30. NORTH MACEDONIA

North Macedonia's economic upswing came to a sudden halt in 2020, as the pandemic hit domestic and foreign demand. During 2021 and 2022, the recovery is expected to regain firm ground. Real GDP growth would average 3.7%. The external sector is unlikely to contribute to growth. Public finances are projected to improve in line with the economic recovery and the gradual phasing out of fiscal support.

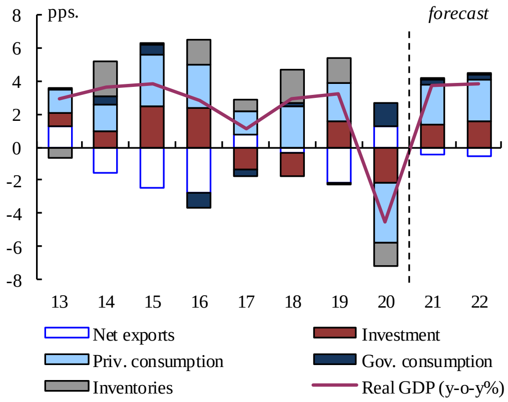
Contraction in 2020 milder than anticipated

North Macedonia experienced a major economic recession in 2020. Output dropped by 4.5%, which is somewhat less than projected in autumn 2020, in part due to government support measures and monetary and regulatory easing. After a steep drop in output between April and June, the annual decline became smaller in the second half of the year, as containment measures were lifted and foreign demand strengthened. Remittances recovered slightly towards the end of the year, bolstering household spending power. Investment picked up in the summer, as public works surged temporarily. External trade suffered from containment measures in trading-partner economies, in particular Germany, which accounts for over half of the country's exports, and through the temporary breakdown of automotive supply chains. Overall, net exports contributed to growth.

Recovery to gain firm ground only in 2022

Still, the economic recovery turns out more sluggish than anticipated earlier. High-frequency indicators, such as industrial production, send mixed signals in early 2021. While the recovery is likely to gain speed throughout 2021, driven by domestic demand, output is expected to rise above its pre-crisis level in 2022 only. With further lifting of containment measures, household spending is projected to firm at accelerating speed in 2021 and 2022, bolstered by further wage increases, employment gains and revival of remittances. Investment is expected to be boosted by at least partial realisation of the government's ambitious plans to invest in road, railway and utilities infrastructure. The recovery in foreign demand, in particular from Germany and China, supported by the restoration of supply chains, is driving export growth. However, the external balance is likely to detract from growth both years, as a result of strong import demand, reflecting rising domestic demand and import-dependent export production.

Graph II.30.1: **North Macedonia - Real GDP growth and contributions**



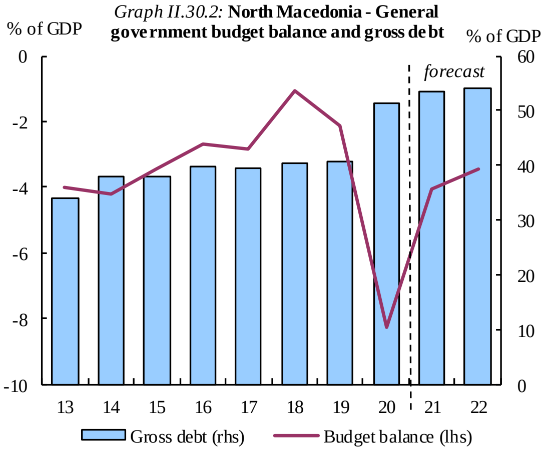
Impact on labour market to remain mild

The labour market, propped up by government subsidies, proved resilient throughout 2020. Job losses remained contained, but rising each quarter, and the labour force shrank successively. The unemployment rate dropped further, compared to one year earlier. With the recovery firming up, and support to employers and workers continued at least this year, as foreseen in the government's fifth package, employment is likely to grow at an accelerated pace over the forecast horizon. Inflation picked up in the second half of 2020, driven by food and fuels prices, including higher excises on oil products, and a statutory rise in electricity prices in August. Both, rising import prices of commodities and firming domestic demand are expected to determine inflation dynamics.

Debt levels jump in response to crisis financing

Public finances deteriorated in 2020, as automatic stabilisers kicked in and the government implemented discretionary support measures totalling some 3% of GDP. Tax revenue recovered in the last quarter, partly on account of inflows of deferred income tax payments. Social contributions benefitted from government subsidies and increased compared to the preceding year. To help finance higher transfers, capital expenditure was cut. In terms of GDP, it came out almost unchanged from the preceding year, at 3.1%. The general government budget deficit quadrupled and debt levels surged on account of heavy crisis-related financing requirements.

Graph II.30.2: **North Macedonia - General government budget balance and gross debt**



Fiscal consolidation to set in with recovery

In line with the economic recovery, public finances are expected to improve over the forecast horizon. Transfers and crisis-related expenditure on goods and services are projected to drop gradually, while capital expenditure is expected to rise substantially. The recovery of public revenue is likely to benefit from ongoing improvements in public financial management, such as the Tax System Reform Strategy, adopted in December, which could boost revenue mobilisation. While the government plans on fiscal consolidation as of 2021, it has not presented measures to underpin this. High fiscal deficits and plans to replenish deposits are likely to drive debt levels further.

Risks to the forecast are on the downside

The fiscal outlook could be challenged in case further support measures are needed or because of weak commitment to revenue mobilisation reforms, such as new plans for tax relief. On the other hand, speedy enforcement of key provisions of the new organic budget law and the recent Action Plan for Public Investment Management could improve the outlook.

Table II.30.1:

Main features of country forecast - NORTH MACEDONIA

	2019			Annual percentage change					
bn MKD	Curr. prices	% GDP	01-16	2017	2018	2019	2020	2021	2022
GDP	689.4	100.0	2.8	1.1	2.9	3.2	**-4.5**	**3.7**	**3.8**
Private Consumption	452.7	65.7	2.6	2.1	3.7	3.5	**-5.6**	**3.6**	**3.7**
Public Consumption	96.8	14.0	1.2	-2.6	1.5	-0.8	**10.1**	**2.2**	**1.6**
Gross fixed capital formation	146.1	21.2	5.4	-5.7	-6.4	8.0	**-10.2**	**7.4**	**8.9**
of which: equipment	:	:	:	:	:	:	**:**	**:**	**:**
Exports (goods and services)	429.5	62.3	6.1	8.3	12.8	7.2	**-10.9**	**12.3**	**10.9**
Imports (goods and services)	527.6	76.5	6.2	5.3	10.7	8.9	**-10.5**	**10.7**	**9.9**
GNI (GDP deflator)	655.8	95.1	:	1.2	2.7	2.7	**-3.5**	**3.3**	**3.5**
Contribution to GDP growth: Domestic demand			3.5	-0.4	1.2	3.8	**-4.4**	**4.1**	**4.4**
Inventories			0.6	0.7	2.0	1.5	**-1.4**	**0.0**	**0.0**
Net exports			-1.1	0.7	-0.4	-2.1	**1.3**	**-0.4**	**-0.6**
Employment			1.7	2.4	2.5	5.0	**-0.3**	**1.0**	**2.5**
Unemployment rate (a)			32.2	22.4	20.7	17.3	**16.4**	**15.8**	**15.2**
Compensation of employees / head			2.4	3.4	5.2	7.8	**7.6**	**4.0**	**2.6**
Unit labour costs whole economy			1.3	4.7	4.8	9.7	**12.4**	**1.3**	**1.3**
Real unit labour cost			-1.4	1.8	0.9	8.5	**11.4**	**1.3**	**0.4**
Saving rate of households (b)			:	:	:	:	**:**	**:**	**:**
GDP deflator			2.7	2.8	3.9	1.1	**0.9**	**0.0**	**0.9**
Harmonised index of consumer prices			2.0	1.3	1.4	0.8	**1.2**	**1.7**	**1.7**
Terms of trade goods			1.1	0.2	2.2	-0.2	**-0.8**	**0.7**	**1.7**
Trade balance (goods) (c)			-22.4	-17.8	-16.2	-17.5	**-16.8**	**-17.3**	**-17.3**
Current-account balance (c)			-3.6	-1.1	-0.1	-3.3	**-3.5**	**-2.2**	**-1.6**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			:	:	:	:	**:**	**:**	**:**
General government balance (c)			-1.4	-2.8	-1.1	-2.1	**-8.3**	**-4.1**	**-3.4**
Cyclically-adjusted budget balance (d)			:	:	:	:	**:**	**:**	**:**
Structural budget balance (d)			:	:	:	:	**:**	**:**	**:**
General government gross debt (c)			32.9	39.4	40.4	40.7	**51.2**	**53.5**	**54.2**

(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.