NORTH MACEDONIA: COVID-19 lethargy

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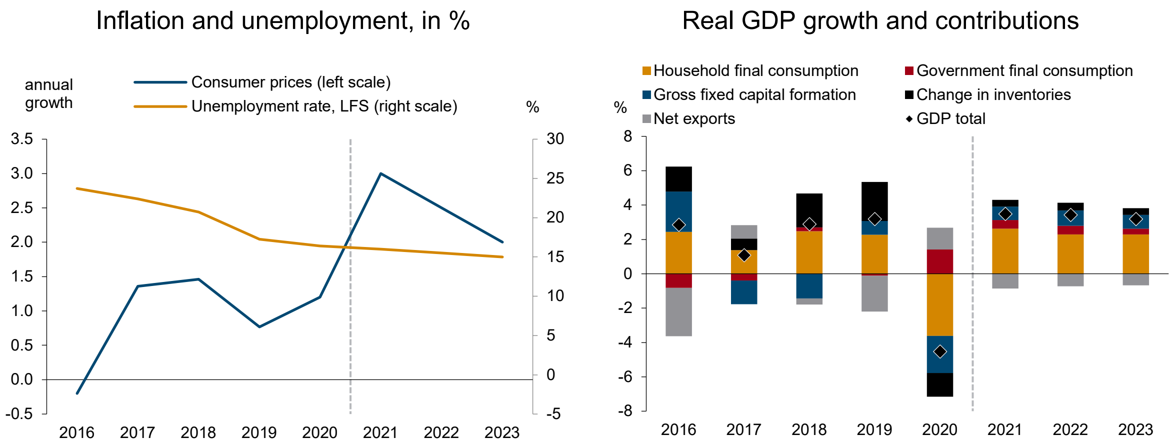
Weak government support, deep-seated structural problems and global issues in the automotive sector all combined to slow economic recovery in North Macedonia in the first half of 2021. We are downgrading our forecast for GDP growth in 2021 from 4.1% to 3.5%. Developments in the years to follow will depend on whether the government starts to undertake structural reforms and invests in green and digital transformation.

Figure 4.15 / North Macedonia: Main macroeconomic indicators



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

The economy of North Macedonia seems to be stuck in a COVID-19 lethargy. GDP in Q2 2021 grew 13.1% year on year, which is the highest growth rate ever observed in the quarterly GDP data for the country – yet that was still 2 percentage points (pp) shy of the decline seen in the corresponding period last year (-14.9%). Thus, the economy is still below its pre-pandemic level. Compared to the previous quarter, growth in Q2 was just 0.3% (seasonally adjusted), which is very weak and much poorer than expected. From a structural perspective, all GDP components grew in Q2 – though that is not surprising, given the steep decline the year before. Imports of goods and services grew most strongly (by 47%), which was due to their weak performance in previous periods.

Industry is growing, but by much less than the decline witnessed last year. Growth in the first half of the year was 6.6% – far short of the fall in the same period of 2020 (-14.6%). Three important sectors of the economy recorded a sizeable decline – mining, energy and manufacture of apparel – reflecting deep structural problems and the government's failure to tackle them. Energy and mining have declined due to lack of investment in renewable energy; in the case of apparel, the problem is the inability on the part of that technologically backward and low-value-added sector to catch up with contemporary trends.

The automotive industry, on the other hand, saw robust growth in the first half of the year (11.5%), though that was still much less than the decline the year before (21.1%). After production in the sector reached pre-crisis levels at the end of 2020, growth slowed markedly – a result of the global problem facing the automotive industry that is caused by the shortage of microchips.

Fiscal policy has not been supportive enough, and that has again taken its toll on the economy. Total government spending in the first half of the year was 34.8% of GDP – well short of the previous year (38.4%). This reflects the decline in government support measures for businesses and households (which were much more generous last year), but also weak capital spending: that averaged only 2% of GDP in the first six months of the year, just half of the planned amount. Had the government carried through its planned level of public investment, the economy would already have reached the pre-crisis level.

Despite the lukewarm fiscal support, public debt has continued to rise in 2021. By the end of Q2, it had reached 64.4% of GDP – 4.2 pp up from 2020. The reason for the rise is the issuance of a 7-year euro-denominated bond in March 2021, with a value of EUR 700m and a historically low yield of 1.866%. Part of the money is being used to repay old loans.

The anaemic economic activity has left its mark on the labour market. Employment in Q2 2021 was 2% below the pre-crisis level of Q1 2020, which means that around 16,000 people have lost their jobs during the pandemic. The sectors that have seen the greatest declines are agriculture, industry, transportation and tourism – all sectors with a sizeable degree of informality, suggesting that the decline in formal employment may be also due to a shift to informality. Despite the fall in employment, unemployment has not risen: during the same period, it also declined – by some 6,000 people, pushing the rate of unemployment to a historical low of 15.9%. The explanation for the divergent dynamics is that the pandemic has led to a pronounced drop-off in labour market activity: some 22,000 people have become inactive during the observed period (bigger than the fall in employment).

Despite the decline in employment, wages have continued to grow. In the first seven months of 2021, they grew by a nominal 6.1%. While the increase can partly be explained by higher inflation and the rise in the minimum wage (1.7% increase in April 2021), there are several additional factors: wages in the cultural sector have risen thanks to a new collective agreement; salaries in health care were increased by the government in response to the pandemic; IT remuneration has risen in line with the boom in that sector; and wages in tourism have grown thanks to the post-pandemic recovery there.

Inflation has been on the rise all year, reaching 3.6% in August. The average for the first eight months of 2021 was 2.7%. While the rise is partly due to higher wages, the main reason is the global increase in energy costs: prices in the 'transportation' sub-category of the national consumer price index were up 6% in the first eight months of the year. The increase in producer prices has been even more pronounced – an average of 8% in the first seven months, culminating in 14% in July, which could be a sign that inflation will remain elevated for some time to come. We are still inclined to believe that this will not continue for too long, and that the country will not see persistently higher inflation. We are upgrading our inflation forecast for 2021 to 3% (from 2.5%), and for 2022 to 2.5% (from 2.2%).

Monetary policy has remained supportive of the economy throughout 2021, and we expect that to continue over the coming months. The central bank cut its main interest rate in March to a historical low of 1.25%, and has given no indication that it will hike the rate any time soon. Given the anaemic economy and (still) not very high inflation, we see no reason for it to do so.

The financial sector has remained stable. Non-performing loans at the end of June 2021 remained close to the level of June 2020 (3.4%). Credit growth is continuing as last year: total private loans in July were 5% higher than the year before. Banks are lending more to households than to companies – household credit is 8.7% up, year on year, while corporate loans are just 1.2% up.

The external sector has been very positive in 2021, but this has had only a limited impact on economic activity. Inflows of foreign direct investment (FDI) were very buoyant in the first half of the year, amounting to EUR 527m, or 9.7% of GDP – the highest in years. To a large extent, this is delayed investment, i.e. investment that was postponed in 2020, due to the pandemic: last year FDI totalled just EUR 74m. But there may also be some indirect near-shoring trends, in the sense that European companies have started investing in the Western Balkans, rather than in Asia, due to the ongoing supply-chain problems. Remittances also held up very well in the first half of 2021: approximated by current transfers, they were 38% up on the same period of 2020 (EUR 773m). The current account deficit in the first half of the year was 3.2% of GDP, which is a normal level for North Macedonia.

Q3 seemed to start out in the same way as the previous six months. Industrial production in July declined by 0.6% year on year, mainly on account of the weak production in the food, apparel and energy sectors, which are all burdened by deep structural problems, low value added, low innovation and low productivity. Retail trade, on the other hand, grew in July by 8.9% in real terms; but again, that is less than the previous year's decline (-11.9%), meaning that the economy is continuing to operate at below its pre-crisis level.

One positive development from Q3 is that the government seems to be stepping up its support for the economy. In July and August, total government spending was 11.7% up year on year, while capital spending was 57% up. Still, it is unclear whether these trends will continue for long, as the country is holding local elections in October, and government spending is restricted during any election campaign.

Another positive development is that the country finally managed to organise a census in September – the first since 2002. Although it will be several months before the official results are announced, on the final day of the census, officials stated that 1.8m people had been recorded – 10% below the population figure from the previous census and the estimates of the Statistical Office. That would mean that many statistical indicators for the country have been inaccurately calculated for years: GDP per capita, the unemployment rate, poverty, etc.

In September and October, the country has been weathering a new and severe wave of COVID-19, but there seems to have been little impact on the economy. The COVID-19 death rate in September was among the highest in the region – a consequence of the weak vaccination programme, the poor health system and widespread COVID scepticism. By the start of October, only 35% of the population had been fully vaccinated, as many people doubt the usefulness of the vaccines. This also makes it highly unlikely that restrictions will be introduced, as they carry a substantial political cost. But as the experience of spring showed, life in North Macedonia will go on as normal, even through a severe pandemic wave. Thus, we do not foresee any serious adverse economic consequences of the ongoing wave.

On account of the weaker-than-expected economic results from the first half of the year, the anaemic start to Q3 and the slim chances of more substantial government support in the remaining months of the year, we are downgrading our GDP growth forecast for 2021 – from 4.1% to 3.5%.

The prospects for the years to come will depend on whether the government starts to tackle the structural problems that burden the country and the economy: widespread corruption, non-functioning institutions, poor infrastructure, low investment in public goods, lack of investment in green and digital transformation, absence of industrial policy and weak innovation capacity.

Table 4.15 / North Macedonia: Selected economic indicators

	2018	2019	2020 1)	2020	2021	2021	2022	2023
				January-June			Forecast	
Population, th pers., average	2,076	2,077	2,073	.	.	2,075	2,075	2,075
Gross domestic product, MKD bn, nom.	660.9	689.4	664.0	304.6	335.6	708	751	790
annual change in % (real)	2.9	3.2	-4.5	-7.3	5.2	3.5	3.4	3.2
GDP/capita (EUR at PPP)	11,340	11,850	11,370	.	.	.	.	.
Consumption of households, MKD bn, nom.	429.2	446.4	434.5	210.3	228.0	.	.	.
annual change in % (real)	3.8	3.5	-5.6	-7.1	6.7	4.0	3.5	3.5
Gross fixed capital form., MKD bn, nom.	132.4	146.1	132.0	.	.	.	.	.
annual change in % (real)	-6.4	4.0	-10.2	.	.	4.0	4.5	4.0
Gross industrial production 2)								
annual change in % (real)	5.4	3.7	-9.6	-14.6	6.6	6.0	5.5	5.0
Gross agricultural production 3)								
annual change in % (real)	10.0	-5.4	7.2	.	.	.	.	.
Construction industry								
annual change in % (real)	-6.8	3.8	1.3	-0.7	-6.1	.	.	.
Employed persons, LFS, th, average	759.1	797.7	794.9	802.3	794.2	800	810	820
annual change in %	2.5	5.1	-0.3	1.3	-1.0	0.5	1.5	1.5
Unemployed persons, LFS, th, average	198.6	166.4	155.9	158.1	150.5	150	150	140
Unemployment rate, LFS, in %, average	20.7	17.3	16.4	16.5	16.0	16.0	15.5	15.0
Reg. unemployment rate, in %, eop	19.3	19.6	25.8	22.7	20.8	.	.	.
Average monthly gross wages, MKD	35,626	37,446	40,566	39,864	42,386	43,500	45,900	47,800
annual change in % (real, gross)	4.2	4.3	7.0	7.9	3.9	4.0	3.0	2.0
Average monthly net wages, MKD	24,276	25,213	27,182	26,709	28,390	29,100	30,700	31,900
annual change in % (real, net)	4.4	3.1	6.5	7.3	3.8	4.0	3.0	2.0
Consumer prices, % p.a.	1.5	0.8	1.2	0.5	2.4	3.0	2.5	2.0
Producer prices in industry, % p.a.	0.9	2.1	0.6	0.9	7.0	8.0	5.0	3.0
General governm.budget, nat.def., % of GDP								
Revenues	30.4	31.5	30.2	28.7	30.1	30.0	30.0	30.0
Expenditures	31.5	33.7	38.4	37.2	34.8	33.0	32.0	31.0
Deficit (-) / surplus (+)	-1.1	-2.2	-8.2	-8.5	-4.7	-3.0	-2.0	-1.0
General gov.gross debt, nat.def., % of GDP	40.4	40.6	51.2	51.7	55.9	52.5	53.0	53.0
Stock of loans of non-fin.private sector, % p.a.	7.2	6.1	4.6	6.7	5.0	.	.	.
Non-performing loans (NPL), in %, eop	5.1	4.6	3.3	4.6	3.4	.	.	.
Central bank policy rate, %, p.a., eop 4)	2.50	2.25	1.50	1.50	1.25	1.25	1.50	2.00
Current account, EUR m	-7	-368	-366	-246	-175	-400	-490	-600
Current account, % of GDP	-0.1	-3.3	-3.4	-5.0	-3.2	-3.5	-4.0	-4.7
Exports of goods, BOP, EUR m	4,883	5,347	4,817	2,014	2,924	5,490	6,150	6,830
annual change in %	19.8	9.5	-9.9	-22.5	45.2	14.0	12.0	11.0
Imports of goods, BOP, EUR m	6,619	7,296	6,622	2,911	3,992	7,520	8,420	9,350
annual change in %	12.9	10.2	-9.2	-17.0	37.1	13.5	12.0	11.0
Exports of services, BOP, EUR m	1,580	1,625	1,447	676	778	1,610	1,790	1,970
annual change in %	10.2	2.8	-10.9	-7.4	15.1	11.0	11.0	10.0
Imports of services, BOP, EUR m	1,209	1,289	1,021	408	455	1,130	1,240	1,360
annual change in %	14.1	6.6	-20.8	-24.0	11.6	10.5	10.0	9.5
FDI liabilities, EUR m	539	488	28	214	527	700	.	.
FDI assets, EUR m	-65	125	-127	99	337	400	.	.
Gross reserves of CB excl. gold, EUR m	2,619	2,961	3,019	3,292	3,704	.	.	.
Gross external debt, EUR m	7,844	8,154	8,536	8,771	10,159	9,900	10,700	11,500
Gross external debt, % of GDP	73.0	72.7	79.3	81.5	88.5	86.0	88.0	90.0
Average exchange rate MKD/EUR	61.51	61.50	61.67	61.7	61.6	61.7	61.7	61.7

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

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