



North Macedonia

Highlights

- **Economic growth has moderated during 2022.** North Macedonia recovered well from the Covid-19 pandemic, as pent-up demand pressures led to an increase in domestic trade and stronger manufacturing in 2021. In 2022, however, inflation is growing and uncertainty has increased, holding back consumption and economic activity.
- **The commitment to a green transition has been strengthened.** In adopting its final National Energy and Climate Plan (NECP), the country set a date of 2027 for the closure of its two coal power plants. The ambitious plan features carbon taxation, energy efficiency measures and gas as a transition fuel.
- **Fiscal decentralisation reform has been adopted.** Municipalities are set to manage a higher portion of tax revenue and service their own debt, in line with defined responsibility and transparency guidelines.

Key priorities for 2023

- **Fiscal sustainability should be carefully maintained.** While policy responses to protect the living standards of citizens in an environment of surging inflation are warranted, care should be taken to avoid untargeted measures or ones that are difficult to reverse. A credible medium-term fiscal strategy in line with the Organic Budget Law would help govern decision-making.
- **Scaling up clean energy is key.** Diversifying energy sources with clean energy would boost the competitiveness of exports in the context of high energy import prices, strong trade links with the European Union (EU) and the EU's upcoming carbon border adjustment mechanism.
- **Enhancement of the business environment would help unleash private-sector potential.** Key steps that should be given priority include the systematisation and streamlining of state subsidies, in addition to linking them to outcomes, addressing informality and, in the long term, comprehensively revamping the education system to address skills mismatches.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	2.9	3.9	-4.7	3.9	2.7
Inflation (average)	1.5	0.8	1.2	3.2	10.6
Government balance/GDP	-1.8	-2.0	-8.2	-5.4	-5.3
Current account balance/GDP	0.2	-3.0	-2.9	-3.1	-6.7
Net FDI/GDP [neg. sign = inflows]	-5.6	-3.2	-1.4	-3.3	-3.2
External debt/GDP	73.0	72.4	78.7	81.9	n.a.
Gross reserves/GDP	26.7	29.0	31.0	31.2	n.a.
Credit to private sector/GDP	50.2	51.3	56.9	56.0	n.a.

Macroeconomic developments and policy response

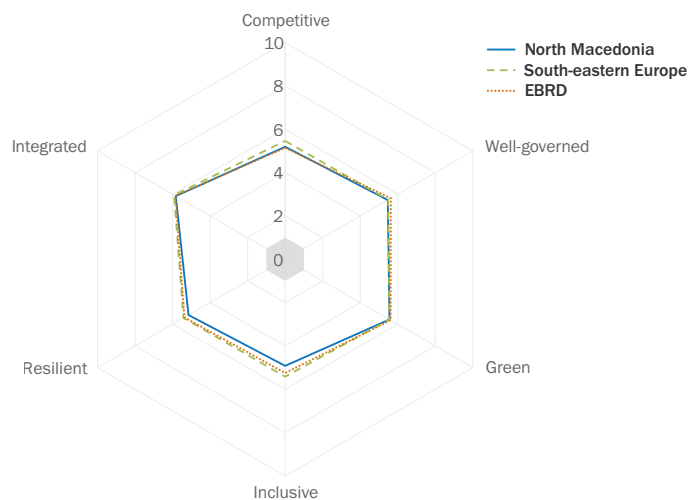
The economic recovery has slowed. Following a relatively strong demand-driven rebound of 3.9 per cent in 2021, economic activity moderated to 2.6 per cent year-on-year growth in the first half of 2022. Supporting economic expansion were strong annual gross investment growth (upwards of 40 per cent), driven by base effects in the first quarter and inventory changes in the second quarter, and persistent household consumption. On the flip side, imports surged 25 per cent year on year, outpacing export growth and damping the growth rate in the first half of 2022. On the production side, strong annual growth in domestic trade, reflecting continued pent-up demand pressures, led the expansion, while the second biggest economic sector, industry, recorded a more muted 2.3 per cent annual growth rate.

Inflationary pressures have accelerated, while energy imports have widened the current account deficit. Annual inflation reached 18.7 per cent in September 2022 as consumers in North Macedonia felt the rising prices of food and energy on world markets through imports. Despite an 18 per cent increase in the minimum wage, effective April 2022, real wage growth turned negative in May. A seven-month state of emergency was declared in the country's energy sector in October 2021 and reinstated in August 2022 due to vulnerabilities in domestic electricity production; household electricity bills increased twice in 2022, while heating prices rose 14 per cent on gas import prices alone. Higher energy prices have also prompted a sharp rise in the current account deficit. Macroeconomic stability is being supported by the managed floating exchange-rate regime, backed by sizeable foreign-exchange reserves of €3.8 billion as of September 2022. The National Bank of North Macedonia raised the key interest rate six times from 1.25 per cent in April to 3.5 per cent as of October 2022.

The government undertook extensive fiscal measures. A 26-measure €400 million package was introduced in March 2022, aiming to protect the living standards of citizens primarily through various tax relief measures, such as a value added tax (VAT) decrease on basic foodstuffs and energy, a delay in applying the upcoming environmental energy tax, the capping of retail trade margins and subsidies, and supporting companies' liquidity through favourable loan terms. Also in March, temporary export bans were introduced for key agricultural products. Fiscal space has tightened since the adoption of the package, prompting the government to undertake a budget rebalancing, featuring a higher 2022 deficit of 5.3 per cent of gross domestic product (GDP) and space for pension increases. The latest €360 million package, adopted in October 2022, is largely an extension of measures introduced in March, with more of the targeted and fewer of the broad-based support measures continued. To help safeguard the economy, the authorities requested a two-year Precautionary and Liquidity Line with the International Monetary Fund (IMF) and reached a staff-level agreement in October.

The economy will continue to grow, albeit at a slower pace. We forecast economic growth of 2.7 per cent in 2022 and 2.3 per cent in 2023 amid an unfavourable global outlook. Although North Macedonia has only limited direct economic links to Russia or Ukraine, the economic impact of the war on Ukraine has already partly materialised in the form of a further rise in prices, which is set to dampen household consumption further. The anticipated slowdown in eurozone export markets, relevant for the automotive sector, in particular, alongside increased uncertainty and tighter financing conditions, which may weigh on investor confidence, may further impact the economy. Fiscal vulnerabilities primarily relate to the upcoming 2022-23 heating season, which is likely to be challenging due to high energy prices worldwide, insufficient domestic production and illiquid state-owned utility companies.

CHART Assessment of transition qualities (1-10)



Structural reform developments

EU accession negotiations have been opened. The long-awaited formal opening of North Macedonia’s EU accession negotiations, the first intergovernmental conference, took place on 19 July 2022. It was followed by the European Commission’s launch of the screening process. However, while screening will go ahead, to start accession negotiations in earnest (which requires an additional intergovernmental conference), North Macedonia will have to first adopt constitutional amendments related to the status of Bulgarian minorities in the country.

The government has adopted an ambitious Growth Acceleration Plan for 2022-26. The plan, adopted by the government in October 2021, aims to support the post-pandemic recovery and GDP growth. It foresees a 5 per cent annual GDP growth rate, partly through a €4 billion allocation to public investment, which is expected to mobilise double that amount in private investment, enhancing competitiveness. Fiscal consolidation, too, is part of the medium-term vision, as public debt is set to be below 60 per cent of GDP by the plan’s end. Since the plan’s adoption, fiscal consolidation has been delayed, however, because of the worsening external environment.

The minimum wage was increased. The new minimum wage law, adopted by parliament in February 2022 and effective from April, brings the minimum wage to 62 per cent of the average wage – a relatively high proportion compared with most EU countries. Nearly a fifth of workers in North Macedonia are set to benefit from the 18 per cent increase. The law also prescribes an annual adjustment of the minimum wage in line with the average net wage and inflation, as well as a benchmark that prohibits the minimum wage going below 57 per cent of the average wage. The policy sparked protest in the public sector, as non-minimum wages were not raised accordingly, most notably among workers employed in education, resulting in a 12 per cent increase in teachers’ wages.

Fiscal decentralisation reform is beginning. The reform encompasses three pillars: (i) the improved fiscal capacity of municipalities, (ii) greater fiscal discipline and (iii) the transparency and accountability of municipal operations. Under the legal amendments adopted in July 2022, municipalities are to be allocated a progressively larger share of personal income tax and VAT revenues, with these revenues set to double from some €45 million in 2022 to more than €80 million in 2024. Two new funds will be established from which municipalities will be able to draw funds, based on their performance in terms of revenue collection. As far as fiscal discipline is concerned, municipalities are set to plan their own revenues and expenditures and will be expected to regularly service debt, while those that declare financial instability will be eligible for a credit line from the ministry of finance.

The country committed to its energy transition pathway. The government adopted the final National Energy and Climate Plan (NECP) for 2021-30 in May 2022. The plan outlines the country's decarbonisation pathway, making North Macedonia the second Western Balkans country to firmly commit to the obligations of an Energy Community contracting party. The plan's ambitions include the closure by 2027 of coal power plants, which currently produce half the country's electricity supply, the introduction of a carbon tax, and a 20 per cent cut in consumption through energy-efficiency measures. Since its adoption, the energy regulator has approved a new pricing model for electricity, valid from July 2022, pegging price to consumption. Diversification efforts through the increased usage of natural gas are also included in the NECP; currently, gas is mostly used for heating in the country's capital, Skopje, and, to a limited degree, by industrial producers. It is sourced entirely from Russia on market terms. Having partially secured financing for a gas interconnector with Greece at the end of 2021, in February 2022, North Macedonia reserved liquefied natural gas (LNG) capacities at the floating terminal in Alexandroupolis, currently under construction, and, in March, joined the EU-led platform for joint LNG purchasing.

The Organic Budget Law was adopted. Adopted in September 2022, it introduces a new set of fiscal rules to guide fiscal consolidation and improve the budget process. Key reforms include medium-term projection, spanning both medium-term budgeting and a five-year fiscal strategy, as well as establishing a Fiscal Council, an independent body assessing fiscal policy.