

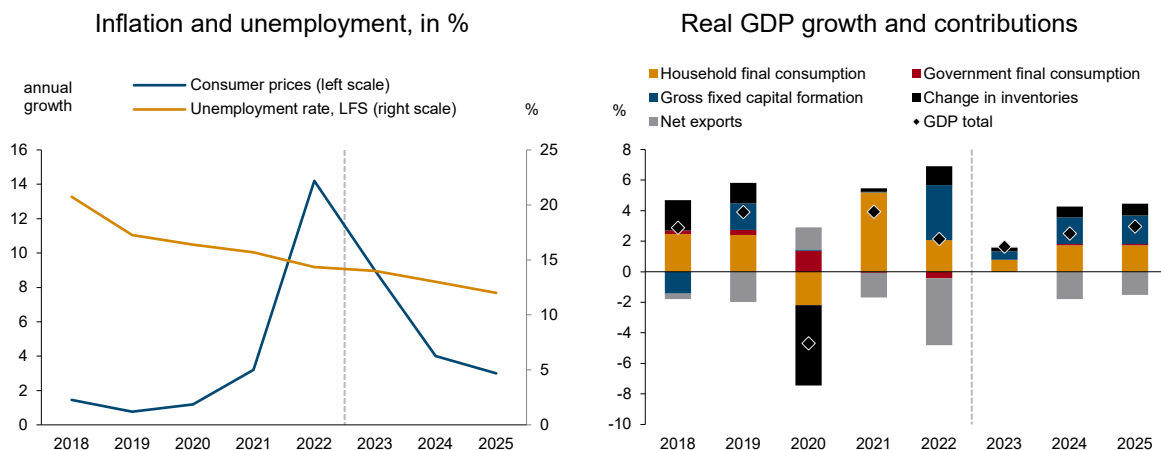


## NORTH MACEDONIA: Defying the winter blues

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The mild winter helped keep the pessimistic scenarios touted at the end of 2022 at bay, and as a result the economy performed better than anticipated. This was partly due to strong foreign direct investment inflows (although the sustainability of these inflows is uncertain). The government's decision to reinstate price controls on essential foodstuffs has succeeded in bringing down inflation, but it is unclear how long these controls will remain in place. Overall, the economic situation in the country seems more positive than it did three months ago, though many challenges remain.

Figure 5.15 / North Macedonia: Main macroeconomic indicators



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

**GDP grew by 2.1% in 2022, exceeding our projections from the previous three rounds.** This was largely due to the mild winter, which helped forestall the worst of the scenarios floated at the end of 2022. From the viewpoint of the GDP components, the primary driver of growth was investment, which increased by 15%. Household consumption also made a contribution, growing by 3.1%, despite the high inflation and the fall in real wages. Government consumption declined for a second year in a row, reflecting the fiscal conservatism of the government. Exports and imports both grew at double-digit pace (in real terms).

**The growth in investment was primarily on account of strong foreign direct investment (FDI) inflows, though these may well turn out to be transitory in nature.** In net terms, FDI reached 5.2% of GDP in 2022 – a significant increase over the 3.3% of the year before. However, a closer look reveals that most of this growth came from intracompany loans from the UK. Previous experience suggests that

these FDI flows may well go into reverse the following year, when the loan is repaid. Thus, the strong FDI inflows from 2022 are unlikely to stay for long. There was some increase in equity capital investment in 2022 – mainly from Germany, Turkey, Austria and Greece – which could suggest that FDI inflows will remain elevated for some years to come, albeit not at the level of last year.

**Another factor that exceeded expectations in 2022 was the resilience of household consumption.**

Despite a 2.9% decline in real wages, household consumption grew by a solid 3.1%. This suggests that people were dipping into their savings to smooth consumption and offset the impact of the cost-of-living crisis. As inflation is expected to ease in 2023, consumption should remain robust.

**Inflation proved more persistent than anticipated, and the government realised that it had to reinstate price controls to tame it.** Inflation averaged 14.2% for 2022 as a whole – slightly above what we were projecting. The measures implemented by the government in the second half of the year – such as lower electricity prices and reduced taxes and tariffs for companies – failed to bring inflation down, as its primary driver was higher company profits, rather than increased production costs. With annual inflation remaining at 16.7% in February 2023, the government reinstated price caps on basic foodstuffs in March. These caps had been successful before (between November 2021 and February 2022), and once again they yielded immediate results, with inflation falling to 14.7% in March.

**The high rate of inflation was also met by an aggressive monetary tightening, which may not be over yet.** The central bank hiked its interest rate 10 times in a single year, so that the base interest rate in March 2023 stood at 5.5% – up from 1.25% a year before. To an extent, the tightening is understandable: the central bank has a mandate to fight inflation, and with inflation stuck in double digits for almost a year, it had to do something. Furthermore, all the major central banks are tightening, and if North Macedonia's failed to follow suit, that would lead to capital outflows and depreciation pressure on the national currency. However, the degree of tightening is open to question, given that the European Central Bank hiked its interest rate only six times over the same period, and by only 350 basis points in total. The moderation of inflation in March may put an end to the hiking cycle; but if the government lifts its price controls too soon, that could once again inflame inflation, which may well lead to another hike in the interest rate.

**The tightening is unlikely to have any major effect on inflation, given its supply-side nature; but it is already taking its toll on the economy.** Credit activity is slowing: overall credit growth in February dropped to 7.7% year on year, the lowest level since the end of 2021. Furthermore, the hike has increased loan interest rates more than deposit rates – the interest rate margin reached 400 basis points in February 2023, up from 360 a year before – which hurts borrowers and swells banks' profits. The level of non-performing loans remains low, though, standing at 2.8% in February.

**In early 2023, economic activity is showing some sign of improvement, though there is a long way to go.** Industrial production in February saw year-on-year growth of 1% for the first time in six months. Retail trade (excluding motor vehicles) in January and February grew 1.2%, year on year. The nominal value of construction works completed in January was 76% higher than a year ago, although that figure is inflated by the big increase in prices in that sector (which is anyway volatile).

**There is nothing new on the political front in the country.** There has been no progress in terms of EU accession, and no prospects of anything happening soon: the constitutional changes that are required to kick-start the negotiations seem far away, as the main opposition party vociferously opposes the proposed changes. In the meantime, internal politics have been marred by several scandals, including one related to the construction of a number of motorways. The Anti-Corruption Commission has raised numerous objections to this project, but such controversies have become commonplace in the country.

**Taking everything into consideration, we are revising our GDP growth forecast for 2023 upwards, and our inflation forecast downwards.** Thanks to the better-than-expected performance at the end of 2022, the solid start to 2023 and the improved global economic outlook, we are revising our 2023 GDP growth forecast upwards to 1.6% (from 1%). At the same time, because of the recently reinstated price caps on basic foodstuffs, we are revising our inflation forecast for 2023 downwards to 9% (from 10%).

**The risks, however, are mostly on the downside, both for GDP and for inflation.** In terms of GDP, much will depend on FDI inflow – the main driver of growth in 2022. One cannot expect this to be as strong in 2023 as it was in 2022 (for the reasons outlined above); the question is how much weaker it will be. The monetary tightening is another risk, especially if the central bank does not reverse its course soon. In terms of inflation, much depends on the government's price controls: if the government lifts the price caps before inflation stabilises (not expected until the autumn), inflation will reignite again.

**Table 5.15 / North Macedonia: Selected economic indicators**

	2019	2020	2021	2022 <sup>1)</sup>	2023	2024 Forecast	2025
Population, th pers., average <sup>2)</sup>	2,077	2,073	1,837	1,827	1,817	1,807	1,797
Gross domestic product, MKD bn, nom.	692.7	669.3	720.4	794.8	881	939	996
annual change in % (real)	3.9	-4.7	3.9	2.1	1.6	2.5	3.0
GDP/capita (EUR at PPP)	11,880	11,350	13,670	14,340	.	.	.
Consumption of households, MKD bn, nom.	447.1	436.4	480.7	549.9	.	.	.
annual change in % (real)	3.7	-3.4	8.0	3.1	1.1	2.5	2.5
Gross fixed capital form., MKD bn, nom.	145.8	144.5	162.4	197.6	.	.	.
annual change in % (real)	8.7	0.4	0.1	16.0	2.2	7.0	7.5
Gross industrial production <sup>3)</sup>							
annual change in % (real)	3.7	-9.6	1.4	-0.2	0.5	2.0	3.0
Gross agricultural production <sup>4)</sup>							
annual change in % (real)	-5.4	1.7	-1.2	2.0	.	.	.
Construction industry							
annual change in % (real)	3.8	1.3	-11.4	-12.1	.	.	.
Employed persons, LFS, th, average <sup>5)</sup>	797.7	794.9	795.1	692.0	700	710	720
annual change in %	5.1	-0.3	0.0	-0.2	0.5	1.0	1.0
Unemployed persons, LFS, th, average <sup>5)</sup>	166.4	155.9	147.9	116.0	110	110	100
Unemployment rate, LFS, in %, average <sup>5)</sup>	17.3	16.4	15.7	14.4	14.0	13.0	12.0
Reg. unemployment rate, in %, eop <sup>5)6)</sup>	19.6	25.8	19.7	19.8	.	.	.
Average monthly gross wages, MKD	37,446	40,566	42,887	47,637	51,900	54,800	57,900
annual change in % (real, gross)	4.3	7.0	2.4	-2.7	0.0	1.5	2.5
Average monthly net wages, MKD	25,213	27,182	28,718	31,859	34,700	36,600	38,600
annual change in % (real, net)	3.1	6.5	2.3	-2.9	0.0	1.5	2.5
Consumer prices, % p.a.	0.8	1.2	3.2	14.2	9.0	4.0	3.0
Producer prices in industry, % p.a.	2.1	0.6	11.1	17.3	7.0	3.0	2.5
General governm. budget, nat. def., % of GDP							
Revenues	31.4	29.9	32.4	32.4	32.5	32.5	32.5
Expenditures	33.5	38.1	37.8	36.9	35.5	35.0	35.0
Deficit (-) / surplus (+)	-2.1	-8.2	-5.4	-4.5	-3.0	-2.5	-2.5
General gov. gross debt, nat. def., % of GDP	40.4	50.8	52.0	50.9	51.0	52.0	53.0
Stock of loans of non-fin. private sector, % p.a.	6.1	4.6	8.2	9.4	.	.	.
Non-performing loans (NPL), in %, eop	4.6	3.3	3.2	2.8	.	.	.
Central bank policy rate, %, p.a., eop <sup>7)</sup>	2.25	1.50	1.25	4.75	6.00	5.50	5.00
Current account, EUR m	-335	-318	-366	-772	-645	-690	-710
Current account, % of GDP	-3.0	-2.9	-3.1	-6.0	-4.5	-4.5	-4.4
Exports of goods, BOP, EUR m	5,347	4,820	6,000	7,346	8,300	9,380	10,600
annual change in %	9.5	-9.9	24.5	22.4	13.0	13.0	13.0
Imports of goods, BOP, EUR m	7,296	6,623	8,371	10,799	11,880	13,250	14,770
annual change in %	10.2	-9.2	26.4	29.0	10.0	11.5	11.5
Exports of services, BOP, EUR m	1,625	1,445	1,743	2,318	2,630	2,950	3,300
annual change in %	2.8	-11.1	20.7	32.9	13.5	12.0	12.0
Imports of services, BOP, EUR m	1,289	1,021	1,248	1,577	1,720	1,920	2,140
annual change in %	6.6	-20.8	22.2	26.4	9.0	11.5	11.5
FDI liabilities, EUR m	488	28	575	803	.	.	.
FDI assets, EUR m	125	-127	187	133	.	.	.
Gross reserves of CB excl. gold, EUR m	2,961	3,019	3,288	3,486	.	.	.
Gross external debt, EUR m	8,154	8,536	9,577	10,856	11,900	12,800	13,700
Gross external debt, % of GDP	72.4	78.7	81.9	84.2	83.0	84.0	85.0
Average exchange rate MKD/EUR	61.50	61.67	61.63	61.62	61.6	61.6	61.6

1) Preliminary and wiiw estimates. - 2) From 2021 according to census September 2021. - 3) Enterprises with 10 and more employees. - 4) wiiw estimate from 2021. - 5) From 2022 based on census 2021. - 6) In % of labour force (LFS). - 7) Central Bank bills (28-days).

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