import.

A modest recovery is expected by the end of 2023, but the risks are exceptionally large and firmly tilted to the downside. As outlined in Box 3 of the staff report, a further decline in oil and gas supplies from Russia, persistent supply disruptions, and further tightening of global financial conditions, in line with the WEO's October 2022 downside scenario, would eventually add significant pressure on external reserves.

The authorities have requested a PLL arrangement to support macroeconomic stability and help replenish buffers

To address both actual and potential balance of payment needs, North Macedonia is requesting a 24-month PLL, in the amount of 290 percent of quota. The authorities have shown transparency on how they intend to use the PLL. Fully in line with the nature of the PLL instrument, the authorities intend to draw on the first half of the arrangement to meet the short-term actual balance of payment needs due to the recent shocks. They intend to treat the second half of the PLL arrangement as precautionary. The authorities have already started operationalizing their commitments and will make every effort to meet the program requirements, including the structural benchmarks, the indicative targets, and the continuous performance criteria.

Staff's assessment confirms that North Macedonia is eligible for the PLL. The country performs strongly in four of the five qualification areas, namely the external position and market access; monetary policy; financial sector soundness and supervision; and data adequacy. With regard to the remaining qualification criterion –i.e., fiscal policy–, important improvements have been made in recent months, in terms of budgetary efforts and the fiscal framework. The authorities have furthermore been taking steps to lengthen domestic debt maturities to smoothen refinancing needs in the years to come. In addition to these qualification criteria, North Macedonia does not face any circumstances under which the Fund may not approve a PLL arrangement. It furthermore has adequate capacity to repay the Fund and the authorities have a proven track record in meeting their financial obligations.

Staff's positive assessment of the qualification for the PLL is consistent with the Executive Board assessment during the Article IV discussion in February 2022, and the informal Executive Board discussion in April 2022. The assessment demonstrates the country's sound economic fundamentals and institutional policy framework. The authorities will continue to implement sound policies in the future. This showcases North Macedonia's willingness and ability to respect the conditions under the PLL.

The authorities intend to exit the PLL at the current expiry of the arrangement end-2024. The PLL will help the country weather current shocks and allow it to sustain its policy efforts. The authorities are convinced that, by end-2024, the program and the reforms to which they have committed will put the North Macedonian economy in a stronger position. This two-year duration is in line with the duration of their previous PLL in 2011-2013 following the European sovereign debt crisis.

The authorities are confident that the PLL will have a catalytical effect on both private and public financing. In 2022, the authorities obtained EUR 300 million in external financing. The authorities are committed to obtaining at least EUR 800 million in external financing in 2023, of which EUR 450 million will be used to amortize a Eurobond. The European Union has announced that it will provide EUR 80 million in budget support to North Macedonia in early 2023 to assist households and small and medium-sized enterprises to cushion the impact of energy price increases. Discussions about possible Macro-Financial Assistance from the EU are ongoing. The European Bank for

Reconstruction and Development (EBRD) has approved EUR 100 million in support for North Macedonia's electricity-producing company, which is subject to parliamentary approval. The authorities are in discussions with the World Bank to receive Development Policy Operation support.

The authorities have implemented appropriate policy actions to address the shocks

Prudent fiscal policy has safeguarded the soundness of public finances. In July of this year, the authorities adopted a supplemental budget for 2022 to address the multiple shocks. The revised budget includes measures to support low-income households and help build food reserves. The additional spending has been partly offset by higher revenue and lower capital spending. The adjustments in spending and revenue have limited the increase in deficit to below earlier projections by staff, despite the challenging macroeconomic environment.

The NBRNM acted decisively to address inflation pressures and will continue doing so going forward. Since the last quarter of 2021, the NBRNM started tightening its monetary policy stance by prudently managing the liquidity of the banking system through foreign exchange interventions and other central bank instruments. In 2022, it adjusted the required reserve instrument on three occasions, enabling the differentiation of forex and domestic currency reserve requirements. Since April 2022, the NBRNM increased the main policy rate seven times by 300 basis points in total, resulting in a widening of spread compared with the ECB. The latest policy rate increase took place in the week of November 14. The NBRNM will continue to carefully monitor incoming macroeconomic data and stands ready to continue undertaking all necessary measures to maintain exchange rate and price stability.

The authorities are strongly committed to policy actions supporting the Fund arrangement

The authorities' actions will focus on safeguarding public finances, ensuring sound public investments, improving energy policies, tackling high inflation, and buttressing financial stability. Besides underpinning the PLL, the actions will lay the groundwork for sustainable long-term growth following the current shocks.

The authorities commit to reducing the budget deficit over the coming years. The budget deficit will be reduced to 4.6% of GDP in 2023, followed by a further reduction to 3.4% of GDP in 2024. Fiscal consolidation will be achieved through both revenue and expenditure measures. On the revenue side, the authorities are committed to a tax reform that will strengthen revenue mobilization. The tax code will be simplified by streamlining preferential treatments and exemptions, which will generate additional revenue. On the expenditure side, subsidies will continue to become more targeted. The authorities will publish an action plan to gradually eliminate electricity subsidies by end- February 2023 (structural benchmark) and commit to eliminating untargeted energy subsidies by 2025. The

authorities will furthermore avoid any broad-based permanent public sector wage increases in 2023 beyond the minimum wage adjustments.

The authorities have taken actions to structurally safeguard public finances. Beyond measures to reduce the deficit in the coming years, the authorities have also adopted an Organic Budget Law in September 2022. The Law provides for a strong medium-term fiscal framework, including limits to deficit and debt levels similar to those in EU Treaties. In addition, the Law introduces significant improvements to budget preparation and execution, as well as to fiscal reporting. A fiscal council has been tasked with assessing the government's macroeconomic and budgetary projections, as well as monitoring adherence to the rules in the Organic Budget Law.

The authorities' prudent fiscal policymaking will go hand in hand with a well-targeted increase in public investments. The scaling-up of investments will be done in close coordination with the IMF to ensure full adherence to the program's fiscal objectives. Part of the investments will go to the Corridor 8/10d road project, which will increase the interconnectedness of North Macedonia with its neighboring countries. To reap the long-term benefits of this investment, the authorities will be mindful of its medium-term fiscal impact and commissioned a comprehensive feasibility study of the road project (structural benchmark). The feasibility study will be available by end-January 2023 at the latest. It will be shared and discussed in detail with IMF staff.

The authorities are committed to preserving central bank independence. In particular, following up on the recommendations of the 2020 Safeguards Assessment, steps will be taken to ensure that the NBRNM has the autonomy to determine the employment conditions of its staff, through amendments to the relevant legislation. The authorities also welcome the safeguards assessment performed as part of the country's requested PLL arrangement. They stand ready to act upon recommendations that emerge from this assessment.

Financial sector legislation is further strengthened. In addition to the introduction of a counter- cyclical capital buffer by August 2023, the authorities are expanding oversight by adopting a formal macroprudential mandate for the NBRNM. Legal work is also ongoing to strengthen deposit insurance and bank resolution frameworks. These legal changes are inspired by EU legislation. In November 2021, the European Commission determined that the supervisory and regulatory framework of North Macedonia could be regarded as equivalent to that applied in the EU. The AML/CFT framework has been improved through legal changes in June 2022. A MONEYVAL assessment of the AML/CFT framework is scheduled to be finalized in 2023. The authorities look forward to the final report and will act swiftly on any recommendations that may emerge.

Structural reforms to boost long-term growth remain high on the authorities' agenda. Efforts will be made to strengthen education and active labor market policies. Minimum wage increases will take into account productivity levels and trends. In view of EU accession negotiations, additional economic reforms will be carried out in the period ahead.

Conclusion and next steps

Throughout the negotiation process towards the PLL staff-level agreement, in-depth, transparent, and candid discussions have greatly deepened the engagement between authorities and staff. This has been instrumental to the many policy actions taken in recent months and fed the strong commitment of all stakeholders to the success of the arrangement.

The authorities are cognizant of the downside risks that the country continues to face. Assistance from the IMF and others will help them steer through the multitude of crises. The authorities have prepared contingency measures in case serious downside risks would nonetheless materialize, including through possible expenditure or revenue measures.

The authorities have shown an interest in an arrangement under the IMF's Resilience and Sustainability Facility (RSF). The RSF would assist North Macedonia in its actions against climate change. They look forward to fruitful interactions with staff to explore the RSF arrangement. The authorities' ongoing work on better targeting energy subsidies and improving energy efficiency will be a useful element in their exchanges with staff.

The start of EU accession negotiations in July 2022 has given the authorities a clear policy objective for the years to come. Together with their partners, they will continue to reform and strengthen their economy over the coming years. The PLL, coupled with the Fund's surveillance and technical assistance, provides valuable support for the authorities in their journey towards EU membership.