NORTH MACEDONIA: Same Old Story

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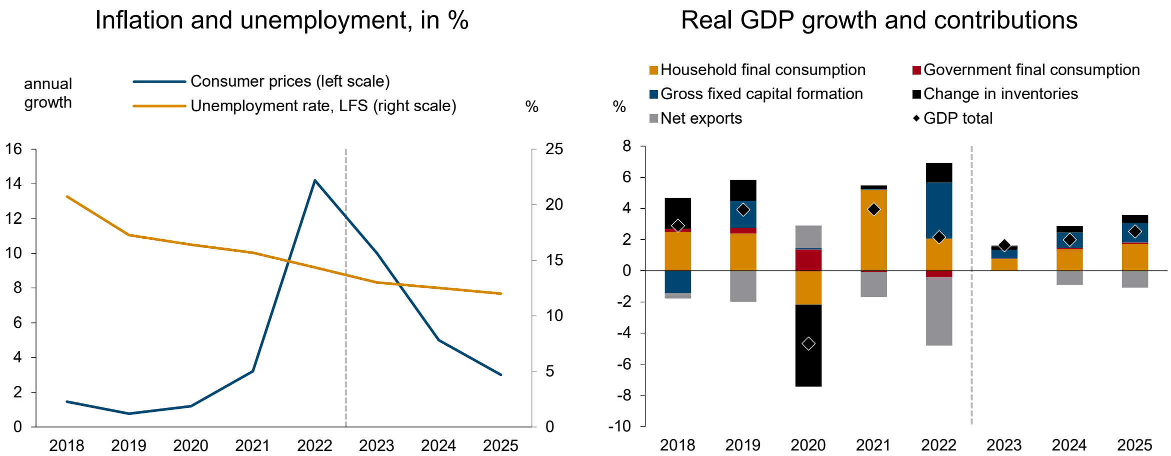
As expected, the economy slowed in Q2, owing to high inflation, restrictive monetary policy and limited foreign direct investment. Driven by company profits, inflation remained very high: the government has reinstated price controls on food products in an effort to tame it (though we do not believe the effects will last long). The GDP forecast for 2023 has been kept unchanged at 1.6%, but our forecast for 2024 has been revised downward to 2%, on account of the cloudier outlook for the EU economy.

Figure 6.15 / North Macedonia: Main macroeconomic indicators



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

The assessment in our previous report – that the robust growth of Q1 could be short lived – has proved accurate. Economic growth in Q2 was lacklustre, with GDP expanding by a mere 1.1% year on year (0.2% quarter on quarter). The slowdown is evident across all GDP components, as each experienced a decline in Q2 – with the sole exception of household consumption, which saw a 1.6% year-on-year increase in Q2 (though that was also weaker than the growth observed over the preceding three quarters). This sluggish economic performance can be attributed to a combination of factors, including high inflation, a restrictive monetary policy stance and limited inflows of foreign direct investment (FDI).

Inflation has shown some sign of moderating in recent months, but it remains very high, eroding people's incomes and exerting downward pressure on economic growth. It fell to 8.3% in August, but over the past three months – when observed on a month-to-month seasonally adjusted basis – the rate at which prices have risen has actually accelerated, since the government repealed the price controls that it introduced at the beginning of the year. Notably, food prices continue to be the primary driver of inflation, registering an approximately 11% increase in August, compared to the same period the previous year. At the same time, the producer price index in July recorded a decline compared to the previous year, while real wages remained stagnant in H1 2023, underscoring the fact that inflation was propelled primarily by company profits, rather than wages.

The high inflation has compelled the government to reintroduce price controls. In mid-September, it imposed price caps on approximately 25 categories of food products, effective until the end of November. While this measure is expected to bring down the prices of those specific products while it is in operation, it should be noted that the list of regulated items is fairly limited and that the measure is intended to run for just two months. Past experience of the two previous episodes of price controls over the last year and a half indicates that once the caps are lifted, companies often significantly increase their prices in order to compensate for their reduced profits during the price-control period. Therefore, it is our belief that the measure is likely to have only a minor impact on inflation and the overall standard of living, unless the government opts to extend it.

Monetary policy has maintained a restrictive stance throughout the year, and while the pace of interest rate hikes has slowed somewhat, the rises have not yet come to a halt. The central bank has consistently raised its policy rate at every meeting this year, bringing it to 6.3% as of September. Notably, the two most recent rate hikes – in August and September – were, at 0.15 percentage points, smaller than earlier increases (of 0.25 percentage points). It is likely, though, that the September hike will be the last this year, as the National Bank of North Macedonia closely follows the European Central Bank (ECB), and in our core scenario we assume that the ECB will not increase its rate before the end of 2023.

Fiscal policy has also fallen short in supporting the economy, despite a notably large deficit in H1 of around 6% of GDP. This deficit is primarily on account of the ongoing construction of a motorway in the western part of the country, which the government has started to pay for but which has faced sluggish progress and has been plagued by numerous scandals. Aside from the motorway project, public spending has remained relatively low in most other areas. Government consumption saw a decline of approximately 4% year on year in H1, and the rises in public-sector wages and social transfers were only marginal.

The labour market situation cannot be analysed in any great detail, as the Labour Force Survey methodology changed at the beginning of the year, and revised data for the period prior to the change have not been made available. According to the new methodology, the unemployment rate for Q2 was reported at 13.1%, which is lower than the previous figure. Although the labour market may face some challenges in 2023 due to the sluggish economy, over the medium term population decline and emigration are expected to result in an inevitable further reduction in unemployment.

Following the robust FDI figures from the previous year, foreign investment declined in H1 2023. During this period it accounted for 4.2% of GDP; while not alarming when compared to the country's long-term trends, this is still approximately 20% lower in real terms than the inflows observed in the corresponding period of last year. This may be attributed to the exceptionally strong inflows of 2022, which, as discussed in our previous reports, were driven primarily by intracompany loans, and were not expected to be sustained.

Remittances remained a strong support for the economy in H1 2023. Secondary income from the balance of payments (a proxy for remittance flows) accounted for 19% of GDP – some 5% up on the same period last year (in real terms). Despite the slowdown in the EU, remittances have proved very stable and are unlikely to be affected by the weaker recovery in the euro area; thus they should continue to support the economy in the coming period.

Despite the country's significant exposure to the German economy, there has been no significant indication of a German recession adversely affecting the North Macedonian economy. Exports to Germany during the first five months of the year increased by approximately 8% year on year in nominal USD terms, while German FDI in the country for the first half year surged by 62% in nominal EUR terms. Even the automotive industry, dominated as it is by German-owned companies, witnessed a substantial 10% expansion in production during the initial seven months, when assessed in real terms. While adverse effects may yet materialise after a time lag, there remains the possibility that German companies could expand their operations in North Macedonia in order to minimise production costs. That would have a positive impact on the local economy.

There have been no major changes in the country's EU integration process. It must still amend its constitution to include Bulgarians in its preamble before accession talks can begin. The opposition continues to be against this, and the ruling majority still does not have the two-thirds majority required to change the constitution. Rumours have been circulating that the ruling majority is attempting to persuade some opposition MPs to support it (in a move not unlike the strategy it used in 2019, when the country's name was changed). However, at the time of writing, there is no clear indication that this will be possible.

In light of all that has been said, we are keeping our GDP forecast for 2023 unchanged at 1.6%. Due to the cloudier outlook for the EU economy in 2024, we are revising our GDP forecast for that year down to 2% (from 2.5%). As for inflation, the steep price rises of recent months have led us to revise our forecast slightly upwards – to 10% in 2023 and 5% in 2024 (up 1 percentage point).

Table 6.15 / North Macedonia: Selected economic indicators

	2020	2021	2022 1)	2022 January-June	2023 January-June	2023 Forecast	2024 Forecast	2025 Forecast
Population, th pers., average 2)	2,073	1,837	1,832	.	.	1,817	1,807	1,797
Gross domestic product, MKD bn, nom.	669.3	720.4	794.8	361	406	889	952	1,005
annual change in % (real)	-4.7	3.9	2.1	3.1	1.6	1.6	2.0	2.5
GDP/capita (EUR at PPP)	11,350	13,670	14,730	.	.	.	.	.
Consumption of households, MKD bn, nom.	436.4	480.7	549.9	259	290	.	.	.
annual change in % (real)	-3.4	8.0	3.1	2.0	2.1	1.1	2.0	2.5
Gross fixed capital form., MKD bn, nom.	144.5	162.4	197.6	.	.	.	.	.
annual change in % (real)	0.4	0.1	16.0	.	.	2.2	4.0	5.0
Gross industrial production 3)								
annual change in % (real)	-9.5	1.5	-0.3	2.3	1.5	1.0	2.0	3.0
Gross agricultural production 4)								
annual change in % (real)	1.7	-7.6	2.0	.	.	.	.	.
Construction industry								
annual change in % (real)	1.3	-11.4	-11.9	-5.4	-6.4	.	.	.
Employed persons, LFS, th, average 5)	794.9	795.1	692.0	693	686	700	710	720
annual change in %	-0.3	0.0	-0.2	-0.1	.	0.5	1.0	1.0
Unemployed persons, LFS, th, average 5)	155.9	147.9	116.0	118	104	100	100	100
Unemployment rate, LFS, in %, average 5)	16.4	15.7	14.4	14.6	13.2	13.0	12.5	12.0
Reg. unemployment rate, in %, eop 5)6)	25.8	19.7	19.8	20.5	18.8	.	.	.
Average monthly gross wages, MKD	40,566	42,887	47,637	46,237	52,869	52,400	55,600	58,400
annual change in % (real, gross)	7.0	2.4	-2.7	-0.8	0.7	0.0	1.0	2.0
Average monthly net wages, MKD	27,182	28,718	31,859	30,950	35,286	35,000	37,100	39,000
annual change in % (real, net)	6.5	2.3	-2.9	-0.9	0.4	0.0	1.0	2.0
Consumer prices, % p.a.	1.2	3.2	14.2	10.0	13.6	10.0	5.0	3.0
Producer prices in industry, % p.a.	0.6	11.1	17.3	19.5	4.8	6.0	3.0	2.5
General governm. budget, nat. def., % of GDP								
Revenues	29.9	32.4	32.4	32.2	32.3	32.0	32.5	32.5
Expenditures	38.1	37.8	36.9	35.1	38.2	36.0	35.5	35.0
Deficit (-) / surplus (+)	-8.2	-5.4	-4.5	-2.9	-5.8	-4.0	-3.0	-2.5
General gov. gross debt, nat. def., % of GDP	50.8	52.0	50.9	47.3	50.3	51.0	52.0	53.0
Stock of loans of non-fin. private sector, % p.a.	4.6	8.2	9.4	9.9	6.5	.	.	.
Non-performing loans (NPL), in %, eop	3.3	3.2	2.8	3.2	2.8	.	.	.
Central bank policy rate, %, p.a., eop 7)	1.50	1.25	4.75	2.00	6.00	6.30	6.00	5.50
Current account, EUR m	-318	-366	-772	-623	-12	-320	-380	-510
Current account, % of GDP	-2.9	-3.1	-6.0	-10.6	-0.2	-2.2	-2.5	-3.1
Exports of goods, BOP, EUR m	4,820	6,000	7,346	3,554	3,706	8,300	9,010	9,710
annual change in %	-9.9	24.5	22.4	21.5	4.3	13.0	8.5	7.8
Imports of goods, BOP, EUR m	6,623	8,371	10,799	5,304	4,898	11,720	12,600	13,550
annual change in %	-9.2	26.4	29.0	32.8	-7.7	8.5	7.5	7.5
Exports of services, BOP, EUR m	1,445	1,743	2,318	1,005	1,213	2,630	2,950	3,300
annual change in %	-11.1	20.7	32.9	29.1	20.6	13.5	12.0	12.0
Imports of services, BOP, EUR m	1,021	1,248	1,577	673	945	1,730	1,940	2,170
annual change in %	-20.8	22.2	26.4	47.1	40.4	10.0	12.0	12.0
FDI liabilities, EUR m	28	575	803	643	588	800	.	.
FDI assets, EUR m	-127	187	133	394	351	150	.	.
Gross reserves of CB excl. gold, EUR m	3,019	3,288	3,486	2,734	3,804	.	.	.
Gross external debt, EUR m	8,536	9,577	10,856	.	.	12,300	13,300	14,200
Gross external debt, % of GDP	78.7	81.9	84.2	.	.	85.0	86.0	87.0
Average exchange rate MKD/EUR	61.67	61.63	61.62	61.7	61.6	61.6	61.6	61.6

1) Preliminary. - 2) From 2021 according to census September 2021. - 3) Enterprises with 10 and more employees. - 4) wiiw estimate in 2022. - 5) From 2023 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS), from 2022 based on census September 2021. - 6) In % of labour force (LFS). - 7) Central Bank bills (28-days).

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