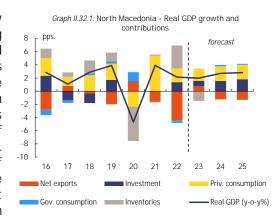
# 32. NORTH MACEDONIA

After a muted post-pandemic recovery, economic growth has slowed down on account of both weaker external demand and more moderate household consumption. Growth is set to accelerate moderately ahead, with inflation expected to mitigate further, wage growth and remittances to bolster disposable incomes, and a substantial stimulus to the economy from a major public infrastructure project. The fiscal deficit is expected to remain elevated, given new spending commitments and high borrowing costs, restraining the decline of public debt from its post-COVID high.

### Domestic demand to drive GDP growth

In the second quarter of 2023, real GDP rose by 1.1% y-o-y, down from 2.1% in the preceding quarter. Household consumption has suffered from the lingering cost-of-living crisis and its growth decelerated for the third consecutive quarter, to 1.6% y-o-y, but remained the main driver of GDP growth. It is expected to firm as disposable incomes strengthen on account of faster real wage growth amid falling inflation. Investment was muted in the first six months of 2023, as private companies dealt with their large inventories built up in 2022. Over the forecast horizon, public investment is set to become an increasingly important driver of capital formation.



The government's major public roads project, covering parts of two key transeuropean Road Corridors, is expected to have a substantial impact on aggregate demand given a high domestic input share.

In the first half of 2023, the current account deficit declined markedly from its 2022 high, as the goods trade balance improved on account of decreasing energy prices, and remittances increased. Looking ahead, both import and export growth are set to pick up gradually. Domestic demand is projected to remain the key driver of the expected acceleration in GDP growth over the forecast horizon. The external side is set to contribute positively to growth in 2023, reflecting the improvement in the terms of trade, but to detract from growth in the following two years, as the recovery of domestic demand boosts import growth, and prevails over the positive impact of firming external demand on exports.

#### Declining unemployment masks shrinking labour force

Low and declining labour market participation, especially for women and young workers, led to a further shrinking of the labour force and a decline in the unemployment rate. During the forecast horizon, employment is expected to continue growing at a moderate pace. While employment growth in manufacturing industries is likely to remain muted at least in 2023, given a large backlog of inventories weighing on current production activity, the services sectors, in particular trade, are likely to account for the bulk of job expansion. The unemployment rate is projected to decline further amid a shrinking labour force.

#### Inflation projected to subside further

Annual consumer price inflation gradually declined from its peak of 19.8% in October 2022 to 6.6% in September 2023. It is projected to remain high, around 9% on average in 2023, with lingering spillover effects from the recent peaks in energy and food prices on domestic sectors, but to eventually ease to the long-term average of 2% by 2025. The central bank increased the key

policy rate further in the first nine months of 2023, yet at a slowing pace, to reach 6.3% in September.

## Fiscal space remains tight

Public finances are strained by high borrowing cost and new spending commitments, even though a budget reallocation in September managed to accommodate the additional expenditure without raising the full-year deficit target. The government raised the minimum pension, and agreed to an additional 10% increase in public sector wages as of September, which adds some 0.2% of GDP to projected current expenditure for 2023. Revenue, despite a boost from lingering high inflation, is suffering from subdued domestic demand. However, in addition to revenue-enhancing amendments to the personal, corporate and value-added tax laws, in September the Parliament adopted the one-off solidarity tax which is expected to add an extra 0.6% of GDP to 2023 revenue. Overall, the general government deficit is projected to increase somewhat in 2023 compared to 2022. Assuming that the government implements planned fiscal consolidation measures, including the phasing out of energy subsidies, the fiscal deficit is set to decline gradually in 2024 and 2025, but to remain well above the pre-pandemic level of 2.2% of GDP in 2019. Government debt is projected to hover above 50% of GDP in the medium-term, as primary deficits remain elevated and interest payments are rising.

#### Risks are mainly on the downside

The growth outlook could be challenged if the major public roads construction project faces significant implementation delays. The fiscal outlook might also deteriorate if this project suffers from serious cost overruns, or if the cost of financing rises faster than projected. Both might also be impacted negatively by political uncertainty in the run-up to the 2024 elections. On the upside, EU accession negotiations may accelerate structural reforms, which would raise the economy's growth potential and bolster fiscal sustainability.

Table II.32.1:

Main features of country forecast - NORTH MACEDONIA

	2022				Annual percentage change					
	bn MKD	Curr. prices	% GDP	04-19	2020	2021	2022	2023	2024	2025
GDP		794.8	100.0	3.3	-4.7	3.9	2.1	2.0	2.7	2.8
Private Consumption		558.1	70.2	3.0	-3.6	8.1	3.1	2.6	3.3	3.4
Public Consumption		115.2	14.5	1.4	9.8	-0.4	-2.6	-0.5	1.4	1.1
Gross fixed capital formation		219.6	27.6	4.8	0.4	0.1	5.8	2.9	5.4	5.6
Exports (goods and services)		595.3	74.9	9.3	-10.9	11.7	13.4	0.9	4.3	5.5
Imports (goods and services)		762.4	95.9	8.4	-10.9	11.9	16.1	-0.1	4.9	6.0
GNI (GDP deflator)		760.1	95.6	3.0	-3.2	2.8	2.2	1.8	2.4	2.5
Contribution to GDP growth:		Domestic demand		3.7	-0.9	5.3	3.1	2.6	4.0	4.2
	ı	nventories		0.9	-5.2	0.2	3.5	-1.4	-0.1	0.0
	1	Net exports		-1.1	1.5	-1.6	-4.4	0.8	-1.2	-1.3
Employment				2.4	-0.4	1.1	0.5	0.9	1.4	1.6
Unemployment rate (a)				29.7	16.6	15.4	14.2	13.8	13.7	13.5
Compensation of employees / head	t			:	3.3	5.7	15.5	9.6	6.4	3.3
Unit labour costs whole economy				:	8.0	2.8	13.7	8.4	5.1	2.0
Saving rate of households (b)				:	:	:	:	:	:	:
GDP deflator				2.7	1.4	3.6	8.0	14.2	8.1	8.0
Consumer price index				1.7	1.2	3.2	14.2	9.5	4.1	2.1
Terms of trade goods				1.0	0.1	-0.3	:	:	:	:
Trade balance (goods) (c)				-21.8	-16.6	-20.0	-27.7	-22.6	-23.2	-23.5
Current-account balance (c)				-2.8	-2.9	-3.1	-5.9	-3.5	-3.6	-2.4
General government balance (c)				-1.7	-8.2	-5.4	-4.5	-4.8	-3.8	-3.5
Structural budget balance (d)				:	:	:	:	:	:	:
General government gross debt (c)				32.8	50.8	52.0	50.9	51.0	51.7	51.1

(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.