



NORTH MACEDONIA

Highlights

- **The economy has entered recession in 2020.** After expanding by 3.6 per cent in 2019, GDP is falling sharply as a result of the Covid-19 pandemic, with industry, trade, transport and tourism being particularly affected.
- **Sizeable and targeted support packages are mitigating the impact of the crisis.** The government is supporting individuals and companies, and protecting employment and poor households through targeted measures including temporary payments of minimum wages in coronavirus-affected companies and loan repayment holidays.
- **The country has stepped up its green economy transition.** A comprehensive law on energy efficiency in line with EU directives has been adopted, and the government is seeking investors to transform an abandoned coal mine into a 100 MW solar park.

Key priorities for 2021

- **Raising the level and quality of public investment is key to increasing productivity and economic convergence.** There are still significant infrastructure and private sector productivity gaps that could be narrowed through higher public investments in transport, energy, education and sustainable environmental infrastructure (for example, water and wastewater treatment, and solid waste management), along with improved planning and implementation.
- **Fiscal sustainability should be prioritised as the short-term crisis response measures expire.** The government should create fiscal buffers, raise the efficiency of tax collection and execute capital expenditures in a timely manner. An enhanced fiscal governance framework would strongly support debt sustainability.
- **Better quality of education is needed to reduce skills mismatches in the labour market.** The persistently high level of youth unemployment indicates that the education system does not meet the needs of businesses. Ongoing reforms in education, if stepped up, can help improve the situation.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	2.8	1.1	2.7	3.6	-5.0
Inflation (average)	-0.2	1.4	1.5	0.8	0.9
Government balance/GDP	-2.7	-2.7	-1.8	-2.0	-7.5
Current account balance/GDP	-2.9	-1.0	-0.1	-3.3	-4.5
Net FDI/GDP [neg. sign = inflows]	-3.3	-1.8	-5.6	-3.2	-1.5
External debt/GDP	74.7	73.4	73.3	71.9	n.a.
Gross reserves/GDP	27.1	23.3	26.8	28.8	n.a.
Credit to private sector/GDP	49.0	49.9	50.5	50.9	n.a.

Covid-19: macroeconomic implications

Economic recovery has been halted by the pandemic. Growth of 3.6 per cent in 2019 was driven mainly by domestic demand, while exports were also robust, growing by 9 per cent, although offset by similar growth in imports. In the first half of 2020 GDP declined by 6.4 per cent year-on-year, with sharply falling activity in industry and trade, transport and tourism. On the expenditure side, only government consumption recorded growth, while private consumption, investments, exports and imports all contracted strongly. Unemployment increased slightly in the second quarter of 2020, to 16.7 per cent, reflecting the impact of the pandemic on the economy, but youth unemployment continued to decline, albeit remaining high at 33.8 per cent. Year-on-year inflation remains low at 0.7 per cent in January to July 2020.

Fiscal deficits and public debt are rising. After a marginal increase in 2019, to 2.0 per cent of GDP, the general government deficit is expected to reach close to 7 per cent of GDP in 2020 due to the combination of falling GDP and revenues and rising costs as a result of the measures adopted to mitigate the effects of the crisis. Lockdown measures and lower external demand have reduced economic activity, resulting in revenue shortfalls, while current spending on health, economic subsidies and social transfers are higher than budgeted, and only partially offset by lower capital expenditure. General government debt is increasing significantly in 2020. In June 2020, general government debt stood at 50.7 per cent of GDP (10.5 percentage points higher than at the end of 2019), while the guaranteed debt accounted for another 8.4 per cent of GDP. Financing for the crisis response measures is mostly external, including funding from the International Monetary Fund (IMF), the European Union (EU), international financial institutions and a €700 million Eurobond issuance in May 2020.

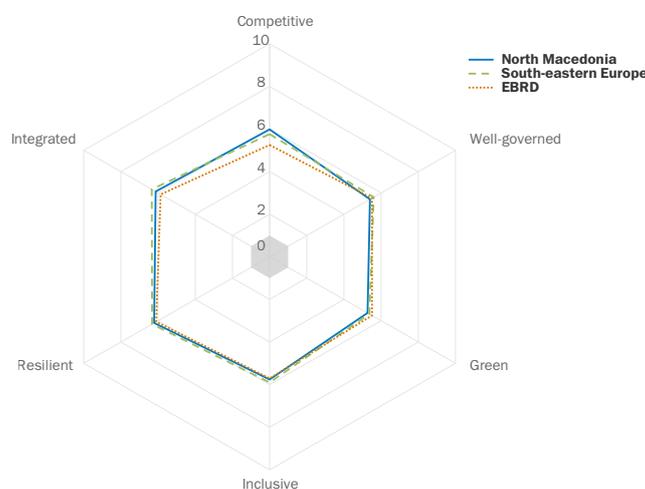
After recession in 2020, a recovery is expected in 2021. GDP is projected to drop by 5.0 per cent in 2020 and recover by 3.0 per cent in 2021. However, risks to the projection are weighted to the downside, and any recovery will be much more protracted if the pandemic persists, both in North Macedonia and among its main trading partners.

Policy response to Covid-19

Four economic packages were introduced to lessen the negative impact of the crisis. The total size of the packages was above €1 billion (around 9.0 per cent of GDP). The first two sets of actions, implemented between March and May 2020, mitigated the impact of the crisis on the economy and the population, while the third package focused on economic recovery and incentivising consumption and industrial production, starting from May 2020. Measures adopted included: the government paying minimum wages of workers between April and June in coronavirus-affected companies and subsidising 50 per cent of social contributions; exempting from tax advances firms and the self-employed until July 2020; providing interest-free loans (€3,000 to €90,000 per company, six-month grace period and two-year repayment period) and soft loans (at a 1.5 per cent interest rate) through the Development Bank of North Macedonia and commercial banks to companies; and increasing value-added tax (VAT) refunds for buying domestic products. The fourth package, adopted in late October 2020, introduced some novelties such as payment cards for vulnerable citizens and a reduction of VAT on the products and services of artisans and restaurants. The central bank has cut its policy rate three times so far in 2020 (from 2.25 to 1.5 per cent). It has also allowed banks to change loan terms faster and through more straightforward procedures, and it extended the time to classify a loan as non-performing from 90 to 150 days by the end of September 2020. In addition, the central bank has set up a €400 million repurchase agreement line with the European Central Bank to provide euro-denominated liquidity to the country's financial sector. The line is to stay in place at least until June 2021.

International institutions are helping to finance the additional costs due to the pandemic. Macro-Financial Assistance from the EU amounted to €160 million, while the IMF's Rapid Financing Instrument was €176.5 million. Other international organisations and some countries also offered financial support to the country.

Assessment of transition qualities (1-10)



Structural reform developments

The European Council decided to open EU accession negotiations with North Macedonia. In March 2020 the European Council decided to open accession negotiations in light of the progress achieved in comprehensive reforms and the fulfilment of the conditions identified by the June 2018 Council. It invited the European Commission to prepare the framework for the negotiations, reflecting on the revised methodology (enhanced approach) of the accession process adopted by the council on the same day. Once the council adopts the negotiating framework, this should be followed “as soon as possible” by the first intergovernmental conference (the formal start of the negotiations). The European Commission presented to member states a draft of the negotiating framework on 1 July 2020.

Implementation of the law on inspection supervision has advanced. The law, adopted in May 2019, aims to streamline the inspection procedure and make it more business friendly, including through warnings for minor breaches, and it provides grace periods for corrective actions. The law entered into force at the end of 2019 and the Inspection Council has in the meantime overseen the completion of checklists and risk-based inspection methodologies for each Inspectorate. This will create the conditions for more transparent and less intrusive inspections for legal businesses. The full implementation of the law, including proper procedural rules, may significantly enhance the quality of the business environment.

The authorities have taken some steps towards improving the energy mix. To diversify the country’s energy mix away from coal, increase the share of renewables and fight air pollution, North Macedonia has initiated plans to develop a solar park on the site of an abandoned coal mine in the western part of the country. In February 2020 the government launched a public tender for investors to construct two photovoltaic units of up to 100 MW in total. In the same month, the country also adopted a comprehensive Law on Energy Efficiency, transposing the relevant EU directives.

The banking sector has remained resilient. At the end of March 2020, liquid assets of the banking sector made up around 30 per cent of total assets, while capital adequacy was at 16.5 per cent, exceeding the regulatory minimum. Lending growth picked up from 5.8 per cent year-on-year in March 2020 to 8.2 per cent in July, on the back of faster lending to the corporate sector. Non-performing loans (NPLs) have declined from 5.4 per cent in June 2019 to 4.7 per cent in March 2020, but may increase as the measure allowing banks to extend the time to classify a loan as an NPL from 90 to 150 days expires at the end of September. Foreign currency (euro) lending has stayed high, at over 40 per cent of total lending in July 2020. In August 2020 the central bank revoked the licence of a small bank without any systemic impact on the sector.