North Macedonia

Highlights

- **Economic growth is picking up in 2024.** The economy grew 2.1 per cent in 2023, down from 2.8 per cent in 2022, as weakening domestic demand was only partly offset by lower imports. A slight slowdown was recorded in the first half of 2024, with real gross domestic product (GDP) growth reaching 1.8 per cent year on year in that period, mainly driven by some services.
- **A two-year Precautionary and Liquidity Line (PLL) with the International Monetary Fund (IMF) is set to lapse in November 2024.** The structural conditionalities of the arrangement focus on the energy sector and the fiscal impact of a large infrastructure project (Corridor 8/10d). The first review by the IMF Executive Board was successfully completed in January 2024.
- **The reform agenda under the European Union's Growth Plan was approved by the European Commission in October 2024.** The Growth Plan for the Western Balkans, adopted by the European Council in May 2024, would provide North Macedonia with around €750 million in 2024-27 upon fulfilment of the conditions set out in the country's reform agenda. The focus areas are judicial reform, the green and digital agendas, and business-environment and human-capital development.

Key priorities for 2025

- **The adoption of implementing legislation for the Organic Budget Law (OBL) needs to be accelerated.** The OBL, which will enter into force with the implementation of an Integrated Financial Management Information System (IFMIS), introduces fiscal rules[1] and a Fiscal Council and strengthens medium-term budgetary procedures. The adoption of secondary legislation to implement the OBL, including the introduction of budget classification, is running behind schedule.
- **Further investment in green transition should be a priority.** This would help North Macedonia reach the ambitious goals set by the National Energy and Climate Plan by 2030, backed by the Just Energy Transition Investment Platform (JETIP), launched in December 2023.
- **The deployment of the Public Investment Management Action Plan and improvements in the legal framework for public-private partnerships and concessions need to be accelerated.** A new Department for Public Investment Management has been set up in the Ministry of Finance, and it is anticipated that the current challenges related to legal, staffing and information technology (IT) issues will be overcome during 2025.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-4.7	4.5	2.2	2.1	2.2
Inflation (average)	1.2	3.2	14.2	9.4	3.5
Government balance/GDP	-8.0	-5.3	-4.4	-4.9	-3.4
Current account balance/GDP	-2.9	-2.8	-6.1	0.4	-2.0
Net FDI/GDP [neg. sign = inflows]	-1.4	-3.3	-5.0	-3.6	-5.0
External debt/GDP	78.7	80.9	82.8	83.2	na
Gross reserves/GDP	31.0	30.8	29.6	33.2	na
Credit to private sector/GDP	55.7	55.5	55.2	55.9	na

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[1] The new Organic Budget Law introduces a 3 per cent limit on the general government deficit-to-GDP ratio and a 60 per cent limit on the general government debt-to-GDP ratio (in principle, applicable since 2023, but suspended by an escape clause until 2025).

Macroeconomic developments and policy response

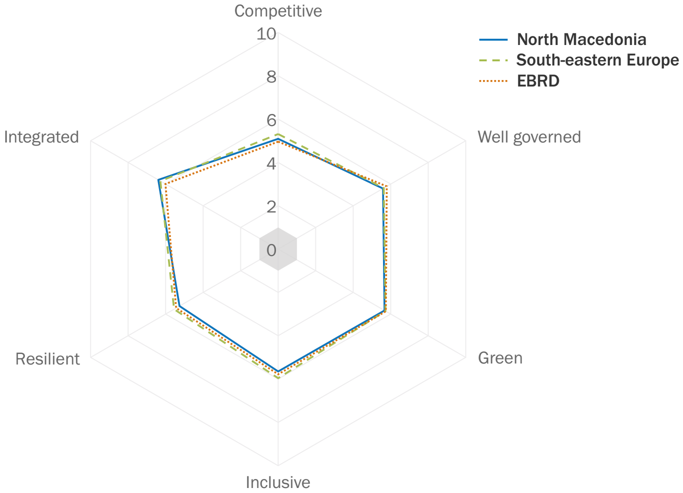
Economic growth is subdued but set to rise in the short term. Real GDP growth slowed from 2.8 per cent in 2022 to 2.1 per cent in 2023 as domestic demand abated due to a deep decline in investment and a slowdown in consumption. Growth remained moderate at 1.8 per cent year on year in the first half of 2024, driven by service sectors, particularly trade and hospitality, supported by easing inflation and rising credit activity. In contrast, industrial production stagnated, while goods exports declined, in line with sluggish demand from major trading partners, switching the current account balance from a surplus in 2023 to a 4.5 per cent of GDP deficit in the first half of 2024. Net foreign direct investment almost doubled compared with the first half of 2023 and, at 6.7 per cent of GDP, was more than sufficient to cover the current account deficit in the first half of 2024. Fixed investment grew at a double-digit pace from a low base the previous year.

Inflation has dropped to low levels, but fiscal policy remains expansionary. The rate of inflation has declined steadily over the past two years, from a peak of 19.8 per cent in October 2022 (the highest level in the Western Balkans region) to 3.5 per cent in October 2024. While food and electricity prices are stabilising, a notable increase has been recorded in the price of services, particularly accommodation services. Monetary policy has eased, with a decline in the key policy rate from a peak of 6.3 per cent to 5.8 per cent in October 2024. Credit activity continues to grow at a similar pace to 2023. Fiscal policy remains expansionary, with another pension increase approved and active from September 2024. The revised 2024 budget foresees a deficit at 4.9 per cent of GDP (similar to last year and higher than the original target of 3.4 per cent of GDP), due to the rise in both current and capital expenditure.

Public debt is rising. The revised budget and greater financing needs for ambitious capital investment kept North Macedonia's general government debt elevated at 49.1 per cent of GDP at the end of the second quarter of 2024. In the first seven months of 2024, the government raised around MKD 49.5 billion (€800 million) on the domestic bond market. It also received the first half of a bilateral loan from Hungary, in the amount of €500 million, with a duration of 15 years (including a three-year grace period) and an annual interest rate of 3.25 per cent. The loan proceeds will be used for municipal capital investment and direct economic support.

Real GDP growth is set to accelerate further in the short term. The economy is forecast to grow by 2.2 per cent in 2024 and 3.5 per cent in 2025 on the back of a recovery in external demand and improving domestic demand, helped by easing inflationary pressures and rising wages, as well as the pick-up in investment driven by infrastructure projects. Downside risks lie in the limited fiscal space created by the country's high public debt levels, the potential for slow progress on European Union (EU) accession and the pace of global (especially eurozone) growth.

Assessment of transition qualities (1-10)



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Structural reform developments

The European Commission approved the reform agenda. North Macedonia stands to gain around €750 million from the Reform and Growth Facility of the EU's Growth Plan for the Western Balkans in 2024-27 once it implements the associated reform agenda. Approval of the reform agenda paves the way for the release of the pre-financing of up to 7 per cent of the total allocation in December 2024. Focus areas are judicial reform, the digitalisation of public administration and cybersecurity, decarbonisation policies, energy efficiency and renewable deployment, and human capital development. There has been little progress in these areas in 2024 because of election-related delays and the time taken to form the new government.

The authorities have adopted a set of energy measures to lower electricity subsidies. The new measures, adopted in 2023, aim to reduce budgetary transfers to the electricity company, ESM, by about two-thirds in 2024. In the medium term, the authorities should continue to implement the ambitious commitments for decarbonisation of the energy sector, with renewable energy supplying electricity at competitive prices to help mitigate pressures from increased energy tariffs and the potential fiscal burden.

The Organic Budget Law is being implemented. Under the law, new fiscal rules will be applied from 2027 in line with the Medium-term Fiscal Strategy 2025-29, bolstering fiscal discipline. Fiscal Council members were appointed by parliament in 2023 and have taken up their work assignments, while the process of recruiting staff to the Council secretariat is ongoing. The Council is expected to become fully operational by the end of 2024.

The government has issued a tender for infrastructure and capital projects in local municipalities. New projects will be supported by €98 million in budgetary financing. State support is to be provided for culture, sports, environmental protection, road infrastructure, education and social projects in local municipalities, with a total planned allocation of €250 million for this purpose.

Informal activity is being tackled. In June 2023, the government adopted the new Strategy and Action Plan for the Formalisation of the Informal Economy 2023-27. The strategy focuses on building institutional infrastructure for detecting and monitoring informal activity, providing statistical data and indicators that will be used for regular monitoring of the informal economy, and digitalising public procedures. In addition, action has been taken to improve the regulatory framework, particularly as regards labour relations. Implementation of a previous strategy to combat the informal economy remains modest.