

NORTH MACEDONIA

Recent developments

Table 1 **2018**

Population, million	2.1
GDP, current US\$ billion	12.7
GDP per capita, current US\$	6100
International poverty rate (\$ 19) ^a	5.3
Lower middle-income poverty rate (\$3.2) ^a	9.8
Upper middle-income poverty rate (\$5.5) ^a	23.2
Gini index ^a	35.6
Life expectancy at birth, years ^b	75.7

Source: WDI, Macro Poverty Outlook, and official data.

Notes:

(a) Most recent value (2016), 2011 PPPs.

(b) Most recent WDI value (2016)

Economic growth rebounded to 2.7 percent in 2018, driven by consumption and net exports, while investment started recovering. Unemployment fell to a historical low, while wage pressure continues. Poverty decreased further, following the trend set in 2009. The fiscal deficit declined in 2018 amid revenue growth and a significant under-execution of capital spending. Nevertheless, public debt increased further. As the political outlook improved, the emphasis should be on economic reforms to reignite EU convergence process and stabilize public finances.

In 2018 the economy grew by 2.7 percent. Supported by consumption and net exports, economic activity picked up in 2018 after stagnating in 2017. Private consumption was the main driver of growth, contributing 2.4 percentage points (pp) because of rises in employment, wages, and lending to households. Net exports, mainly FDI-related, contributed 1.7 pp. The remaining 0.8 pp came from government consumption as investments reduced growth by 2.2 pp. On the production side, wholesale and retail trade and information and transportation services were the main drivers of growth, contributing 2.3 pp. The manufacturing contribution of 0.6 pp was driven by higher production of busses, electric machinery, food and beverages, pharmaceuticals, and basic and fabricated metal products. Construction rebounded from October thanks to higher public investment and a continued recovery of private investment.

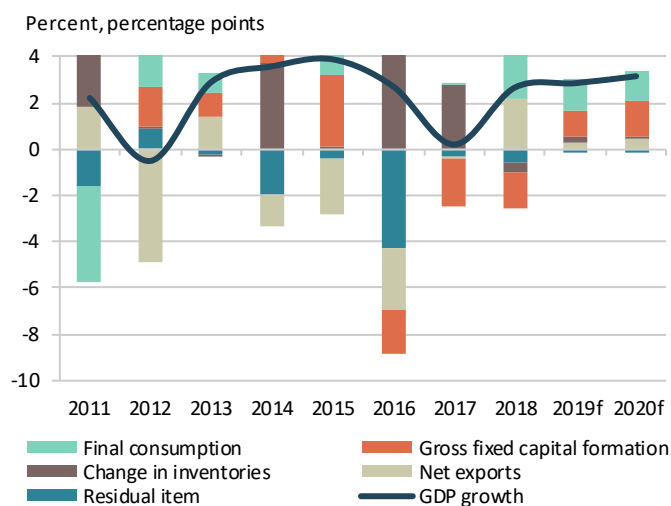
Labor market continued improving in 2018. The employment rate increased by one percentage point to 45.1 percent, while the activity rate increased only slightly to 56.9 percent. The employment expansion was broad-based, with significant gains for young men and prime-age women. Unemployment rate declined to 20.7 percent in 2018, compared to 22.7 percent a year earlier. Most of the new jobs were created in manufacturing, wholesale and retail trade, and industries closely related to tourism. Led by agriculture, manufacturing, trade

and public-sector, wage growth was 5.8 percent in 2018, compared to 2.6 percent in 2017. Using the US\$5.5/day (2011 PPP) poverty line, poverty is projected to have fallen to below 21 percent in 2018, continuing a decreasing trend present since 2009. Employment growth and increases in salaries, partly led by the minimum wage increase, are expected to have driven most of the poverty reduction in recent years. The additional income-generation opportunities at the bottom of the income distribution also contributed to a decline in inequality, with the Gini index falling from 43 in 2009 to 35.6 in 2015.

Consumer price inflation remained moderate in 2018, at 1.5 percent, led by rise in transport prices (up by 7.5 percent) and non-tradables. Annual growth of broad money accelerated further to 11.8 percent, reflecting accommodative monetary policy stance and rise in deposits. In December, the central bank reduced further the key policy rate by 25bp to a historically low 2.5 percent. Loans and deposits growth accelerated. The bulk of the overall credit increase of 7.3 percent, continued to be accounted for by households (growth of 10 percent). The banking sector remained stable and well capitalized--the NPL ratio stood at 5.1 percent at end-2018 and capital to risk-weighted assets stood at 16.3 percent.

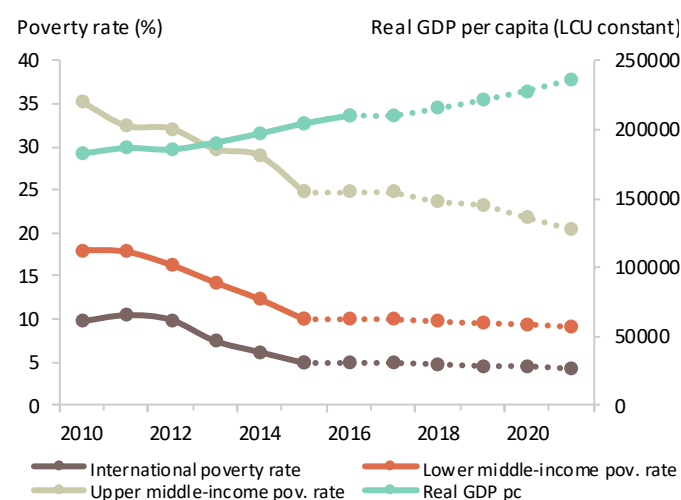
Revenue growth and under-execution of capital investments brought the fiscal deficit down in 2018. General government revenues rose 4.2 percent, tracking rises in social contributions, excises, and corporate and personal income tax revenues. Net VAT revenues also increased, despite

FIGURE 1 North Macedonia / Real GDP growth and contributions to real GDP growth



Source: North Macedonian Statistical Office.

FIGURE 2 North Macedonia / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see table 2.

a surge in refunds to clear arrears to businesses. Spending went up only 1.1 percent because the historically largest drop in capital spending made up for higher current spending by 6.3 percent caused by a surge in social transfers and higher subsidies to firms. The general government deficit declined from 2.8 percent in 2017 to 1.8 percent (adding in the Public Enterprise for State Roads raises the deficit to an estimated 2.3 percent of GDP).

The current account deficit (CAD) declined to 0.3 percent of GDP in 2018, compared to 1 percent in 2017. The continued solid export performance of FDI-related industries like automobiles and electrical machinery was supplemented by growth of exports in such traditional products as iron and steel, furniture, and apparel. This helped to bring down the goods trade deficit to 16.2 percent of GDP. Net services exports surplus remained solid at 3.3 percent of GDP, driven by transport and services for processing manufactured goods. Net private transfer inflows continued increasing and were more than sufficient to cover the entire goods and services deficit. Net FDI inflows surged to 5.8 percent of GDP in 2018, due to significant investments coming from UK. Gross external debt, excluding central bank transactions, increased by September to 77.6 percent of GDP (up 3.4 pp y-o-y), reflecting the January 2018 issuance of Eurobonds.

Outlook

The economic outlook is positive, with growth expected at average 3.1 percent during 2019-2020. Construction activity spurred by investments is expected to recover, as technical difficulties that interrupted the construction of one of the highways are resolved. The manufacturing sector should benefit from the renewed FDIs cycle, propelled by higher exports, and still stable demand along the supply chain to Germany. Private consumption is projected to rise supported by higher wages, employment, and rising credit to households.

Poverty is expected to continue trending downwards. Real wage growth and continuous improvement in labor markets, especially with expansions of employment in construction, manufacturing and the tourism-related industries, will provide more income earning opportunities at the bottom of the distribution, where unemployment is still high. Public investment in infrastructure should sustain employment creation. The social assistance reform currently under implementation should reduce poverty, as the re-orientation of benefits envisioned should favor poorer households.

Risks and challenges

Lower growth prospects in Europe could affect exports and thus growth in North Macedonia. The successful resolution of agreement with Greece on the country's name dispute and deblocking of the EU membership processes provide a stimulus for growth and reforms. Strengthening public spending efficiency and broadening the tax base would help stabilize public debt and rebuild fiscal buffers against future shocks. In the baseline scenario of gradual consolidation, the PPG debt-to-GDP ratio is expected to rise to 55 percent by 2021, to decline thereafter, which underscores the need for strong and front-loaded structural reforms to stabilize debt in the medium term. Increasing overall levels of productivity in the economy remains one of the most important challenges for local firms to be able to compete globally and sustain increases in salaries. As poverty continues declining, tailored policies will be needed to support human capital accumulation and job preparedness for specific groups where poverty could remain entrenched.

TABLE 2 North Macedonia / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	2.8	0.2	2.7	2.9	3.2	3.6
Private Consumption	3.9	0.6	3.3	2.4	2.1	2.3
Government Consumption	-4.9	-2.5	6.2	1.0	0.8	0.5
Gross Fixed Capital Investment	-6.2	-8.7	-7.2	5.0	6.0	6.5
Exports, Goods and Services	9.1	8.1	15.3	7.5	8.1	8.2
Imports, Goods and Services	11.1	6.4	9.1	5.8	6.1	6.1
Real GDP growth, at constant factor prices	2.0	0.1	2.8	2.9	3.2	3.6
Agriculture	-0.4	-13.5	-5.0	1.8	1.5	1.5
Industry	-2.9	-1.0	2.2	5.5	5.9	6.4
Services	4.5	2.3	3.9	2.0	2.3	2.6
Inflation (Consumer Price Index)	-0.2	1.3	1.5	1.8	1.9	2.2
Current Account Balance (% of GDP)	-2.9	-0.8	-0.3	-1.7	-2.1	-1.8
Net Foreign Direct Investment (% of GDP)	3.3	1.8	5.8	4.4	4.6	4.8
Fiscal Balance (% of GDP)	-3.8	-3.5	-2.3	-3.5	-2.9	-2.5
Debt (% of GDP)	48.7	47.7	48.4	53.4	54.4	55.0
Primary Balance (% of GDP)	-2.6	-2.1	-1.1	-2.1	-1.5	-1.1
International poverty rate (\$1.9 in 2011 PPP)^{a,b}	4.9	4.9	4.8	4.5	4.5	4.2
Lower middle-income poverty rate (\$3.2 in 2011 PPP)^{a,b}	10.0	10.0	9.7	9.5	9.4	9.0
Upper middle-income poverty rate (\$5.5 in 2011 PPP)^{a,b}	24.8	24.7	23.7	23.2	21.8	20.4

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

Notes: e = estimate, f = forecast.

(a) Calculations based on ECAPOV harmonization, using 2015-SILC-C. Actual data: 2015. Nowcast: 2016-2018. Forecast are from 2019 to 2021.

(b) Projection using neutral distribution (2015) with pass-through = 0.87 based on GDP per capita in constant LCU.