NORTH MACEDONIA: Healing COVID-19 Wounds

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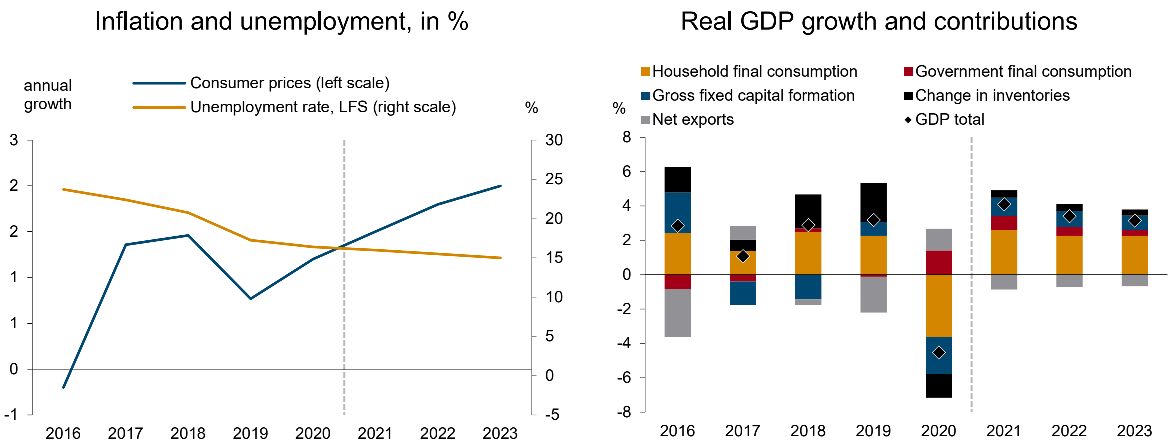
After a large initial decline, North Macedonia's economy improved in the second half of 2020, ending the year with a minus of 4.5%. The improvement came as a result of government fiscal support. 2021 will be a year when the damage created by the pandemic will be slowly repaired, with real GDP growing by 4.1%. The pre-crisis level of activity will be reached at the beginning of 2022, and then, when ground zero is reached after two lost years, old structural challenges will come to the fore.

Figure 4.15 / North Macedonia: Main macroeconomic indicators



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

North Macedonia's economy went through two phases during the COVID-19 pandemic in 2020. The first one, from the second quarter of the year, saw GDP decline by 14.9% year on year, among the biggest contractions in Europe. Then in the second half of the year it declined by just 2%, among the best in Europe. For the whole year GDP contracted 4.5%, the European average.

Looking at the individual components of GDP, they all dropped for the year as a whole, except government consumption. Household consumption declined by 5.6% as people were reluctant to spend amidst the burning pandemic. Gross capital formation declined 10.2%, as companies refrained from investing due to high uncertainty. Exports declined by 10.9% due to reduced demand from abroad. Imports declined by 10.5% as a result of reduced domestic demand, offsetting the decline in exports. In contrast, government consumption grew by 10.1% owing to government support for the economy, thus cushioning 1.4 pp of the GDP decline.

The government was perhaps a bit slow with its support to the economy, but at the end of the day, the support was solid. It enacted four stimulus packages during 2020, consisting of wage subsidies to firms, credit guarantees, favourable credit lines, direct financial support to selected groups and tax holidays. The first three were adopted in Q2, with implementation in Q2 and Q3, while the fourth one was adopted in Q3, with implementation in Q4. Consequently total government expenditures grew by 12% for the whole year (10% in the first half, 14% in the second). As a share of GDP, they reached 36.8% of GDP for the whole year, which is some 4 pp above the average of the past three years. The deficit reached 8.2%, the highest in the last two decades.

The labour market response was muted due to government measures. Employment for the whole of 2020 declined by just 0.3% (3,000 people), but this was also driven by an increase in employment in Q1. Starting from Q2 employment fell by 2.7% (22,000 people). Inactivity increased due to the pandemic, with 13,000 people becoming inactive throughout the year. As the increase in inactivity was more pronounced than the decline in employment, unemployment actually declined for the whole year, by 10,000 people, bringing the rate of unemployment to 16.4% (from 17.3% in 2019). Average net wages rose 6.5% in real terms, driven by increases in the minimum-wage and public-sector wages.

The recession was evident in other sectors of the economy as well. FDI halted almost completely, reaching just EUR 74 million for the whole year, down from EUR 488 million in 2019. Secondary income, driven primarily by remittances, which are very important for the country, declined sizeably, by 20%, amounting to EUR 1.4 billion. Private sector credit growth slowed to 4.6% from 6.1% in 2019, but the banking sector remained stable, with non-performing loans falling to 3.3% due to the debt moratoria. Inflation averaged 1.2% over the whole year, reflecting weak domestic demand and low global commodity prices. It would have been even lower had the government not raised the fuel excise duty and electricity prices during the pandemic.

Expectations for 2021 cannot be very optimistic as the year seems to be starting off on the wrong foot. The country is going through a new pandemic wave, with figures at early April exceeding the peak from December. The government prioritised business over health for a long time, avoiding a lockdown, which overwhelmed hospitals. This was also hurting the economy indirectly as it leaves the disease to spread freely, forcing people and businesses to refrain from spending and investing. Light lockdown was eventually introduced at the begging of April, with a curfew and a closure of restaurants and bars, but at the time of the writing of this text, there were no indications that the situation started to improve.

General vaccination seems light years away; at the beginning of April, the country only started to immunize the risky groups. The government failed to obtain vaccines on its own, so had to rely on the COVAX mechanism. The first batch of these vaccines, 24,000 doses, arrived only at the end of March, but will not be enough even for the people at risk. Previously, Serbia donated around 5,000 doses, which has been enough for just a part of healthcare personnel. It is unclear when general inoculation will start but it will certainly not be finished before autumn, meaning that the economy will remain anaemic throughout the summer, growing only compared to the significant decline of the previous year.

High-frequency data for January 2021 are mixed, but are more indicative of a sluggish recovery than of a rebound. Industrial production is 13.5% down compared to the year before, while retail trade is 2% up (in real terms). Total government revenues are 5% below the previous year, whereas goods exports are growing strongly at 15%. Still, this is entirely due to higher commodity prices, as the country exports metals. Given the high volatility of metals prices on international markets, exports may well decline in the coming months.

We forecast only a partial recovery of economic activity in 2021, growing 4.1%, and reaching the pre-pandemic level only at the beginning of 2022. All GDP components are expected to grow - household consumption by 4%, gross investment by 5%, exports by 9.5%, and imports by 9% - but they will all remain below 2019 levels. Only government consumption will remain elevated, growing by 5% this year, reflecting the supportive fiscal policy announced by the government.

The government has adopted another, fifth package of support to the economy in early 2021, but parliament still has to pass the required laws. The package is similar to the previous ones including wage subsidies, zero-interest credit and direct support to selected groups of businesses and people. It is smaller than previous packages though, amounting to 1.5% of GDP. It brings the planned deficit for 2021 to 5% of GDP, which seems like a careful and gradual consolidation after last year's deficit of 8.2%. It is questionable, however, whether the government will be able to achieve this deficit, as it has suffered from insufficient spending capacity in previous years, resulting in poor enactment of planned budgets.

To be able to finance the planned fiscal support, the government issued a 7-year Eurobond in March 2021, for the amount of EUR 700 million, with a yield of 1.866%. This is the lowest yield the country has achieved so far, reflecting favourable conditions on global financial markets. This external borrowing implies that domestic financial resources will be available for private initiatives, which might prove useful for the recovery. In addition, the central bank reduced its main interest rate again in March to 1.25%, meaning that domestic financing conditions are likely to be favourable in 2021.

All economic indicators are expected to improve marginally in 2021, following the recovery of economic activity. Employment will increase by 0.5% (5,000 new jobs). Unemployment will decline by 6,000, pushing the rate of unemployment to 16% (from 16.4% in 2020). Wages will grow 3% in real terms due to the minimum-wage increase, slowing from the growth observed in previous years. Despite higher commodity prices, inflation will average 1.5%, reflecting still weak domestic demand. FDI will increase from the previous year, reaching EUR 400 million (3.5% of GDP), but will still remain 18% below the 2019 level. Secondary income will reach EUR 1.55 billion, 10% higher than in 2020, but also 10% below that of 2019.

The pre-crisis level of economic activity will be reached at the beginning of 2022, and then, when COVID-19 wounds are healed, two years will be lost, but old structural problems will remain. The economy will be faced with poor governance and non-functional institutions; high unemployment, poverty and inequality; low competitiveness and innovation capacity; low human capital and high emigration. Medium-term prospects will depend on whether the government tries to address these issues, or will let yet another good crisis go to waste.

Table 4.15 / North Macedonia: Selected economic indicators

	2017	2018	2019	2020 1)	2021	2022 Forecast	2023
Population, th pers., average	2,075	2,076	2,077	2,075	2,075	2,075	2,075
Gross domestic product, MKD bn, nom.	618.1	660.9	689.4	664.0	702	739	778
annual change in % (real)	1.1	2.9	3.2	-4.5	4.1	3.4	3.2
GDP/capita (EUR at PPP)	10,790	11,340	11,850	11,490	.	.	.
Consumption of households, MKD bn, nom.	405.9	429.2	446.4	434.5	.	.	.
annual change in % (real)	2.1	3.8	3.5	-5.6	4.0	3.5	3.5
Gross fixed capital form., MKD bn, nom.	139.0	132.4	146.1	132.0	.	.	.
annual change in % (real)	-5.7	-6.4	4.0	-10.2	5.0	4.5	4.0
Gross industrial production 2)							
annual change in % (real)	0.2	5.4	3.7	-9.6	7.0	6.0	5.0
Gross agricultural production 3)							
annual change in % (real)	-9.9	10.0	-0.3	1.7	.	.	.
Construction industry							
annual change in % (real)	-27.2	-6.8	3.8	1.3	.	.	.
Employed persons, LFS, th, average	740.6	759.1	797.7	794.9	800	810	820
annual change in %	2.4	2.5	5.1	-0.3	0.5	1.5	1.5
Unemployed persons, LFS, th, average	213.6	198.6	166.4	155.9	150	150	140
Unemployment rate, LFS, in %, average	22.4	20.7	17.3	16.4	16	15.5	15.0
Reg. unemployment rate, in %, eop	20.1	19.3	19.6	25.8	.	.	.
Average monthly gross wages, MKD	33,688	35,626	37,446	40,566	42,400	44,500	46,800
annual change in % (real, gross)	1.2	4.2	4.3	7.0	3.0	3.0	3.0
Average monthly net wages, MKD	22,928	24,276	25,213	27,182	28,400	29,800	31,300
annual change in % (real, net)	1.2	4.4	3.1	6.5	3.0	3.0	3.0
Consumer prices, % p.a.	1.4	1.5	0.8	1.2	1.5	1.8	2.0
Producer prices in industry, % p.a.	4.8	0.9	2.1	0.6	2.5	1.5	2.0
General governm.budget, nat.def., % of GDP							
Revenues	31.0	30.4	31.5	28.6	29.0	29.5	30.0
Expenditures	33.8	31.5	33.7	36.8	34.0	33.0	32.5
Deficit (-) / surplus (+)	-2.8	-1.1	-2.2	-8.2	-5.0	-3.5	-2.5
General gov.gross debt, nat.def., % of GDP	39.4	40.4	40.6	51.2	52.5	53.0	53.0
Stock of loans of non-fin.private sector, % p.a.	5.4	7.2	6.1	4.6	.	.	.
Non-performing loans (NPL), in %, eop	6.2	5.1	4.6	3.3	.	.	.
Central bank policy rate, %, p.a., eop 4)	3.25	2.50	2.25	1.50	1.25	1.50	2.00
Current account, EUR m	-105	-7	-372	-373	-380	-440	-470
Current account, % of GDP	-1.0	-0.1	-3.3	-3.5	-3.3	-3.7	-3.7
Exports of goods, BOP, EUR m	4,075	4,883	5,323	4,813	5,370	5,930	6,520
annual change in %	15.4	19.8	9.0	-9.6	11.5	10.5	10.0
Imports of goods, BOP, EUR m	5,862	6,619	7,293	6,621	7,380	8,150	8,920
annual change in %	9.7	12.9	10.2	-9.2	11.5	10.5	9.5
Exports of services, BOP, EUR m	1,434	1,580	1,635	1,445	1,600	1,780	1,970
annual change in %	3.2	10.2	3.4	-11.6	11.0	11.0	10.5
Imports of services, BOP, EUR m	1,060	1,209	1,285	1,013	1,120	1,230	1,350
annual change in %	1.0	14.1	6.2	-21.1	10.5	10.0	9.5
FDI liabilities, EUR m	351	539	488	74	.	.	.
FDI assets, EUR m	171	-65	125	-131	.	.	.
Gross reserves of CB excl. gold, EUR m	2,097	2,619	2,961	3,019	.	.	.
Gross external debt, EUR m	7,372	7,844	8,154	9,000	9,800	10,500	11,300
Gross external debt, % of GDP	73.4	73.0	72.7	83.4	86.0	88.0	90.0
Average exchange rate MKD/EUR	61.57	61.51	61.50	61.67	61.7	61.7	61.7

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

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