

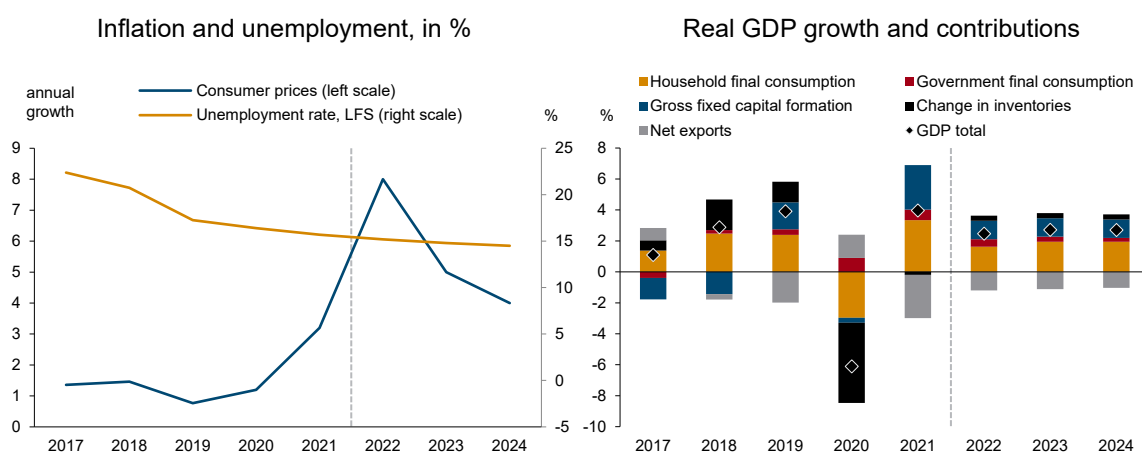


NORTH MACEDONIA: Too fragile for so many shocks

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The country has not yet recovered from the pandemic shock, and now the energy crisis and the war in Ukraine are rubbing salt into its wounds. The economic prospects appear gloomy, with weak growth and elevated inflation. We are revising our GDP projection for 2022 downwards, to 2.5% (from 3.5%); meanwhile, we expect inflation to be higher, at around 8% (from 3.5%).

Figure 4.15 / North Macedonia: Main macroeconomic indicators



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

North Macedonia is one of the few Eastern European economies not to have recovered yet from the pandemic downturn. GDP fell by 6.1% in 2020 and bounced back by just 4% in 2021, meaning that the country is still below its pre-pandemic income level. One of the reasons for this is certainly the inappropriate fiscal support provided by the government: it was poorly targeted and did not reach those who were most affected by the pandemic, but was instead snatched up by the high-profit companies. The bleak results are also due to certain objective factors: the problems faced by the automotive industry globally have also affected the North Macedonian automotive sector.

The situation has been further aggravated by the energy crisis, which struck at the end of 2021.

The country had not invested in the energy sector for decades, so that its current level of electricity generation is below the levels seen in Yugoslav times. This has made it heavily dependent on imports, with 63% of its total energy needs coming from abroad (the highest figure in the Western Balkan region). When global electricity prices soared at the end of 2021, North Macedonia found itself in deep trouble. The government cobbled together a plan that consisted of restarting some old coal-fired plants, spending public money on supporting the energy companies (including private ones) and raising the price of electricity. It managed to avoid power cuts, but its fiscal space was eroded.

The rise in the cost of electricity added to the already growing inflation, pushing it to its highest level in 15 years. Annual inflation in March reached 8.8%, and there is no indication that it will slow down any time soon. The government tried to tame it by introducing price controls; but they turned into a textbook example of how *not* to use price controls. First, the prices of basic foodstuffs were frozen in December 2021; but then, just three months later, in March 2022, the emphasis switched to limiting companies' profit margins. This change in strategy resulted in food shortages and panic buying, as both people and firms knew that prices would rise following the switch. To cushion the jump in prices, the government decided to reduce taxes (VAT, excise duties and import tariffs) on food and energy products; but this does not seem to have proved too effective – between February and March, food prices rose by 2.3%, fuel prices by 6.1% and the overall price level by 1.6%.

The negative effects of inflation on the economy are already visible. Purchasing power has been eroded, and average real wages in the country in January were 0.6% lower than a year before. Retail trade (excluding fuel) in January and February saw real growth of just 0.8% year on year, whereas just a few months earlier, in September 2021, it had been growing at a rate of 10.9%. Business sentiment in manufacturing in February 2022 was at its lowest ebb since January 2021, when the country was in the grip of the pandemic. This comes despite the fact that industrial production in January and February 2022 grew by 3.6% year on year.

The war in Ukraine will add to these woes, primarily through the higher price of energy and food. The unavailability of data makes it hard to gauge the effects, but the March price hike, which came despite the reduction in taxes, suggests that prices will continue to rise, eating into real incomes, reducing household consumption and slashing business investment. In addition to the inflation channel, the trade channel may also play a role, leading to reduced exports to the EU. Heightened uncertainty about how the war will unfold may also lead to the postponement of foreign and domestic investment. Direct effects from the war will be small, as both Russia and Ukraine are only small trade and investment partners for North Macedonia.

Remittances from abroad could provide some cushioning, though it will be limited, as the European economies where most of the country's diaspora is located will also slow down. Secondary income in the balance of payments grew by around 40% in 2021, having declined in 2020 by about 20%. As the level in 2021 was very high, and as remittances to North Macedonia are procyclical (i.e. they decline in bad years), we expect them to remain at a similar level in 2022 as in 2021.

Due to the upsurge in inflation, the central bank raised its policy rate to 1.5% in April (from 1.25%), which is the first hike since the onset of the pandemic. The increase is modest, more of a symbolic gesture, and in real terms, the interest rate remains deeply negative. It is unlikely to have any major impact on inflation, though it is likely to push commercial banks' interest rates up, which may slow down the economy a bit. Since the central bank decided to make a move on inflation, one might expect further hikes by the end of the year, though they will be also modest.

To offset the adverse social effects of inflation, the government has raised the minimum wage by roughly 20% from March 2022. While reactions to this have been mostly positive, it has created an obligation on the part of the government to adjust all wages in the public sector to the higher minimum wage, as stipulated in the collective agreement. The government has so far refused to do this, claiming that it would fuel inflation. As a consequence, several trade unions have initiated protests and strikes,

including a general strike in schools. It is hard to see at the moment how the situation will develop, but it is possible that the protests will grow and add to the political tensions in the country, which are already high. That would take a further toll on the economy.

One event that heightened the tension – or perhaps just reflected the deep divisions in society – was the announcement of the preliminary results of the census conducted towards the end of 2021. This, the first census since 2002, had been eagerly anticipated for years; but nevertheless, around 7% of residents refused to take part, claiming that it was rigged. Accordingly, the authorities had to use data from the administrative records for these people. In consequence, the census results did not contain information on their ethnic or religious background. This sparked unrest in society, with many ethnic and religious groups denouncing the results.

Leaving that to one side, the census officially confirmed the demographic decline in the country. The resident population of North Macedonia has fallen by about 10% over the past two decades – from 2m in 2002 to 1.8m in 2021. The main economic implication of this decline is that the growth prospects for the country will be lower than previously expected, due to the smaller and contracting labour force. It is also more obvious now that the population is ageing, which places additional strain on the social system. Most of the macroeconomic and social indicators for the country will also be affected by the revised population statistics: GDP per capita is likely to be slightly higher than before; the unemployment rate will be lower; and the poverty rate probably higher.

One potential positive development for the coming period could be the unlocking of the process leading to the country's accession to the EU. Bulgaria famously vetoed the start of accession talks with North Macedonia in December 2020, and since then the process has been stalled. The new Bulgarian prime minister, Kiril Petkov, visited North Macedonia in January 2022, in a move that was widely interpreted as a conciliatory step. Bilateral relations between the two countries have improved over the past few months: among other things, a direct air link between the two capitals has been re-established. The war in Ukraine could act as a catalyst, as the EU tries to limit the scope for Russian interference in the region – and especially if the EU decides to fast-track Ukraine's accession. But uncertainties remain, as many Bulgarian parties continue to oppose any lifting of the veto. Even if the process is unlocked, it is unlikely to have any major short-term effects: the positive impact of the move will be felt mainly over the medium term.

In light of all this, we are revising our GDP forecasts downwards, and our inflation forecasts upwards. For 2022, we now expect GDP to grow by 2.5% (down from the January figure of 3.5%), and inflation to average 8% (up from 3.5%). For 2023 and 2024, we project GDP to grow by 2.7% in both years, and inflation to moderate slightly, to 5% in 2023 and 4% in 2024.

Table 4.15 / North Macedonia: Selected economic indicators

	2018	2019	2020	2021 ¹⁾	2022	2023	2024
					Forecast		
Population, th pers., average	2,076	2,077	2,073	2,072	2,071	2,070	2,069
Gross domestic product, MKD bn, nom.	660.9	692.7	655.9	723.2	800	863	922
annual change in % (real)	2.9	3.9	-6.1	4.0	2.5	2.7	2.7
GDP/capita (EUR at PPP)	11,390	11,940	11,170	11,900	.	.	.
Consumption of households, MKD bn, nom.	429.2	447.1	434.9	469.3	.	.	.
annual change in % (real)	3.8	3.7	-4.6	5.0	2.5	3.0	3.0
Gross fixed capital form., MKD bn, nom.	132.4	145.8	144.8	191.4	.	.	.
annual change in % (real)	-6.4	8.7	-1.6	13.0	4.5	4.5	4.5
Gross industrial production ²⁾							
annual change in % (real)	5.4	3.7	-9.6	1.4	1.5	2.0	2.0
Gross agricultural production ³⁾							
annual change in % (real)	10.0	-5.4	1.7	-1.2	.	.	.
Construction industry							
annual change in % (real)	-6.8	3.8	1.4	-11.4	.	.	.
Employed persons, LFS, th, average	759.1	797.7	794.9	795.1	800	800	800
annual change in %	2.5	5.1	-0.3	0.0	0.5	0.5	0.5
Unemployed persons, LFS, th, average	198.6	166.4	155.9	147.9	140	140	140
Unemployment rate, LFS, in %, average	20.7	17.3	16.4	15.7	15.2	14.8	14.5
Reg. unemployment rate, in %, eop	19.3	19.6	25.8	19.7	.	.	.
Average monthly gross wages, MKD	35,626	37,446	40,566	42,887	46,300	49,100	52,100
annual change in % (real, gross)	4.2	4.3	7.0	2.4	0.0	1.0	2.0
Average monthly net wages, MKD	24,276	25,213	27,182	28,718	31,000	32,900	34,900
annual change in % (real, net)	4.4	3.1	6.5	2.3	0.0	1.0	2.0
Consumer prices, % p.a.	1.5	0.8	1.2	3.2	8.0	5.0	4.0
Producer prices in industry, % p.a.	0.9	2.1	0.6	11.1	15.0	4.0	3.0
General governm. budget, nat. def., % of GDP							
Revenues	30.4	31.4	30.5	32.3	31.0	31.0	31.0
Expenditures	31.5	33.5	38.9	37.7	35.0	34.0	33.0
Deficit (-) / surplus (+)	-1.1	-2.1	-8.3	-5.4	-4.0	-3.0	-2.0
General gov. gross debt, nat. def., % of GDP	40.4	40.4	51.9	51.8	55.0	57.0	58.0
Stock of loans of non-fin. private sector, % p.a.	7.2	6.1	4.6	8.2	.	.	.
Non-performing loans (NPL), in %, eop	5.1	4.6	3.3	3.2	.	.	.
Central bank policy rate, %, p.a., eop ⁴⁾	2.50	2.25	1.50	1.25	1.50	2.00	2.00
Current account, EUR m	-7	-368	-366	-416	-880	-940	-1,010
Current account, % of GDP	-0.1	-3.3	-3.4	-3.5	-6.8	-6.7	-6.8
Exports of goods, BOP, EUR m	4,883	5,347	4,817	5,996	7,230	8,240	9,190
annual change in %	19.8	9.5	-9.9	24.5	20.5	14.0	11.5
Imports of goods, BOP, EUR m	6,619	7,296	6,622	8,371	10,170	11,540	12,870
annual change in %	12.9	10.2	-9.2	26.4	21.5	13.5	11.5
Exports of services, BOP, EUR m	1,580	1,625	1,447	1,742	2,070	2,320	2,550
annual change in %	10.2	2.8	-10.9	20.4	19.0	12.0	10.0
Imports of services, BOP, EUR m	1,209	1,289	1,021	1,243	1,480	1,670	1,850
annual change in %	14.1	6.6	-20.8	21.8	19.0	12.5	10.5
FDI liabilities, EUR m	539	488	28	615	.	.	.
FDI assets, EUR m	-65	125	-127	180	.	.	.
Gross reserves of CB excl. gold, EUR m	2,619	2,961	3,019	3,288	.	.	.
Gross external debt, EUR m	7,844	8,154	8,536	9,547	12,200	13,600	14,900
Gross external debt, % of GDP	73.0	72.4	80.3	81.4	94.0	97.0	100.0
Average exchange rate MKD/EUR	61.51	61.50	61.67	61.63	61.7	61.7	61.7

1) Preliminary and wiiw estimates. - 2) Enterprises with 10 and more employees. - 3) wiiw estimate from 2020. - 4) Central Bank bills (28-days).

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