31. NORTH MACEDONIA

Recovery is set to speed up with improved investment outlook

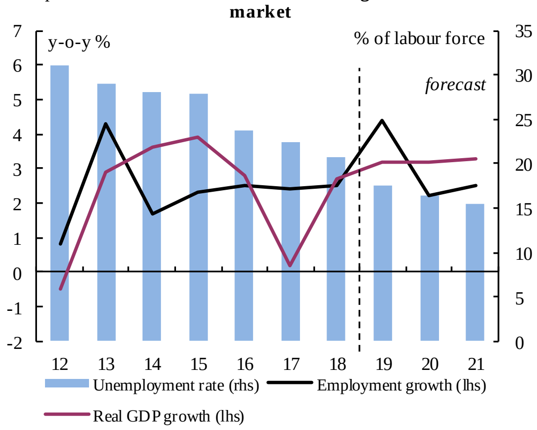
Economic growth is set to gain speed, supported by solid household spending and the ongoing recovery of investment. With a more difficult external environment ahead, net exports are not expected to contribute to economic growth over the forecast horizon. Fiscal consolidation measures are having a beneficial impact on the primary balance, but are not sufficient to stabilise debt levels.

Domestic demand is set to strengthen further

The economic recovery strengthened in the first half of 2019 as investment caught up after several quarters of weakness, in spite of heavy under-execution of government capital expenditure and muted foreign investment. Household spending also supported growth, while the external balance contributed negatively, for the third quarter in a row, as investment-related imports rose.

Over the forecast horizon, domestic demand is projected to be the sole growth driver, underpinned by robust private consumption and a continued recovery in investment following a protracted period of weakness. Households' disposable income is expected to be strengthened by further employment gains, solid, though diminishing increases in net wages, and raises in minimum and public sector wages, pensions and social transfers. Strong annual growth in household credit will also support private consumption. Investment benefits from a wide range of fiscal incentives, introduced under the 2018 Plan for Economic Growth and stepped up in the recent 2019 budget rebalancing, as well as from solid growth in long-term corporate lending. The ongoing clearance of public sector arrears is supporting companies' liquidity.

Graph II.31.1: **North Macedonia - Real GDP growth and labour market**



External balance is expected to contribute negatively to growth

Net exports, on the other hand, are set to become an increasing drag on the expansion, as import growth is likely to accelerate with firming investment, while export growth is projected to slow down amidst a weak external environment and capacity constraints of foreign companies in the country. The latter account for over half of the country's exports. The current account is set to deteriorate until 2021, mainly on account of the widening merchandise trade deficit.

Inflation expected to remain muted

Consumer price inflation in the year to date, including core inflation, remained below its level of one year earlier. Food, alcohol and health were driving prices, with energy and transport prices declining. The CPI is projected to increase slightly over the forecast horizon, mainly as domestic demand is firming, backed by higher wages.

Government measures expected to support employment

The labour market improved further in 2018. These dynamics are expected to continue, supported by the government's employment-related subsidies, and by an extension of active labour market measures. Government policies to incentivise a move from informal to formal employment are beginning to bear fruit, and will likely be reflected in smaller reductions in the unemployment rate in the coming years.

Risks to forecast are on the downside

Downside risks to the growth outlook come mainly from a stronger than expected deterioration of the external environment, exacerbating the drag on growth from net exports. Risks on the domestic side stem from further delays in key public infrastructure works; from potential for renewed political instability; and from rising divergence between labour productivity and wage dynamics undermining external competitiveness - since September 2017, the government has raised minimum wages on several occasions, with a hike of 16% planned in December, and another one announced for 2020.

Policy reforms underpin fiscal consolidation

The 2019 general government fiscal deficit is likely to remain below target (3% of GDP), as capital expenditure is set to continue being heavily underexecuted. Reforms on the revenue side, which became operational in early 2019, such as a progressive income tax system and a rise in social contribution rates, have bolstered revenue. The fiscal balance is projected to improve gradually, as the positive net effect from recent policy measures (i.e. the pensions deficit, social assistance reform in force since June 2019) is set to increase. However, subsidies for investment and employment are expected to be stepped up in 2020-2021.

Risks to fiscal projections arise from possible ad hoc increases in pensions (the government has just announced an increase beyond the recently agreed CPI-only indexation for 2020), and public sector wages. Potential calls on guarantees for public enterprises also present a downward risk. The government expects the primary balance to decline to 0.5% of GDP in 2022, which would not be sufficient to stabilise debt levels. General government debt is set to rise further in each of the forecast years, as a result of primary fiscal deficits and financing requirements for significant repayment obligations in 2020 and 2021. Figures do not include the debt of the Public Enterprise for State Roads, which amounted to over 5% of 2018 GDP.

Graph II.31.2: **North Macedonia - Public finances**

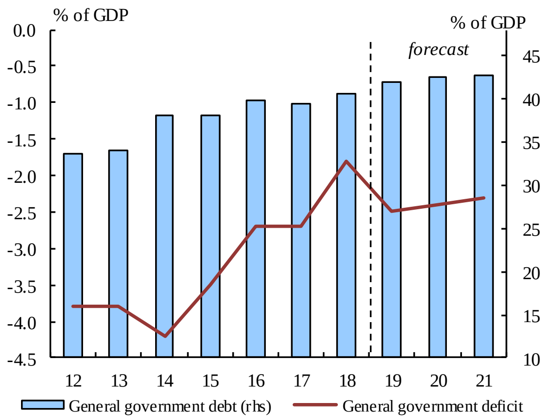


Table II.31.1:

Main features of country forecast - NORTH MACEDONIA

		2018			Annual percentage change					
	bn MKD	Curr. prices	% GDP	00-15	2016	2017	2018	2019	2020	2021
GDP		660.3	100.0	2.9	2.8	0.2	2.7	**3.2**	**3.2**	**3.3**
Private Consumption		424.7	64.3	3.0	3.9	0.7	2.9	**3.1**	**2.9**	**2.9**
Public Consumption		100.7	15.2	1.3	-4.9	-2.5	6.2	**3.1**	**2.8**	**2.2**
Gross fixed capital formation		167.6	25.4	4.7	9.9	0.8	-7.2	**8.6**	**9.3**	**8.7**
of which: equipment		-	-	-	-	-	-	**-**	**-**	**-**
Exports (goods and services)		398.4	60.3	6.6	9.1	8.1	15.3	**9.9**	**9.7**	**9.2**
Imports (goods and services)		481.3	72.9	7.1	11.1	6.4	9.0	**10.2**	**10.1**	**9.3**
GNI (GDP deflator)		632.6	95.8	2.8	2.0	0.2	2.4	**3.2**	**3.6**	**3.9**
Contribution to GDP growth:	Domestic demand			3.7	4.2	0.3	1.0	**4.6**	**4.9**	**4.7**
	Inventories			0.6	1.5	0.1	-0.6	**0.0**	**0.0**	**0.0**
	Net exports			-1.3	-2.8	-0.1	2.2	**-1.5**	**-1.7**	**-1.4**
Employment				1.7	2.5	2.4	2.5	**4.4**	**2.2**	**2.5**
Unemployment rate (a)				32.5	23.7	22.4	20.7	**17.5**	**16.5**	**15.5**
Compensation of employees / head				2.3	0.9	0.9	5.0	**4.0**	**3.4**	**2.4**
Unit labour costs whole economy				1.1	0.5	3.1	4.8	**5.2**	**2.4**	**1.6**
Real unit labour cost				-1.7	-2.8	-0.3	0.5	**3.0**	**0.6**	**-0.6**
Saving rate of households (b)				-	-	-	-	**-**	**-**	**-**
GDP deflator				3.0	3.5	3.4	4.3	**2.1**	**1.7**	**2.3**
Consumer-price index				-	-0.2	1.3	1.5	**1.4**	**1.9**	**2.0**
Terms of trade goods				0.7	7.1	-0.8	-9.7	**-0.1**	**-0.1**	**-0.1**
Trade balance (goods) (c)				-22.6	-18.8	-17.8	-16.2	**-17.5**	**-19.1**	**-20.4**
Current-account balance (c)				-4.5	-2.9	-1.0	-0.3	**-1.4**	**-2.0**	**-2.1**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-	-	-	-	**-**	**-**	**-**
General government balance (c)				-	-2.7	-2.7	-1.8	**-2.5**	**-2.4**	**-2.3**
Cyclically-adjusted budget balance (d)				-	-	-	-	**-**	**-**	**-**
Structural budget balance (d)				-	-	-	-	**-**	**-**	**-**
General government gross debt (c)				33.3	39.8	39.5	40.5	**41.9**	**42.5**	**42.7**

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP. (d) At the end of September 2019, the national statistics office published revised data for 2017 real GDP growth (1.1%), but did not provide a breakdown by components. Hence, the revision was not taken into account.