

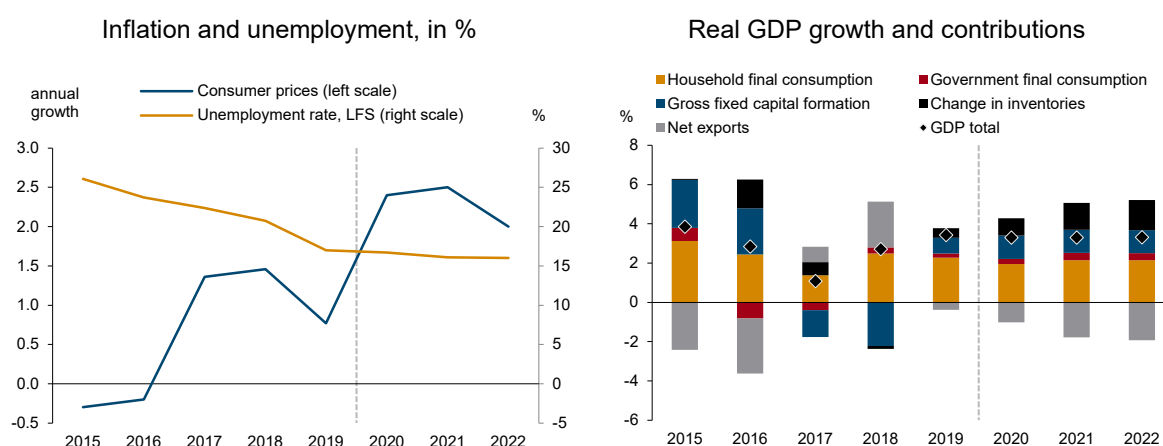


## NORTH MACEDONIA: Lingering EU uncertainty inhibits potential growth

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After a long period of stagnation and negative development, rising investments and a boost in consumption will ensure stable GDP growth for North Macedonia in the period 2020-2022 of about 3.3% p.a. The construction industry has started to expand and recorded solid growth rates in 2019. In addition, unemployment will fall to a historical low in 2020. Despite stable projections, North Macedonia still suffers from various socioeconomic issues. Moreover, the delay to the start of EU accession talks has dampened the country's growth potential.

**Figure 6.15 / North Macedonia: Main macroeconomic indicators**



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

**Despite political uncertainty, economic growth remains stable.** The positive trend in economic growth in the first half of 2019 was dampened by the failure to begin talks on EU accession, which created political uncertainty and deterred foreign investors. However, thanks to stimulation by private and government consumption, a stable GDP growth rate of about 3.3% p.a. is still expected in the period 2020-2022. The relaxation of the labour market, caused by a decrease in unemployment from 20.7% in 2018 to about 16.5% in 2020, as well as a growth in real wages, will likely boost private consumption to about 3.3% p.a. in the period 2020-2022. Private consumption and strong investments remain key factors that will drive growth in 2020.

**The government received substantial loans to launch several infrastructure projects.** China, in particular, is investing heavily in North Macedonia's infrastructure, as may be seen from the construction of the Kicevo–Ohrid motorway, which is valued at EUR 600 million and funded by the Chinese Exim Bank. The European Bank for Reconstruction and Development also provided loans of EUR 12 million to extend the Kriva Palanka–Deve Bair road. Those construction projects, which will be completed in 2021, will contribute to a stable investment growth of about 6% in 2020. It is expected that this trend will continue in the medium term, especially as FDIs will remain high in the period 2020-2022.

**As a consequence of falling global commodity prices, most notably oil prices, inflation remained at about 1.5% in 2019.** The expected slight (0.8%) rise in inflation on food prices, following an increase in energy prices, will not affect household consumption in 2020: it will continue to rise on account of an increase in minimum wages and falling unemployment. At the beginning of 2020, the central bank unsuccessfully reduced interest rates in order to bump inflation; however, investor enthusiasm – which is drawn to the denar's higher return on capital over the euro, combined with an appreciation of the denar against the dollar – will still result in a low inflation rate of 1% in 2020. Inflation will pick up, but lower energy prices mean it will remain low, at an average of 2% p.a. in the period 2021-2022.

**North Macedonia's productive capacity is heavily dependent on foreign investment in its industrial zones.** Germany remains the country's most important trading partner, since German investors within the automotive supply sector export their goods to Germany for further processing. However, the positive development of foreign trade depends heavily on the development of the German economy, especially in view of North Macedonia's strong connection to its automotive industry; this could become a challenge in the future. A surplus in the secondary income account, which is still influenced by remittances from workers in the diaspora, means that North Macedonia's current account deficit can be expected to increase only moderately, to about 2% of GDP annually in the period 2020-2022. In 2019, remittances totalled about EUR 295 million. Although this corresponds to 2.5% of North Macedonia's GDP, it is still relatively low in comparison to other countries in the Western Balkans.

**Regulating public debt remains an issue for North Macedonia.** Constant changes in the country's fiscal policy caused North Macedonia's public debt to rise from 21% of GDP in 2008 to 48.5% in 2018. In 2019, expenditure on pension and social transfer payments rose to 60% of the budget, while public debt amounted to 40% of GDP. The increase in public-sector wages further contributed to high government expenditure in 2019. As of 2020, North Macedonia is still struggling to regulate its public debt, which is why the government is aiming for a budget deficit of 2.3%, focusing investments on human capital. This moderate reduction in the deficit from the 2019 figure will contribute marginally to stabilisation of North Macedonia's public debt in the period 2020-2022. Recent policy measures – which saw profound reform of the country's pension system in 2019 – are also contributing to North Macedonia's fiscal discipline. In 2020, North Macedonia's budget deficit will still widen to 2.5%, since the government is aiming to increase pensions to keep pace with wage growth. However, an improvement in tax collection and reduced borrowing following the completion of several investment projects mean that the budget deficit can be expected to shrink by 2022 to about 2.2%. Fiscal projections, however, remain uncertain over the long term, due to the possible risk of an increase in public-sector wages.

**North Macedonia's legal framework continues to be favourable to foreign investors, with a ten-year tax exemption and free access to public services.** Labour costs remain low, despite an increase in real wages, since the government has provided favourable investment conditions for businesses, with the introduction of technological and industrial development zones. Labour – particularly in the prominent automotive sector – remains cost-competitive. Due to the increased 'brain drain' from the country, the shortage of skilled labour will continue to be a problem in the long term. Looking at North Macedonia's labour market, it is clear that, despite high levels of unemployment, there is a lack of skilled, technically trained workers. Emigration from North Macedonia became a viable option for many skilled workers following the easing of restrictions on the immigration of skilled workers to the EU. This applies particularly to Germany and Austria: as of 1 January 2020, qualified workers from non-EU countries have been able to apply for 56 different occupations in Austria. In March 2020, Germany will likely follow suit with a similar regulation.

**Political uncertainty has risen because of EU uncertainty.** North Macedonia has been a candidate for EU membership since 2005. But its name dispute with Greece, combined with staggering corruption and organised crime, has blocked the commencement of EU accession talks for 15 years. Under Prime Minister Zaev, however, North Macedonia resolved its name dispute and introduced reforms in the areas of administration, justice and security, in order to properly tackle corruption and organised crime. The failure to open EU accession talks in 2019, despite all these efforts by North Macedonia, has sparked an early election, to be held in April 2020. With the announcement of the snap election and the resignation of Zaev as prime minister, policy uncertainty will rise, leading to adverse effects on private and public investments in 2020. The European Council will once again consider opening accession talks in May 2020. It is likely that a further postponement of EU accession talks could weaken the momentum of public reforms in North Macedonia and damage investor confidence.

**The cancellation of the EU accession talks triggered a serious government crisis in the country.**

In the forthcoming election, the right-wing VMRO-DPMNE, under the leadership of Hristijan Mickoski, could benefit from this political crisis, since it has consistently criticised the pro-European stance of the SDSM-led government. Opinion polls conducted in November 2019 showed that 22.1% of respondents opted for the Social Democrats (i.e. the SDSM), while 20.4% chose the VMRO-DPMNE. With such a narrow margin in the opinion polls, it could again be up to the ethnic Albanian party DUI to assume the role of king-maker in the formation of a new government. The SDSM, with former Prime Minister Zaev, continues to present itself as the guarantor of North Macedonia's western integration, particularly within the European Union – a stance the Social Democrats will maintain after the election. However, the cancellation of the EU accession talks, combined with allegations of corruption levelled by the VMRO-DPMNE, means that the SDSM has lost the trust of the general populace – and that is likely to influence electoral behaviour in April 2020. Those allegations and the cancellation of the EU accession talks additionally make it more difficult for Zaev to enforce pro-EU policies and reforms, even in the case of victory.

**The Prespa Agreement remains controversial among North Macedonia's populace.** In 2019, with ratification of the Prespa Agreement, the country's long-running dispute with Greece was finally resolved and it officially became known as North Macedonia. In return, Greece stopped blocking North Macedonia's accession to the EU. The VMRO-DPMNE's critical stance towards the Prespa Agreement remains a potent ingredient in the mix: the party's announcement that – should it gain a two-thirds majority in the forthcoming election (which seems unlikely) – it will revise the Agreement helps to bolster its popularity among EU sceptics. Nevertheless, the repercussions of such a step would be severe for North Macedonia's western integration, as the Prespa Agreement is linked to possible EU membership. The Prespa Agreement itself continues to stir up controversy in North Macedonia. During the national referendum on the subject in 2018, 98% of those who voted approved the agreement, but overall voter turnout was only 36%. Furthermore, the 'amnesty deal' introduced by the Social Democrats in 2018 to gain support for ratification of the Prespa Agreement, is also perceived rather negatively by the populace, since it excuses several VMRO-DPMNE MPs over their (indirect) participation in the assault on parliament in April 2017 (which was actually staged to prevent the Social Democrats from assuming power).

Table 6.15 / North Macedonia: Selected economic indicators

	2015	2016	2017	2018	2019 <sup>1)</sup>	2020	2021 Forecast	2022
Population, th pers., average	2,070	2,072	2,075	2,076	2,100	2,100	2,100	2,100
Gross domestic product, MKD bn, nom.	559.0	594.8	618.1	658.1	686.0	726	769	810
annual change in % (real)	3.9	2.8	1.1	2.7	3.4	3.3	3.3	3.3
GDP/capita (EUR at PPP)	10,400	10,800	10,900	11,500	12,000	.	.	.
Consumption of households, MKD bn, nom.	380.2	392.2	405.9	427.3	450.0	.	.	.
annual change in % (real)	4.5	3.6	2.1	3.8	3.5	3.0	3.3	3.3
Gross fixed capital form., MKD bn, nom.	133.3	145.0	139.0	130.2	140.0	.	.	.
annual change in % (real)	10.5	9.9	-5.7	-9.9	4.0	6.0	6.0	6.0
Gross industrial production <sup>2)</sup>								
annual change in % (real)	4.9	3.4	0.2	5.4	3.7	4.5	6.0	6.0
Gross agricultural production <sup>3)</sup>								
annual change in % (real)	5.2	5.2	-9.9	5.0	4.0	.	.	.
Construction industry								
annual change in % (real)	40.7	7.2	-27.2	-6.8	3.1	.	.	.
Employed persons, LFS, th, average	706.0	723.6	740.6	759.1	795.0	810	820	830
annual change in %	2.3	2.5	2.4	2.5	5.0	1.5	1.5	1.5
Unemployed persons, LFS, th, average	248.9	225.0	213.6	198.6	170.0	160	160	160
Unemployment rate, LFS, in %, average	26.1	23.7	22.4	20.7	17.0	16.7	16.1	16.0
Reg. unemployment rate, in %, eop	22.1	21.2	20.1	19.3	19.8	.	.	.
Average monthly gross wages, MKD	32,171	32,821	33,688	35,626	37,300	39,000	40,800	42,400
annual change in % (real, gross)	3.0	2.2	1.2	4.2	4.0	2.0	2.0	2.0
Average monthly net wages, MKD	21,904	22,342	22,928	24,276	25,100	26,200	27,400	28,500
annual change in % (real, net)	2.7	2.2	1.2	4.4	2.8	2.0	2.0	2.0
Consumer prices, % p.a.	-0.3	-0.2	1.4	1.5	0.8	2.4	2.5	2.0
Producer prices in industry, % p.a.	-3.9	-3.1	4.8	0.9	2.1	3.0	3.0	3.0
General governm. budget, nat.def., % of GDP								
Revenues	31.0	30.6	31.0	30.5	29.0	32.0	32.0	32.0
Expenditures	34.4	33.2	33.8	31.6	30.8	33.0	33.0	33.0
Deficit (-) / surplus (+)	-3.4	-2.7	-2.8	-1.1	-1.8	-1.0	-1.0	-1.0
General gov.gross debt, nat.def., % of GDP	46.6	48.7	47.6	48.6	47.0	46.0	46.0	45.0
Stock of loans of non-fin.private sector, % p.a.	9.6	-0.1	5.4	7.2	6.1	.	.	.
Non-performing loans (NPL), in %, eop <sup>4)</sup>	10.4	6.4	6.2	5.1	4.6	.	.	.
Central bank policy rate, %, p.a., eop <sup>5)</sup>	3.25	3.75	3.25	2.50	2.25	2.25	2.50	2.75
Current account, EUR mn	-177	-275	-105	-15	-80	-80	-120	-180
Current account, % of GDP	-2.0	-2.9	-1.0	-0.1	-0.7	-0.7	-1.0	-1.4
Exports of goods, BOP, EUR mn	3,047	3,529	4,075	4,881	5,515	5,810	6,090	6,370
annual change in %	9.4	15.8	15.4	19.8	13.0	5.2	4.8	4.6
Imports of goods, BOP, EUR mn	4,870	5,342	5,862	6,616	7,410	7,770	8,170	8,590
annual change in %	5.0	9.7	9.7	12.9	12.0	4.9	5.1	5.1
Exports of services, BOP, EUR mn	1,378	1,390	1,434	1,571	1,650	1,720	1,810	1,900
annual change in %	5.7	0.9	3.2	9.5	5.0	4.0	5.0	5.0
Imports of services, BOP, EUR mn	1,029	1,049	1,060	1,209	1,318	1,350	1,390	1,430
annual change in %	11.8	2.0	1.0	14.1	9.0	2.0	3.0	3.0
FDI liabilities, EUR mn	262	495	351	539	500	500	.	.
FDI assets, EUR mn	59	179	171	-65	380	100	.	.
Gross reserves of NB excl. gold, EUR mn	2,049	2,370	2,097	2,619	2,961	.	.	.
Gross external debt, EUR mn	6,291	7,217	7,372	7,844	8,300	9,200	9,300	9,500
Gross external debt, % of GDP	69.3	74.7	73.4	73.3	77.5	77.5	74.4	72.3
Average exchange rate MKD/EUR	61.61	61.60	61.57	61.51	61.50	61.4	61.4	61.7

1) Preliminary and wiiw estimates. - 2) Enterprises with 10 and more employees. - 3) wiiw estimate from 2018. - 4) The decline in the loans in 2016 was due to the write-off of doubtful and contested claims on loans. - 5) Central Bank bills (28-days).

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