NORTH MACEDONIA: Perfect storm brewing

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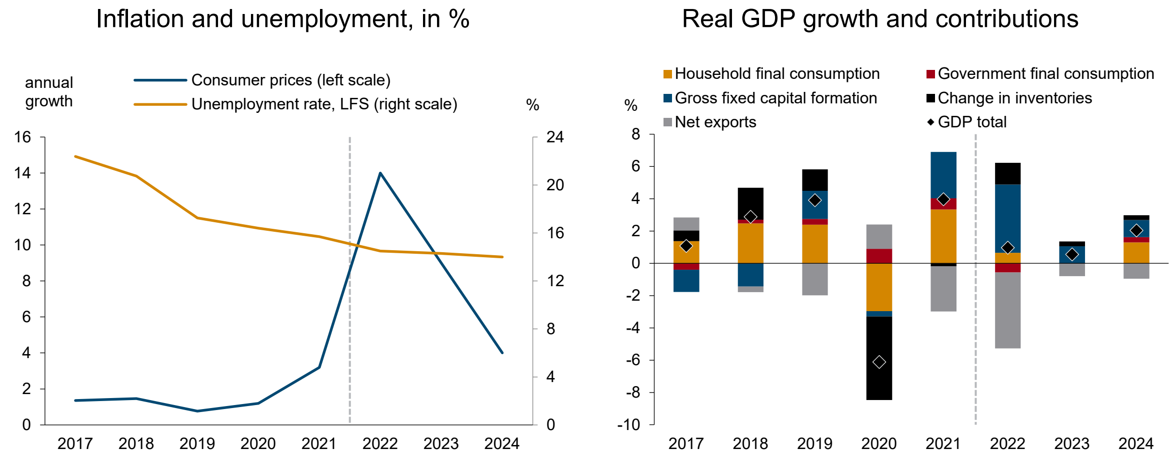
Inflation is out of control and is eating into real incomes. Soaring global electricity prices are taking an additional toll, as some big industrial plants may be forced to close over the winter. Monetary and fiscal policies are becoming more and more restrictive, further crippling the economy. On top of that comes a possible recession in Germany, which takes half of all Macedonian exports.

Figure 6.15 / North Macedonia: Main macroeconomic indicators



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

The inflation genie is out of the bottle and the government has so far failed to get it back in. In August, inflation reached 16.8%, the highest since hyper-inflationary 1994. The main driver was foodstuffs, whose prices rose by 22.5%. Transport and housing followed, with increases of 19.3% and 18.2%, respectively. The government has been trying to tame inflation by imposing limits on the sales margin that companies can charge on basic foodstuffs, but the measure, in force since March 2022, has proved totally ineffective.

Because of inflation, real wages are in freefall, despite their nominal growth. In nominal terms, the average net wage in the country in the month of July grew by 11.5% year on year; but in real terms, it declined by 3.9%. Since the 18% rise in the minimum wage at the start of the year, the government has done nothing to prop up wages. It even rejected the idea of indexing other public-sector wages to the new minimum wage, which led to strikes and protests over the summer.

This all made for only lukewarm economic activity in the first half of the year. GDP grew by 2.4% in Q1 and by 2.8% in Q2 – among the lowest in the whole CESEE region. What growth did occur was driven by investment: the increase of 42% in real terms (!) in the first half of the year was certainly impressive, but was mainly due to the previous year's low base. It was also followed by a surge in imports: up 25% over the same period (again in real terms), they fully offset the growth in investment. Among the other components, household consumption grew by a solid 4.5%, reflecting a post-pandemic recovery, while government consumption declined by 3.4%, due to the fiscal problems the country is facing.

The current account deficit widened significantly under pressure from high food and energy prices. In the first half of the year, it reached 10.3% of GDP, the highest for 12 years. Strong foreign direct investment (FDI) inflows helped maintain the external balance: they grew by 15% year on year in nominal terms in the first half of the year to reach 4% of GDP, which is high for the country. Remittances (proxied by 'secondary income' in the balance of payments accounts) grew even more, by 24%, providing a lifebelt for many households.

But the real problems seem to have emerged only in the third quarter of the year. Industrial production in July declined by 5% year on year, after growth of 2.5% in the first six months. Meanwhile, retail trade declined by 4.5%, having grown by 2.6% in the first half year.

Despite the tough economic times, monetary policy is not providing any support; quite the reverse – it is getting more and more restrictive. The central bank has hiked its interest rate five times since April, to 3% in September (from the earlier 1.25%). Bank interest rates have already started rising because of this, though still only marginally. The growth in credit to the private sector has started to wilt, from 9.9% in April to 9.7% in July (in nominal terms), with the deceleration evident in both the corporate and the household sector. While the slowdown is still small, it is likely to get bigger, especially as monetary policies take some time to filter through.

Fiscal policy has not been very supportive either. The budget deficit for the first half of the year was 2.6% of GDP, which was just half of the planned deficit of 5.3%. Despite the buoyant revenues brought about by inflation (total budget receipts grew by 2% year on year in the first seven months, in real terms), government spending has been very weak. Total budget spending, in real terms, declined by 7% year on year in the first seven months. This slide was especially evident in public investment, which declined by 20% year on year over the same period, in real terms. Public debt declined from 61% of GDP at the end of 2021 to 56% at the end of June 2022, but this was entirely due to the inflation, which raised the nominal GDP.

The government is having a hard time borrowing on the markets. It announced in May that it was carving out a deal with the International Monetary Fund, but to date nothing has come of that. It managed to borrow EUR 250m (2% of GDP) in September, in the form of registered bonds (*Namensschuldverschreibungen*) sold to German investors. But this falls far short of the external financing requirements of the budget adopted, which exceed EUR 1bn (8% of GDP). A tax reform has been announced, starting from 2023, but that does not envisage the introduction of a progressive tax, focusing instead on taxing companies' reinvested earnings and heaping social contributions on the self-employed. The additional revenues from the reform are estimated at EUR 50m (0.4% of GDP), which is clearly inadequate.

On top of all that comes the energy crisis, which is especially challenging for North Macedonia. The country does not depend too much on gas – only 14% of its total energy demand is for gas, which is among the lowest figures in CESEE. But as of early October, it is still unclear whether the capital city will have centrally supplied heating in the coming winter. Furthermore, the country imports around a third of its electricity requirements, which is the highest of all CESEE countries. With electricity prices soaring, the government is having difficulty finding affordable power. It tried to reach a deal with some neighbouring countries, but the high prices involved meant that none of the attempts has been successful. The cost of electricity for households and small companies is capped, but bigger companies have to pay market prices: given the surge in prices, they may be forced to close for a while. Some big industrial plants have already announced temporary closures during the winter.

A further problem is the country's heavy reliance on exports to Germany, which could be painful if there is energy rationing in Germany in the coming months. Almost half of the country's exports (47% in 2021) go to Germany – a figure that is far and away the highest of all the CESEE countries. Exports to Germany account for 28% of North Macedonia's GDP, meaning that a recession in Germany would, almost inevitably, imply a recession in North Macedonia.

The dire economic situation will have severe social impacts as well. The proportion of people at risk of poverty or social exclusion in North Macedonia stands at around 40%. With a current poverty rate of 22%, this means that an additional 18% of the population could now easily fall into poverty because of the crisis. Absolute poverty in the country – defined as having to live on less than USD 2.15 per day (based on 2017 purchasing power parities) – stands at 3.4%, according to the latest available data. That figure could easily escalate now, given that the government is not taking any particular measures to protect the poor.

The upshot of all this is that we now take a gloomier view of the coming period than three months ago. As far as GDP growth is concerned, we keep the forecast for 2022 unchanged at 1%, which means that for the second half of the year we are forecasting a slight decline in GDP. For 2023, we now forecast GDP growth of 0.6%, which is a downward revision of almost 2 percentage (pp) points compared to the previous forecast.

Our current view on inflation is that it will be much higher and much more persistent than previously thought. Specifically, we now forecast that inflation in 2022 will average 14% for the whole year (3 pp above our summer forecast). For 2023, we forecast inflation of 9% – again 3 pp higher than was anticipated three months ago.

Table 6.15 / North Macedonia: Selected economic indicators

	2019	2020	2021 [1)]	2021 January-June	2022 January-June	2022 Forecast	2023 Forecast	2024 Forecast
Population, th pers., average [2)]	2,077	2,073	1,837	.	.	1,827	1,817	1,807
Gross domestic product, MKD bn, nom.	692.7	655.9	723.2	333	384	832	912	968
annual change in % (real)	3.9	-6.1	4.0	5.5	2.6	1.0	0.6	2.0
GDP/capita (EUR at PPP)	11,940	11,170	13,450	.	.	.	.	.
Consumption of households, MKD bn, nom.	447.1	434.9	469.3	228	259	.	.	.
annual change in % (real)	3.7	-4.6	5.0	6.0	4.4	1.0	0.0	2.0
Gross fixed capital form., MKD bn, nom.	145.8	144.8	191.4	.	.	.	.	.
annual change in % (real)	8.7	-1.6	13.0	.	.	16.0	4.0	4.0
Gross industrial production [3)]								
annual change in % (real)	3.7	-9.6	1.4	6.6	2.5	1.0	0.5	2.0
Gross agricultural production [4)]								
annual change in % (real)	-5.4	1.7	-1.2	.	.	.	.	.
Construction industry								
annual change in % (real)	3.8	1.4	-11.4	-6.1	-5.5	.	.	.
Employed persons, LFS, th, average [5)]	797.7	794.9	795.1	794	693	695	700	710
annual change in %	5.1	-0.3	0.0	-1.0	.	.	0.5	1.0
Unemployed persons, LFS, th, average [5)]	166.4	155.9	147.9	150	119	120	120	120
Unemployment rate, LFS, in %, average [5)]	17.3	16.4	15.7	16.0	14.7	14.5	14.3	14.0
Reg. unemployment rate, in %, eop	19.6	25.8	19.7	20.9	17.6	.	.	.
Average monthly gross wages, MKD	37,446	40,566	42,887	42,386	46,237	46,900	50,100	52,600
annual change in % (real, gross)	4.3	7.0	2.4	3.9	-0.8	-4.0	-2.0	1.0
Average monthly net wages, MKD	25,213	27,182	28,718	28,390	30,950	31,400	33,500	35,200
annual change in % (real, net)	3.1	6.5	2.3	3.8	-0.9	-4.0	-2.0	1.0
Consumer prices, % p.a.	0.8	1.2	3.2	2.4	10.0	14.0	9.0	4.0
Producer prices in industry, % p.a.	2.1	0.6	11.1	7.0	19.5	17.5	5.0	3.0
General governm. budget, nat. def., % of GDP								
Revenues	31.4	30.5	32.3	30.4	30.3	30.0	30.5	31.0
Expenditures	33.5	38.9	37.7	35.6	33.0	33.0	32.5	32.5
Deficit (-) / surplus (+)	-2.1	-8.3	-5.4	-5.2	-2.7	-3.0	-2.0	-1.5
General gov. gross debt, nat. def., % of GDP	40.4	51.9	51.8	54.7	45.2	50.0	51.0	52.0
Stock of loans of non-fin. private sector, % p.a.	6.1	4.6	8.2	5.0	9.9	.	.	
Non-performing loans (NPL), in %, eop	4.6	3.3	3.2	3.4	3.2	.	.	
Central bank policy rate, %, p.a., eop [6)]	2.25	1.50	1.25	1.25	2.00	3.50	3.00	2.50
Current account, EUR m	-335	-318	-366	-144	-629	-1,240	-1,260	-1,150
Current account, % of GDP	-3.0	-3.0	-3.1	-2.7	-10.1	-9.2	-8.5	-7.3
Exports of goods, BOP, EUR m	5,347	4,820	6,000	2,926	3,554	7,380	8,270	9,100
annual change in %	9.5	-9.9	24.5	45.2	21.5	23.0	12.0	10.0
Imports of goods, BOP, EUR m	7,296	6,623	8,371	3,995	5,301	10,880	12,190	13,290
annual change in %	10.2	-9.2	26.4	37.2	32.7	30.0	12.0	9.0
Exports of services, BOP, EUR m	1,625	1,445	1,744	779	998	2,210	2,480	2,730
annual change in %	2.8	-11.1	20.7	15.4	28.2	27.0	12.0	10.0
Imports of services, BOP, EUR m	1,289	1,021	1,248	458	673	1,620	1,780	1,960
annual change in %	6.6	-20.8	22.2	12.1	47.1	30.0	10.0	10.0
FDI liabilities, EUR m	488	28	575	533	633	800	.	.
FDI assets, EUR m	125	-127	187	349	386	300	.	.
Gross reserves of CB excl. gold, EUR m	2,961	3,019	3,288	3,704	2,734	.	.	.
Gross external debt, EUR m	8,154	8,536	9,577	10,165	10,379	10,800	12,600	13,700
Gross external debt, % of GDP	72.4	80.3	81.6	86.6	76.7	80.0	85.0	87.0
Average exchange rate MKD/EUR	61.50	61.67	61.63	61.6	61.7	61.5	61.5	61.5

1) Preliminary. - 2) From 2021 according to census September 2021. - 3) Enterprises with 10 and more employees. - 4) wiiw estimate in 2021. - 5) From 2022 according to Census September 2021. - 6) Central Bank bills (28-days).

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