



## North Macedonia

### Highlights

- **Economic growth has slowed in 2023.** The economy grew more slowly in the first half of 2023 than it did in 2022, as weakening domestic demand was only partially offset by lower imports and higher net exports.
- **A two-year Precautionary and Liquidity Line (PLL) arrangement with the International Monetary Fund (IMF) is ongoing.** The structural conditionalities under the arrangement focus on the energy sector and the fiscal impact of a large infrastructure project. The first review was planned for May 2023, but has been delayed.
- **Renewable energy sources are being commissioned at an enhanced rate.** In the first half of 2023 the Energy and Water Services Regulatory Commission issued licences for electricity production from renewable energy sources to 278 planned power plants, more than it issued in the whole of 2022.

### Key priorities for 2024

- **Continued fiscal consolidation under the new fiscal rules is needed.** The authorities should follow up on commitments made under the PLL arrangement with the IMF to continue reducing the budget deficit in the medium term, returning the deficit to limits envisaged under the Organic Budget Law.
- **Public investments need enhanced evaluation, implementation and monitoring.** The first step set out in an action plan created in response to the IMF's Public Investment Management Assessment (PIMA) is to establish a PIMA unit within the Ministry of Finance.
- **Reform efforts and public investment in the transmission network should complement private-sector investment in renewable energy sources.** The draft National Energy and Climate Plan should be updated to reflect the aftermath of the energy crisis. Investments should be made in the transmission network and in making systems more flexible to ensure that renewable energy capacity can be integrated into the power grid. Electricity subsidies, which are still high, should be increasingly directed towards vulnerable groups.

#### Main macroeconomic indicators (per cent)

|                                   | 2019 | 2020 | 2021 | 2022 | 2023 proj. |
|-----------------------------------|------|------|------|------|------------|
| GDP growth                        | 3.9  | -4.7 | 3.9  | 2.1  | 2.0        |
| Inflation (average)               | 0.8  | 1.2  | 3.2  | 14.2 | 10.0       |
| Government balance/GDP            | -2.0 | -8.0 | -5.4 | -4.5 | -4.7       |
| Current account balance/GDP       | -3.0 | -2.9 | -2.8 | -6.0 | -3.3       |
| Net FDI/GDP [neg. sign = inflows] | -3.2 | -1.4 | -3.3 | -5.1 | -5.2       |
| External debt/GDP                 | 72.4 | 78.7 | 81.9 | 83.6 | n.a.       |
| Gross reserves/GDP                | 29.0 | 31.0 | 31.2 | 29.9 | n.a.       |
| Credit to private sector/GDP      | 46.7 | 51.6 | 50.8 | 52.4 | n.a.       |

## Macroeconomic developments and policy response

**Economic growth continues at a moderate pace.** Gross domestic product (GDP) growth slowed to 2.1 per cent in 2022 and moderated further to 1.6 per cent year on year in the first half of 2023 as household consumption growth slowed despite elevated inflation. Net exports turned more favourable in the first half of the year amid a contraction in imports. Exports maintained a positive growth rate in the first quarter of the year, boosted by strong electricity production, before contracting in the second quarter in line with subdued external demand. The current account narrowed to near zero in the first half of the year in line with favourable movements in the trade balance and a sharp increase in remittances. Retail trade performance remained strong, going beyond double-digit growth rates and driving growth on the production side. Meanwhile, the construction sector entered a deep contraction in the second quarter of the year, stifling growth.

**Monetary and fiscal measures are supporting the economy amid inflationary shocks.** Annual inflation peaked at 19.8 per cent in October 2022 and gradually decelerated to 6.6 per cent in September 2023. The National Bank of the Republic of North Macedonia tightened monetary policy in the past 18 months, raising the policy rate several times, from an all-time low of 1.25 per cent in April 2022 to 6.3 per cent in September 2023. As inflation was largely driven by food prices, the government imposed price caps on basic foodstuffs (including the most popular types of bread, dairy products, pasta, eggs, rice and some fruit and vegetables) in April 2023, before lifting the caps in June, citing favourable market conditions. The parliament approved a pension increase, valid from March 2023, and a hike in the minimum wage effective from April 2023.

**The country has turned to external funding to satisfy elevated liquidity needs.** In light of a Eurobond repayment coming due, the authorities returned to the external market in March 2023 via a four-year Eurobond of €500 million issued at a 6.96 per cent yield. The issuance came after a month-long delay owing to a government reshuffle and was oversubscribed, with order books exceeding €2 billion. Alongside the ongoing IMF programme, the European Union's (EU) €80 million budget support grant and €100 million in macro-financial assistance are helping to finance the budget deficit. The European Central Bank has extended the duration of a €400 million repo line to the National Bank of the Republic of North Macedonia by another year, until January 2024.

**Slow growth is forecast in the short run.** Despite the expansionary fiscal policy measures, household demand is set to remain moderate in the short term as inflation is still high. The slowdown in North Macedonia's main trading partners will continue to affect exports, alongside increased uncertainty and tighter financing conditions, which may weigh on investor confidence. GDP growth is therefore likely to remain modest, at around 2 per cent in 2023, before accelerating to 3 per cent in 2024 on the back of an expected global recovery.



## Structural reform developments

**A domestic day-ahead power trading platform has been launched.** The platform, which was launched in May 2023, aims to encourage investment in renewable energy production and help to make energy systems more stable by providing clear and transparent pricing signals.

**Renewable energy sources are being commissioned at an enhanced rate.** In the first half of 2023 the Energy and Water Services Regulatory Commission issued licences for electricity production from renewable energy sources for 278 planned power plants, more than were issued in the whole of 2022. According to the regulatory authority, the total installed capacity of the planned power plants licensed in the 18 months from January 2022 to June 2023 amounted to 270 MW, enough to power 104,000 average households if the investments are fully realised.

**A two-year PLL arrangement with the IMF is in place, but the first review has been delayed.** The IMF Board approved the arrangement in November 2022, providing upfront access to €530 million. The structural conditionalities under the arrangement include gradually eliminating electricity subsidies, improving energy efficiency, and producing a comprehensive and independent study to monitor fiscal risks stemming from the Corridor VIII and Corridor X-d road project. The first review was planned for May 2023, but had not taken place by early September as the impact of the project on public finances was still being assessed. Satisfactory implementation of the arrangement is also a condition for the disbursement of €100 million in macro-financial assistance from the EU, approved in June 2023.

**Additional measures and regulations have been introduced to preserve financial stability.** The measures are in line with the provisions of the Law on Financial Stability, which was adopted in July 2022. The Financial Stability Committee was set up and held its first meeting in November 2022, and submitted its first annual financial stability report to parliament at the end of March 2023. A decision on the credit risk management methodology was adopted in February 2023 that aims to strengthen the management of non-performing and restructured loans and is due to enter into force in 2024. The National Bank of the Republic of North Macedonia also introduced borrower-focused macroprudential measures (caps on loan-to-value and debt service-to-income ratios) in the first half of 2023 to help contain risks, particularly in the real-estate sector. A new law on bank resolution, adopted in October 2023, introduces a comprehensive framework for addressing problems in troubled financial institutions, including through the establishment of a bank resolution fund.

**Tax reform has begun.** In line with amendments to the Law on Personal Income adopted at the end of 2022, progressive taxation, which had been set to enter into force from 2023, was abolished. Taxation of interest on savings was postponed until the country accedes to the EU. In turn, the amendments aim to broaden the tax base by targeting undue exemptions and reliefs in the existing system. The amendments are part of a broader effort to reform the taxation system and include amendments to the corporate income tax and value-added tax (VAT) regime adopted by the government in December 2022, but not yet by the parliament (as at September 2023).