

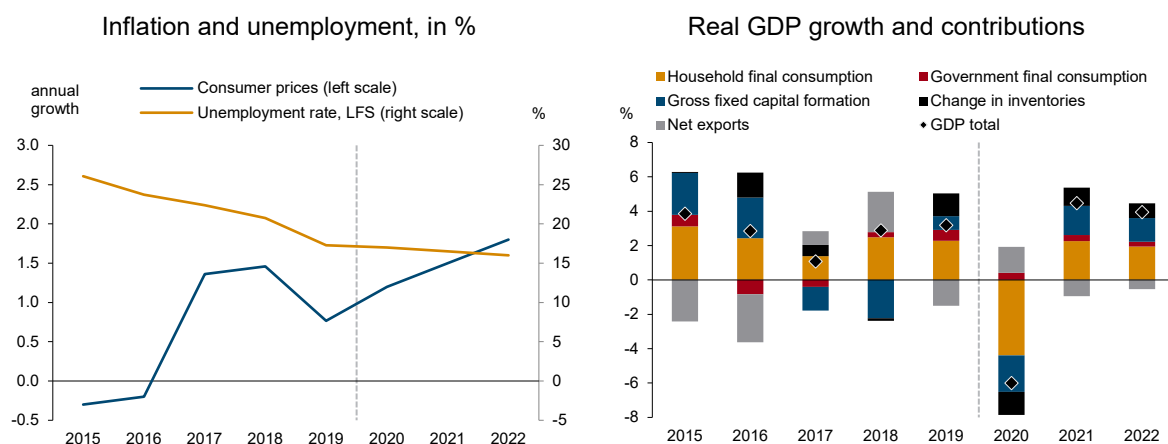


NORTH MACEDONIA: Pandemic mishandling and inadequate fiscal support take toll on the economy

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Since May, North Macedonia has failed to contain the pandemic. The government has also not provided adequate fiscal support to the economy. That led to a decline in GDP in Q2 of 12.7% year on year, which was greater than expected. We are thus downgrading our GDP forecast for 2020 from -5% to -6%. Prospects for the future depend crucially on the government's fiscal support and on management of the health aspects of the pandemic.

Figure 4.15 / North Macedonia: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

North Macedonia mishandled the pandemic. Following the gradual and timely restrictions of March and April, which kept the number of COVID-19 cases among the lowest in Europe, the government started reopening the economy too early, ahead of the July parliamentary elections. As a result, the country never saw an end to the first wave of the pandemic, and since May the number of new and fatal cases has consistently been among the highest in Europe.

This, accompanied by the inadequate fiscal support, caused GDP in Q2 to decline by 12.7% year on year (y-o-y). The large number of cases created uncertainty and pessimism in society and caused households and companies to refrain from spending. Household final consumption declined by 11.6% y-o-y in Q2, while gross capital formation (which also includes changes in inventories) fell even more – by 25.6%. At the same time, the actual support that the government provided to the economy was very modest. Government consumption grew by only 1.5% y-o-y in Q2, and total general government spending in Q2 amounted to 39.7% of GDP (much lower than in other countries), which was clearly inadequate.

The weak fiscal support was not because of limited fiscal space, but because of poor enactment and targeting of the stimulus packages. The government adopted three stimulus packages in Q2, worth in total EUR 550 million (5% of GDP). The structure of the packages was similar to that in other countries – tax exemptions, debt moratoria, cheap credits, credit guarantees, and various direct subsidies to firms and households, the biggest one being the minimum wage per worker, for firms affected by the crisis, for a duration of three months. To finance these packages, the country borrowed heavily, issuing a Eurobond and taking loans from the IMF, the World Bank and the European Commission of more than EUR 1 billion in total (approximately 10% of GDP). This raised the public debt to 59.5% of GDP at the end of Q2, from 48.9% at the end of 2019, but provided money to support the economy during the crisis. Still, implementation of the stimulus packages was dismal, and only around EUR 200 million, or 36% of the amount announced, was actually spent.

Despite the sizeable decline in economic activity, the labour market did not fare too badly in Q2. Employment declined by 2.2%, compared to Q1. Most of the people affected became inactive, due to the pandemic and the government subsidies, and so the rate of unemployment increased by only 0.5 percentage points, to 16.7%. The y-o-y growth of net wages for the first six months of 2020 averaged 7.3% in real terms, driven by an increase in the minimum wage and public sector wages that dated from before the pandemic.

Inflation remains low, despite the modest increase in recent months. It averaged 0.9% for the first nine months of the year, although it did reach 1.9% in September. Apart from the wage increase, two main factors have led to this rise – a hike in the fuel excise duty from April and a jump in the cost of electricity from August. We still expect inflation to remain at below 2% in the coming years.

Monetary policy was supportive during the crisis. The central bank reduced its main rate twice, in March and May, by 50 basis points (bps) in total, to 1.5%. This is the lowest level in history. Commercial banks followed suit and lowered their interest rates, both on deposits and on loans, by approximately 15 bps. Total credits grew by 6.6% y-o-y at the end of Q2, more than the central bank projection of 4.3%, which implies that the easing of the monetary policy has probably had an effect. There are no signs that the rate will increase, and we expect it to stay at the current level until the end of 2021. The central bank also initiated two rounds of debt moratoria, which have likely supported needy companies and households.

The current account deficit widened to 4.6% of GDP in the first half of the year, from 3.3% in 2019. This was driven by remittances, which are very important for the country and which declined by 21% y-o-y in the first six months, due to the pandemic. At the same time, the trade balance improved, as the decline in exports of goods of 22.5% was offset by a decline in imports of 17%. Foreign direct investment inflows in the first half of the year amounted to EUR 205 million, which is slightly worse than last year's EUR 423 million for the whole year.

Data for Q3 indicate that economic activity remains anaemic and that the recovery will be very sluggish. Industrial production in July and August remains 9% lower than in the same period of 2019. Retail trade in July was still 10% below the July level last year. Preliminary data from the Employment Agency suggest that unemployment may increase in Q3 even more than in Q2, as the government's protective measures have expired. New claims for unemployment benefits in July and August were 2% of the total number of employed persons, which is close to the figure for Q2.

The fourth stimulus package adopted at the end of September seems unlikely to bring any substantial change. It is very similar, both in nature and in size (EUR 470 million), to the previous three. Given the poor implementation of the first three packages, and considering the limited time until the end of the year, we do not foresee that it will provide the support needed.

Meanwhile, the number of COVID-19 cases started growing again in October and for the first time in several months the government announced new restrictions. The restrictions announced by mid-October are still mild and closures like those from March and April seem unlikely; the economy is not expected to suffer terribly from them. The bigger question is whether they will prevent a fresh upsurge in COVID-19 cases. Recalling the failure in April-May, and taking into account that public support for restrictions is now much weaker than in spring, we doubt whether the new restrictions will prove successful.

Overall, the economic prospects for North Macedonia over the coming months seem pretty gloomy. The inappropriate management of the health aspects of the crisis and the weak fiscal support are taking their toll on the economy. We are thus downgrading our GDP forecast for 2020 from -5% to -6%. Due to the bigger drop in 2020, we are revising our forecast for 2021 upwards, from +4% to +4.5%.

Table 4.15 / North Macedonia: Selected economic indicators

	2017	2018	2019 ¹⁾	2020 1Q	2020 2Q	2020 1-2Q	2020 Forecast	2021 Forecast	2022
Population, th pers., average	2,075	2,076	2,077	.	.	.	2,100	2,100	2,100
Gross domestic product, MKD bn, nom.	618.1	660.9	689.4	165.7	149.8	315.5	656	696	737
annual change in % (real)	1.1	2.9	3.2	0.2	-12.7	-6.4	-6.0	4.5	4.0
GDP/capita (EUR at PPP)	10,690	11,350	11,830	.	.	.	.	.	.
Consumption of households, MKD bn, nom.	405.9	428.8	446.0	104.6	105.7	210.3	.	.	.
annual change in % (real)	2.1	3.8	3.5	1.2	-11.6	-5.6	-6.8	3.5	3.0
Gross fixed capital form., MKD bn, nom.	139.0	132.4	146.1	.	.	.	.	.	.
annual change in % (real)	-5.7	-9.9	4.0	.	.	.	-10.0	8.0	6.5
Gross industrial production ²⁾									
annual change in % (real)	0.2	5.4	3.7	-3.7	-25.0	-14.6	-10.0	8.0	6.0
Gross agricultural production ³⁾									
annual change in % (real)	-9.9	10.0	4.0	.	.	.	.	.	.
Construction industry									
annual change in % (real)	-27.2	-6.8	3.8	6.3	-5.1	-0.7	.	.	.
Employed persons, LFS, th, average	740.6	759.1	797.7	811.1	793.4	802.3	780	800	810
annual change in %	2.4	2.5	5.1	2.7	-0.1	1.3	-2.5	2.0	1.5
Unemployed persons, LFS, th, average	213.6	198.6	166.4	156.6	159.6	158.1	160	160	150
Unemployment rate, LFS, in %, average	22.4	20.7	17.3	16.2	16.8	16.5	17	16.5	16.0
Reg. unemployment rate, in %, eop	20.1	19.3	19.6	20.1	22.4	22.4	.	.	.
Average monthly gross wages, MKD	33,688	35,626	37,446	40,371	39,357	39,864	40,900	42,800	44,900
annual change in % (real, gross)	1.2	4.2	4.3	10.7	5.2	7.9	8.0	3.0	3.0
Average monthly net wages, MKD	22,928	24,276	25,213	27,056	26,362	26,709	27,400	28,600	30,000
annual change in % (real, net)	1.2	4.4	3.1	10.0	4.6	7.3	7.5	3.0	3.0
Consumer prices, % p.a.	1.4	1.5	0.8	0.6	0.5	0.5	1.2	1.5	1.8
Producer prices in industry, % p.a.	4.8	0.9	2.1	2.0	-0.1	0.9	1.0	1.3	1.6
General governm. budget, nat.def., % of GDP									
Revenues	31.0	30.4	31.5	28.1	27.3	27.7	28.0	28.5	29.0
Expenditures	33.8	31.5	33.7	32.5	39.7	35.9	37.0	34.0	33.0
Deficit (-) / surplus (+)	-2.8	-1.1	-2.2	-4.5	-12.4	-8.2	-9.0	-5.5	-4.0
General gov.gross debt, nat.def., % of GDP	39.4	40.4	40.6	41.8	50.7	50.7	52.0	55.0	58.0
Stock of loans of non-fin.private sector, % p.a.	5.4	7.2	6.1	5.9	6.7	6.7	.	.	.
Non-performing loans (NPL), in %, eop	6.2	5.1	4.6	4.8	4.6	4.6	.	.	.
Central bank policy rate, %, p.a., eop ⁴⁾	3.25	2.50	2.25	2.00	1.50	1.50	1.50	1.50	2.50
Current account, EUR mn	-105	-7	-372	-149	-86	-235	-550	-510	-440
Current account, % of GDP	-1.0	-0.1	-3.3	-5.5	-3.5	-4.6	-5.2	-4.5	-3.7
Exports of goods, BOP, EUR mn	4,075	4,883	5,323	1,131	876	2,007	4,390	4,980	5,580
annual change in %	15.4	19.8	9.0	-9.2	-34.8	-22.5	-17.5	13.5	12.0
Imports of goods, BOP, EUR mn	5,862	6,619	7,293	1,679	1,232	2,911	6,130	6,900	7,660
annual change in %	9.7	12.9	10.2	-2.4	-31.1	-17.0	-16.0	12.5	11.0
Exports of services, BOP, EUR mn	1,434	1,580	1,635	383	295	678	1,350	1,530	1,710
annual change in %	3.2	10.2	3.4	1.3	-17.0	-7.5	-17.5	13.5	12.0
Imports of services, BOP, EUR mn	1,060	1,209	1,285	216	188	404	1,080	1,220	1,350
annual change in %	1.0	14.1	6.2	-21.7	-27.2	-24.3	-16.0	12.5	11.0
FDI liabilities, EUR mn	351	539	488	233	-28	205	400	.	.
FDI assets, EUR mn	171	-65	125	106	-13	93	150	.	.
Gross reserves of NB excl. gold, EUR mn	2,097	2,619	2,961	2,695	3,292	3,292	.	.	.
Gross external debt, EUR mn	7,372	7,844	8,154	8,310	8,782	8,782	8,900	9,800	10,800
Gross external debt, % of GDP	73.4	73.0	72.7	78.4	82.8	82.6	84.0	87.0	90.0
Average exchange rate MKD/EUR	61.57	61.51	61.50	61.6	61.7	61.7	61.7	61.7	61.7

1) Preliminary. - 2) Enterprises with 10 and more employees. - 3) wiiw estimate in 2019. - 4) Central Bank bills (28-days).

Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.