30. NORTH MACEDONIA

Domestic demand, even though supported by government measures, remains muted also after the lifting of containment measures. A sharp drop in remittances impacts adversely on household spending. There are timid signs that external demand is recovering, and growth of private consumption and investment is projected to return in the fourth quarter. Driven by domestic demand, a full recovery to pre-COVID levels is likely to take until 2022. The fiscal deficit, widening markedly in 2020, is set to narrow gradually again in 2021 and 2022, as growth returns and crisis-related transfers are scaled back.

Severe economic contraction in 2020

With strict containment measures in place in North Macedonia and trade partner economies, output contracted in the second quarter by 12.7%, after slight growth of 0.2% in the first three months. Private consumption dropped by 5.2% in the first half of the year. Household income was hit by a steep drop in remittances, while wages continued to increase strongly, propelled by government wage subsidies. Investment tumbled by some 13% in the first half of the year. The government adopted four sets of measures, totalling some 9% of expected full-year GDP, with implementation extending into 2021. Still, the economy will likely contract this year by more than projected in spring.

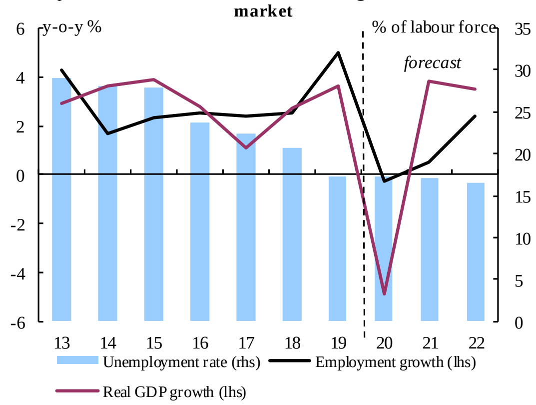
Recovery to remain incomplete in 2021

There are cautious signals that domestic economic activity is picking up. Supported by central bank measures, lending to the private sector remained buoyant. On the external side, production of automotive supplies strengthened, in line with developments in the German economy, which is destination for almost half of North Macedonia's exports. The recovery will rely largely on strengthening domestic demand and is likely to remain incomplete until 2022, as uncertainty about the course of the pandemic and related containment measures is restraining household spending, in spite of robust employment prospects and a quick recovery of remittances, and delaying some private investment at least in 2021.

Firming domestic demand drives trade deficit

In 2020, the current account is set to deteriorate markedly as the expected improvement in the trade balance is likely to underperform the decline in remittances. This picture is likely to be reversed in 2021 and 2022, when the resumption of domestic demand is forecast to heavily drive import growth. The foreign balance is projected to detract from growth in 2021 and 2022.

Graph II.30.1: **North Macedonia - Real GDP growth and labour market**



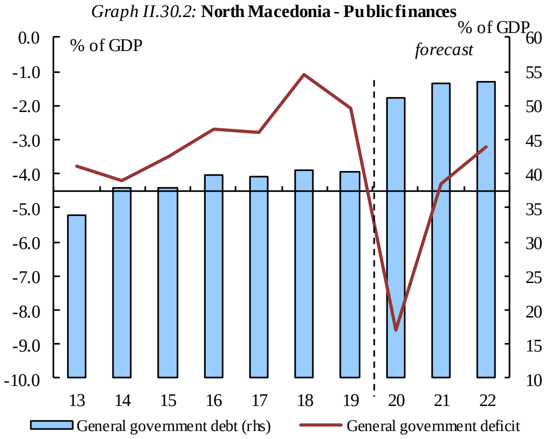
Impact on labour market to remain mild

After strong employment growth in 2019, the labour market held up well so far. The drop in employment was only small in the second quarter, as established foreign copanies, in particular, have kept their skilled workers on the payroll. Given substantial government support to employment, crisis-induced job losses are likely to remain mild in the second half of the year. A gradual resumption of employment growth is projected for 2021 and 2022, in line with the economic recovery. As discouraged workers drop out of the labour market, the labour force is set to decline this year, and the unemployment rate is forecast to remain stable, supported by growth and statutory active employment measures.

Some pressure on consumer prices arises

Rising food and electricity prices, along with a hike in excises on oil products partially offsetting the lower oil prices, have compensated for a decline in commodities and transport prices in the year to September. In the following two years, firming domestic demand will generate upward pressure on prices, while the impact of the excise tax rise would diminish next summer. Altogether, inflation is likely to remain muted.

Graph II.30.2: **North Macedonia - Public finances**



Crisis causes delay in debt stabilisation

The shortfall in public revenue was more benign in the first half of the year than anticipated in spring. Still, revenue declined by 8% y-o-y. A second budget revision in October sets a higher deficit than originally planned, to accommodate spending for the fourth package of anti-crisis measures, worth EUR 470 million. Due to the decline in economic activity and of the fiscal impact of crisis measures, the deficit is set to widen in 2020 by more than projected in spring, before narrowing thereafter due to a growth-induced rise in revenue and the phasing out of crisis-related transfers. To cover the budget financing needs in 2020, and partially in 2021, the government obtained a EUR 176 million credit line from the IMF, and macro-financial assistance from the EU of EUR 160 million, in addition to issueing a EUR 700 million Eurobond issued in May. As a result, general government debt is likely to exceed 50% of GDP this year and is forecast to increase further in 2021 and 2022, driven by still sizeable budget deficits. The stabilisation of the debt ratio, originally envisaged to set in post-2021, will be delayed.

Risks to the forecast are on the downside

Given the importance of remittances for household income, more muted transfers in 2021 and 2022 would possibly impact negatively on private consumption spending. On the external side, risks arise from potentially bleaker prospects for the car industry in Germany. On the other hand, swift implementation of reforms to improve public revenue mobilisation and of a medium-term expenditure framework might improve public finances above projection.

Table II.30.1:

Main features of country forecast - NORTH MACEDONIA

	2019		Annual percentage change						
bn MKD	Curr. prices	% GDP	01-16	2017	2018	2019	2020	2021	2022
GDP	697.5	100.0	2.8	1.1	2.7	3.6	**-4.9**	**3.8**	**3.5**
Private Consumption	451.9	64.8	2.6	2.1	3.7	3.5	**-4.3**	**4.5**	**4.7**
Public Consumption	104.6	15.0	1.2	-2.6	2.0	4.4	**3.3**	**2.9**	**3.1**
Gross fixed capital formation	144.0	20.6	5.4	-3.8	-12.8	6.6	**-12.0**	**12.7**	**13.2**
of which: equipment	-	-	-	-	-	-	**-**	**-**	**-**
Exports (goods and services)	430.3	61.7	6.0	8.3	15.6	8.3	**-15.5**	**15.3**	**12.0**
Imports (goods and services)	527.3	75.6	6.2	5.2	9.1	9.0	**-12.5**	**14.9**	**13.1**
GNI (GDP deflator)	666.6	95.6	2.7	1.1	2.4	3.3	**-4.9**	**3.8**	**3.5**
Contribution to GDP growth: Domestic demand			3.5	0.1	-0.1	4.3	**-4.8**	**5.8**	**6.2**
Inventories			0.5	0.2	0.5	0.8	**0.0**	**0.0**	**0.0**
Net exports			-1.2	0.8	2.3	-1.5	**-0.1**	**-2.0**	**-2.8**
Employment			1.8	2.4	2.5	5.0	**-0.3**	**0.5**	**2.4**
Unemployment rate (a)			32.0	22.4	20.7	17.3	**17.3**	**17.1**	**16.6**
Compensation of employees / head			2.4	1.0	5.0	3.0	**6.7**	**4.0**	**2.2**
Unit labour costs whole economy			1.4	2.3	4.8	4.4	**11.9**	**0.7**	**1.2**
Real unit labour cost			-1.2	-0.5	1.1	2.0	**12.6**	**-0.2**	**-1.0**
Saving rate of households (b)			-	-	-	-	**-**	**-**	**-**
GDP deflator			2.7	2.8	3.7	2.3	**-0.7**	**0.9**	**2.1**
Consumer-price index			-	1.4	1.5	0.8	**0.9**	**1.2**	**1.5**
Terms of trade goods			1.1	-0.1	0.1	-0.3	**-0.2**	**0.8**	**1.8**
Trade balance (goods) (c)			-22.4	-17.8	-16.2	-17.0	**-16.7**	**-17.4**	**-17.6**
Current-account balance (c)			-4.5	-1.0	-0.1	-3.3	**-4.2**	**-3.9**	**-3.8**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-	-	-	-	**-**	**-**	**-**
General government balance (c)			-	-2.8	-1.1	-2.1	**-8.6**	**-4.5**	**-3.2**
Cyclically-adjusted budget balance (d)			-	-	-	-	**-**	**-**	**-**
Structural budget balance (d)			-	-	-	-	**-**	**-**	**-**
General government gross debt (c)			32.9	39.4	40.6	40.2	**51.1**	**53.2**	**53.6**

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.