

## Growth still appears under pressure

Burdened with slowing growth and weak demand in key trading partners, poor investment appetite and below average agricultural season, real GDP expanded just 1% y/y in 2023. High-frequency indicators, except for retail, suggest meager output carried into the 1Q24. Inflation dropped to around 3% at the end of last year but risen again to 4% in March and April after the freeze on certain food items expired. The government's fiscal space is limited due to continuous wage pressures and Eurobond maturities in 2025 and 2026. The recent parliamentary and presidential elections have resulted in a change in government, with power now shifting to the right-side spectrum.

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### Forecasts Overview

Economy	2024f	2025f
Real GDP growth (%)	2.3	3.4
Unemployment (%)	12.7	12.4
CPI (%), average	3.5	3.4
Budget balance (% GDP)	-4.4	-3.4
Public debt (% of GDP)	63.1	62.7
Current account (% GDP)	-2.9	-2.6

Source: Erste Group Research

Ratings	Current	Outlook
S&P	BB-	stable
Fitch	BB+	stable

Source: Bloomberg

General	2024f
Population (in mn)	1.8
GDP/Capita EUR	7,904

Source: Erste Group Research

**Note:**

\*Information on past performance is not a reliable indicator for future performance.

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- Economy expanded 1% y/y 2023. Despite stagnating exports, a strong drop in imports in 2023 means the biggest impulse to growth came from the net external side. On the domestic side, personal consumption continued its steady positive contribution, but public spending surprised negatively as it contracted on a yearly basis. The biggest hit came from the investments side as together with inventories they recorded a drop of 16.7% y/y.
- High frequency indicators suggest weak economic activity continued at the start of 2024 as well. Industry declined 2.4% y/y on average in 1Q with a heavy contraction in manufacturing activity in March. On the external side, exports of goods moved deeper into negative territory showing a 9.2% y/y drop in 1Q, alongside stagnating imports thus suggesting strong negative contribution early in the year. We expect a positive impetus from the investment and inventory side, especially in 2H24. Overall, we have slashed our expectations for 2024 by 0.3pp, now forecasting average GDP growth of 2.3% y/y this year, before accelerating to 3.4% y/y in 2025 as the 8/10d highway project gains more traction and external demand recovers.
- Inflation has come a long way since it peaked in late 2022 at almost 20% y/y. In 1Q24 it averaged 3.4% y/y, with food prices still the dominant driver especially after the expiration of temporary freezing of certain food items which started to feed into inflation as of March. Acknowledging overall easing of supply-side pressures, decline in global oil prices and slowdown in imported inflation, we expect the inflation rate to average 3.5% y/y and 3.2% y/y in 2024 and 2025 respectively.
- The country recorded a C/A surplus of 0.7% of GDP in 2023, only the second time in its history. Improvement stems from the narrowing of trade deficit as imports declined heavily after stockpiling in previous years and better domestic electricity production. For this year we forecast a moderate deficit of around 3% of GDP due to reemerged pressures on the trade balance side, as the 8/10d highway project accelerates.
- Monetary policy remains on the cautious side, with the CB bill interest rate at 6.3% since September. Changes were made to the reserve requirement setup and maintenance, mainly aimed at further supporting the denarization process and increasing long term savings in the banking system. Reserves recovered from earlier losses incurred at the start of the war in Ukraine, and now after 1Q24 cover almost 5 months of imports.
- Both budget revenues and expenditures increased by roughly 14% y/y, resulting with a 16.5% y/y wider budget gap landing at 4.9% of the GDP. Budget gap should narrow by 0.5pp this year due to lower subsidization of electricity prices and stronger GDP growth.
- This year's twin elections resulted in a triumphant victory for the right-wing VMRO DPMNE and a crushing defeat for the pro-EU Social Democrats. Talks about government formation should be concluded soon.

## Real economy

### Growth slowed in 2023

Economic activity slowed in 2023. Growth was under pressure throughout the year, due to weak performance of key trading partners, notably Germany, slower than expected progress on the key infrastructure project 8/10d highway and poor agricultural season. Looking at the structural breakdown of the GDP, household consumption growth slowed a bit compared to 2022, rising 2.4% y/y but still adding almost 2pp to headline growth. The key impetus to growth came from the external side, as imports contracted 5.8% y/y, which alongside stagnating exports allowed for almost 6pp positive contribution to the GDP. The key negative performance was observed through investments and inventory performance which declined by massive 16.7% y/y.

### High frequency indicators indicate the economy is still under pressure

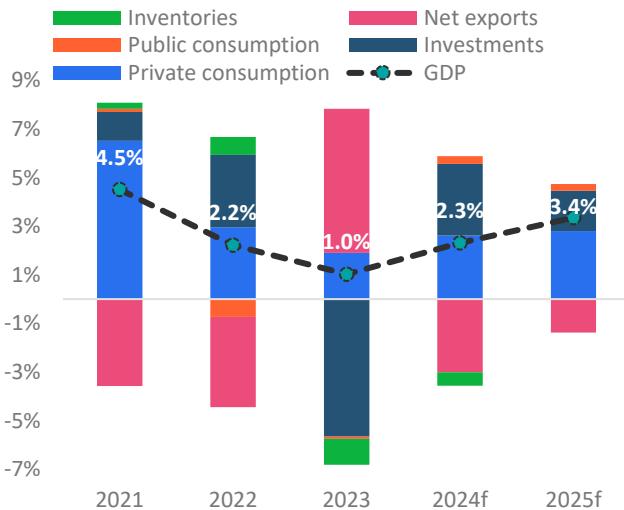
High frequency indicators, except for stable consumption pattern, indicate the economy is still under pressure. Industrial production contracted 2.4% y/y in 1Q after tumbling in March. Trade data is looking especially worrisome, as export of goods contracted 9.2% y/y in 1Q24 indicating still meagre growth in key trading partners. Meanwhile, imports declined 0.9% y/y in the same period but are poised to accelerate as the highway project speeds up. Investments should accelerate this year after a strong contraction last year, but the extent heavily depends on the key infrastructure project. Regarding the labor market, jumping to the conclusion that things have improved just because the unemployment rate went down by 1.3pp on average would be premature, as this is mostly due to people dropping out of the labor force. Overall employment rate in 2023 was roughly 2pp lower than in 2022.

### Only moderate growth acceleration this year

Due to observed weak start of the year we have again reduced FY24 GDP forecast by 0.3pp to 2.3% y/y. In 2025, we expect growth to accelerate to 3.4% y/y. In the near term, domestic risks are skewed to the upside as investments could be even higher as financing for the first part of the highway is secured and budgeted. Consumption also looks upbeat as nominal wage growth early in the year is above forecasted. On the other hand, external risks are skewed to the downside. Growth in key trading partners is still weak, consequently trade balance data suggests strong negative contribution to growth early in the year. Finally, shifting of power in the political arena to the right-side spectrum might leave some investors sidelined before we get more clarity regarding the new government key priorities and future EU course.

### Growth slowed in the last two years

#### GDP contributions



Source: Makstat, Erste Group Research

### Industry slowing, retail recovering

#### Real retail trade; Industrial production (y/y, %, 3mma)



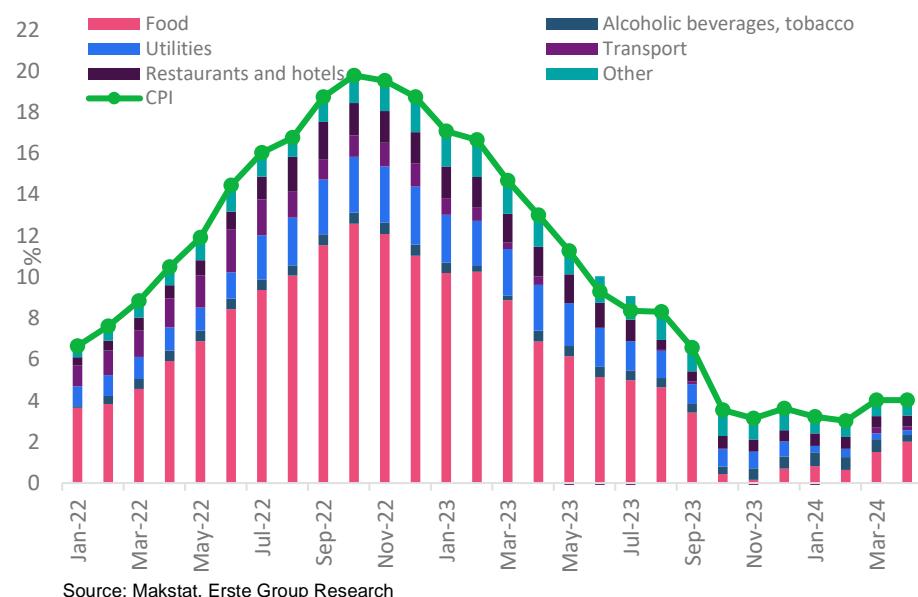
Source: Makstat, Erste Group Research

**Food inflation again on the rise**

Headline inflation averaged 9.4% y/y in 2023. Prices went from January's 17% y/y to below 4% at the end of year. Normalization reflects base effects, tighter monetary policy as well as caps on certain food prices. Mentioned caps were scraped in February and started to feed into inflation since, hence food inflation in April is again responsible for 50% of headline inflation in April.

**Food prices again main driver of inflation**

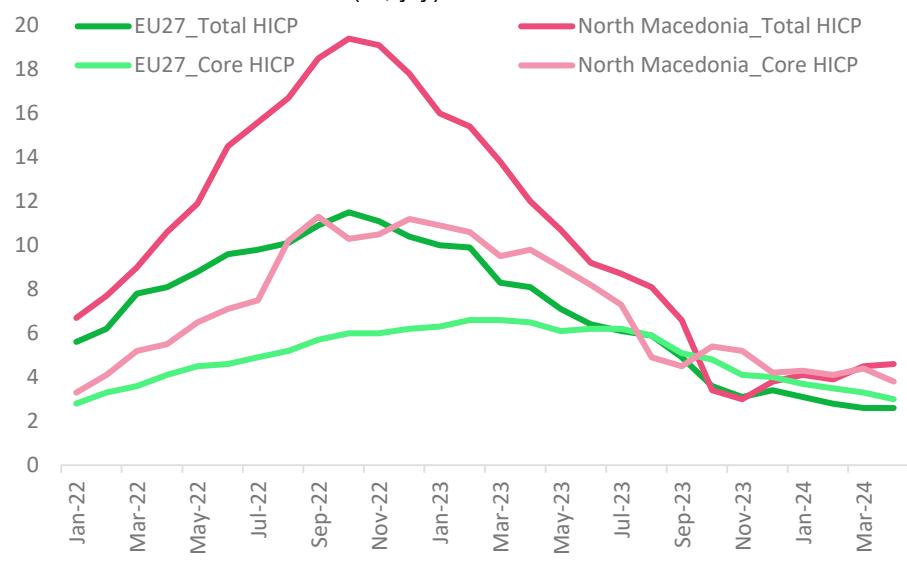
CPI contributions (%)

**Average CPI in 2024 expected at 3.5% y/y**

Overall, we expect inflation to average around 3.5% y/y both in 2024 and 2025. This is somewhat lower than what was expected at the end of last year, when we assessed higher risks from the international environment. Core inflation started to ease around the end of 1Q. Meanwhile, strong domestic wage growth is the key factor which could underpin higher inflation numbers down the road.

**Core inflation easing**

Total HICP and Core HICP (% y/y)



## External position

### In 2023 a surplus in the C/A was recorded

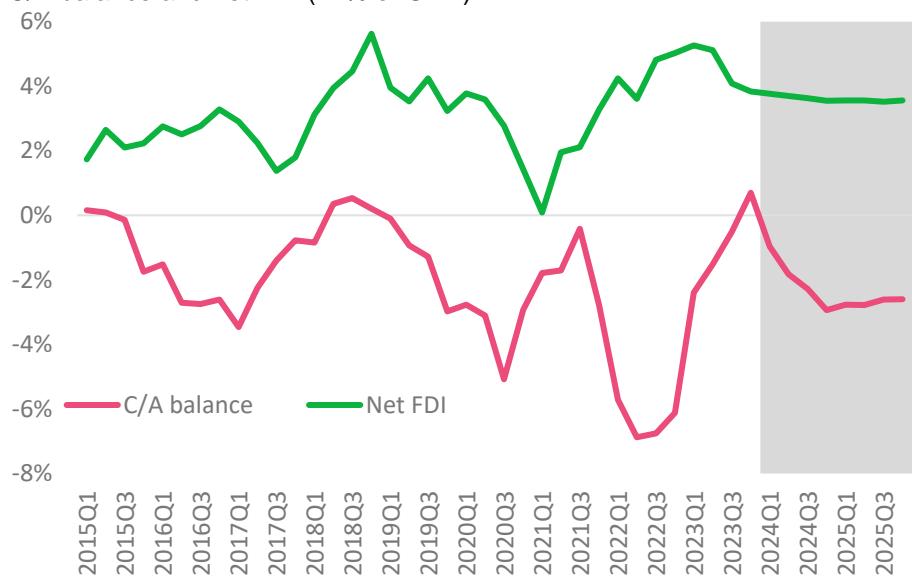
For only the second time in its history, the country recorded a C/A surplus. The final result was a surplus of 0.7% of the GDP which stems largely from the contraction of imports in 2023. With energy import pressures abating due to heavy stockpiling in 2022, the trade deficit shrank by 7.8pp to 18.9% of GDP last year. The primary income deficit was a tad wider but overall was neutralized by slightly better surplus in the secondary account. Net FDI inflows decelerated to 3.8% of GDP, down from 5% in 2022. Gross foreign exchange reserves improved to around 33% of the GDP. This year we expect a moderate gap of around 3% of the GDP due to already mentioned widening of the trade balance gap. FDI flows after the new government formation will also be an important signpost to observe.

### Credit agencies kept outlook on stable

Fitch has kept both the 'BB+' credit rating and stable outlook on North Macedonia in its assessment in April. Meanwhile, S&P kept its 'BB-' rating with a stable outlook at the start of the year, but it will be interesting to see their assessment at the end of July when the next review is scheduled, especially after recent political changes. Both issuers praised macroeconomic stability with adherence to credible and consistent policy mix, underpinned by the stable exchange rate peg to the euro. Fitch has also outlined favorable governance indicators and EU accession process. The latter will likely be a hot topic in the coming months given the changes on the political scene.

### C/A balance will deteriorate this year

C/A balance and net FDI (in % of GDP)



Source: NBRNM, Erste Group Research

### IMF completed the first review under the PLL arrangement

IMF completed the first review under the Precautionary and Liquidity line arrangement for North Macedonia early this year, which allowed the government access to around EUR 200mn. Looking at the government's cash buffer, as of end of April it stands at around EUR 670mn or 4.6% of the GDP. According to our calculations, this year's gross refinancing needs stand at around 8.6% of the GDP roughly equally split between redemptions and budget gap needs. We expect funding will consist of existing cash buffer alongside IFI and banks credit lines. We expect the MoF will issue a Eurobond later this year, in order to prefinance for January 2025 Eurobond maturity. 2026 also brings a Eurobond redemption, so the new government will need to carefully assess and plan the situation.

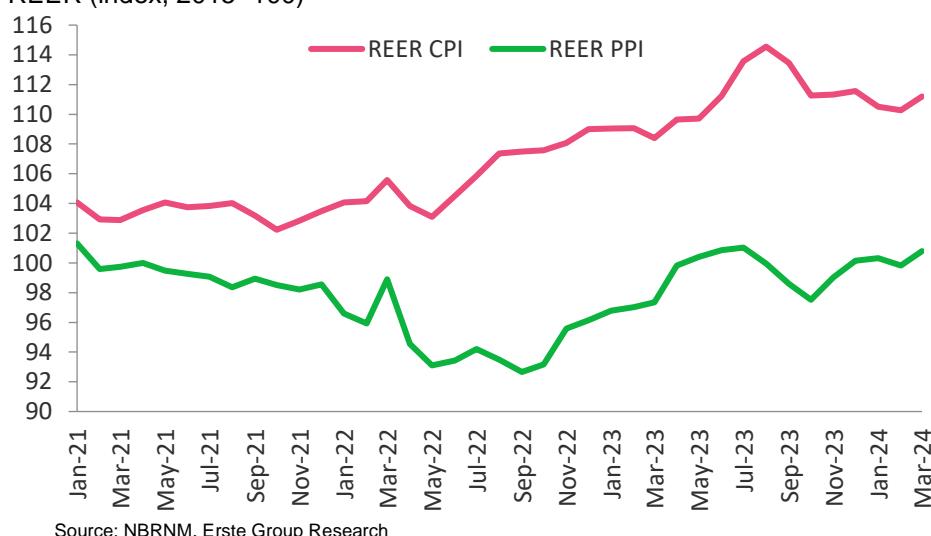
## Monetary and Fiscal Developments

### Monetary policy remains cautious

The NBRNM has kept monetary policy tight throughout the past period, as required by economic conditions, and in line with IMF recommendations. Cooperation with the IMF remains close, with the two aggregating to work together on a transition plan for changes in the operational framework. As for operational decisions, the central bank has kept the key policy rate at 6.3%, up from a historical low of 1.25% before the beginning of the tightening cycle in spring 2022. To mitigate risk from high mortgage growth, the NBRNM introduced certain limits which have cooled off mortgage credit and real estate prices.

### Competitiveness deteriorating since mid-2022

REER (index, 2015=100)

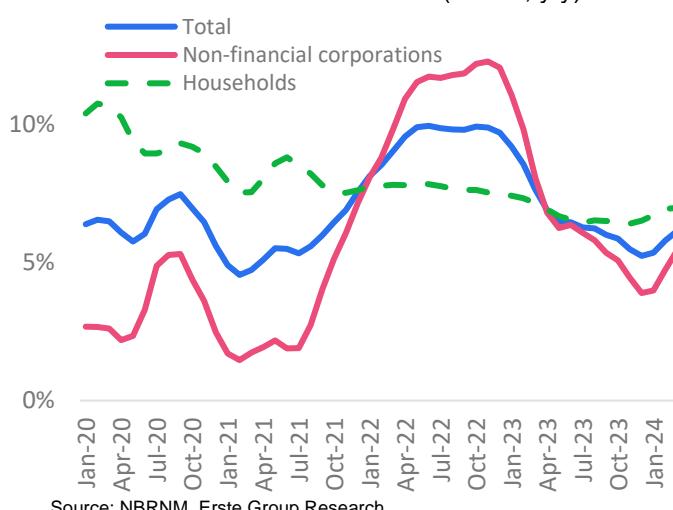


### Loan growth slowed to mid-single digits

Credit activity growth amounted 5.1% y/y in 2023, driven mostly by solid household demand (6.7% y/y), while growth to corporates shows 3.5% y/y expansion. Central banks effort to support dinarization are visible, as LCY credit activity outpaced FCY one. On the liabilities side, total deposits increased 8.7% y/y in 2023 but with stronger growth on the corporate side compared to retail. L/D ratio has thus decreased by 3pp, dropping to 83.2%. The banking system remains stable and well-capitalized. Overall NPL dropped to record low 2.8%. Profitability improved owing to stronger net interest income.

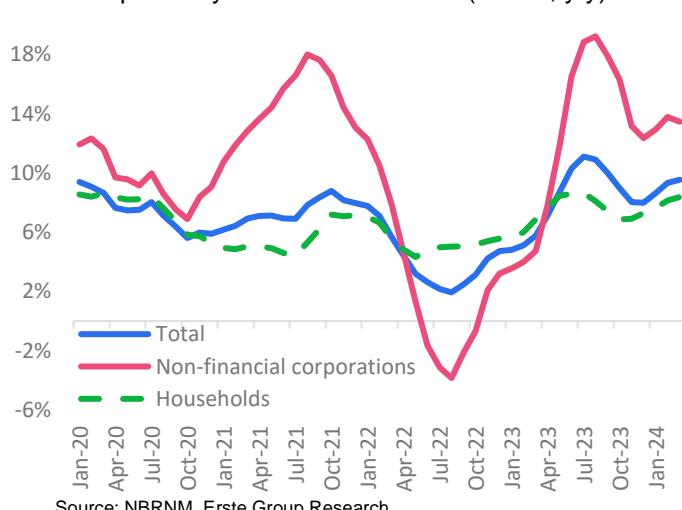
### Loan growth slowed but still overall solid

Bank loans to institutional sectors (3mma, y/y)



### Corporate deposits recovered

Bank deposits by institutional sectors (3mma, y/y)

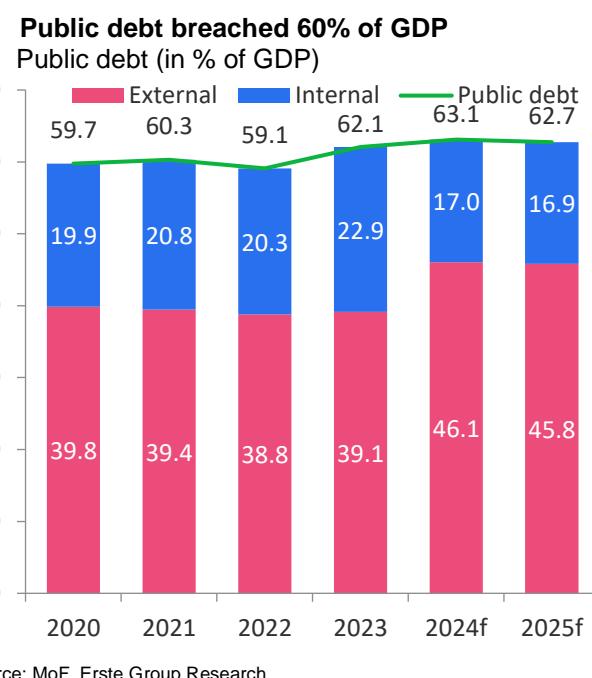
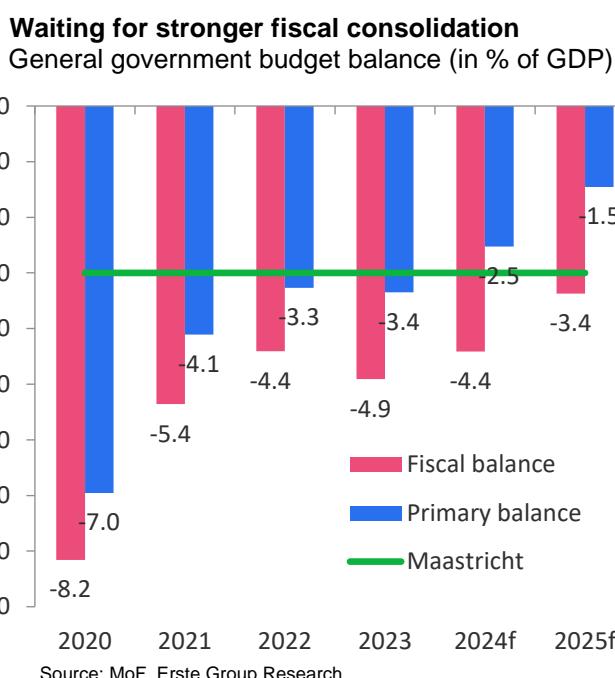


**Budget gap remains (too) high**

The general government deficit in 2023 landed above target, at 4.9% of GDP. Higher than expected deficit is a largely a result of weaker than expected economic activity. Both revenues and expenses rose roughly 14% y/y. Meanwhile, 1Q24 data are not encouraging, as 5.3% y/y growth in revenues is overshadowed by massive 21% y/y jump on the expenditure side thus shaping a 1.6% of GDP gap already after the 1Q.

**Public debt could peak in 2024**

General government deficit should narrow this year owing to budgeted spending adjustments, recent revenue-raising measures, and some pick-up in economic activity. However, while the outgoing administration penciled-in a 3.4% of GDP gap for the FY, we see it 1pp higher at 4.4% of GDP given more conservative growth expectations and weak early year budget figures. Due to expected prefinancing of 2025 Eurobond maturity, we see public debt peaking this year at around 63% of GDP (including guaranteed debt).



## Politics

### Constitutional changes still on hold

VMRO DPMNE trounced the ruling Social Democrats in last month's parliamentary and presidential elections. The outlines of the country's new cabinet are already taking shape. VMRO DMPNE leader, Mr. Mickoski was open before and after the elections that he would prefer to see as his party's main ethnic Albanian partner, the joint Albanian opposition Vlen. Vlen, which is composed of several smaller Albanian parties, also hinted at cooperation. To cement the new government's support in parliament, the VMRO DPMNE is also expected to invite the ZNAM party of former Social Democrat Maksim Dimitrievski to join them in power. All together, they would control 77MPs in the 120-seat parliament, with VMRO-DPMNE a dominant force controlling 58 legislators. In the presidential elections, VMRO DPMNE's candidate Gordana Siljanovska-Davkova became the country's first female president after defeating Pendarovski, who was endorsed by the Social Democrats.

Only 10 days after the landslide victory of the right-wing VMRO DPMNE party in North Macedonia's double parliamentary and presidential elections, its leaders have already raised hackles in Greece and Bulgaria, as well as Brussels. Their refusal to use the country's constitutional name, Republic of North Macedonia, which was agreed with Greece in 2018 – and their resistance to Bulgaria's demand for a constitutional change – bode ill well for the country's already long-drawn-out EU accession bid. The head of European Council, Charles Michel, criticized the "very disappointing" choice of words by the new president Siljanovska. At the same time, EU failed to address Greece's delays in fulfilling its own obligations which leaves North Macedonia in a difficult situation.

## Forecasts

Annual	2016	2017	2018	2019	2020	2021	2022	2023f	2024f	2025f
Nominal GDP (EUR mn)	9,657	10,038	10,744	11,262	10,852	11,835	13,033	13,655	14,460	15,415
Population (mn)	2.1	2.1	2.1	2.1	2.1	2.1	1.8	1.8	1.8	1.8
GDP per capita (EUR)	4,657	4,837	5,173	5,424	5,221	5,700	7,096	7,450	7,904	8,443
Real GDP (growth y/y %)	2.8	1.1	2.9	3.9	-4.7	4.5	2.2	1.0	2.3	3.4
Private consumption (growth y/y %)	3.9	2.1	3.7	3.7	-3.8	8.8	3.8	2.4	3.3	3.5
Fixed capital formation (growth y/y %)	12.5	-2.2	1.7	9.5	-15.7	3.7	9.4	-16.7	10.6	5.5
Nominal gross wages (EUR)	533	548	579	609	658	696	773	892	1,005	1,111
Gross wages growth (%)	2.0	2.6	5.7	5.1	8.0	5.8	11.1	15.4	12.6	10.6
CPI (y/y, average %)	-0.2	1.4	1.5	0.8	1.2	3.2	14.2	9.4	3.5	3.4
CPI (y/y, year end %)	-0.2	2.4	0.9	0.4	2.3	4.9	18.7	3.6	4.1	2.8
Unemployment (%)	23.7	22.4	20.7	17.3	16.4	15.7	14.4	13.1	12.7	12.4
Trade balance (% of GDP)	-18.8	-17.8	-16.2	-17.3	-16.6	-19.7	-26.7	-18.9	-20.6	-20.3
Current account balance (% of GDP)	-2.6	-0.8	0.2	-3.0	-2.9	-2.8	-6.1	0.7	-2.9	-2.6
Net FDI inflow (% of GDP)	3.3	1.8	5.6	3.2	1.4	3.3	5.0	3.8	3.5	3.6
General government budget balance (% of GDP)	-2.7	-2.8	-1.1	-2.1	-8.2	-5.4	-4.4	-4.9	-4.4	-3.4
Public debt (% of GDP)	48.8	47.7	48.4	49.2	59.7	60.3	59.1	62.1	63.1	62.7
Foreign debt to GDP (%)	74.7	73.4	73.0	72.4	78.7	80.9	82.8	83.9	84.8	85.4
Bond yield (EUR 2025) average						2.0	5.5	6.4	5.1	4.7
Bond yield (EUR 2025) year-end						2.7	6.7	5.2	4.9	4.4
EUR/MKD	61.6	61.6	61.5	61.5	61.7	61.6	61.6	61.6	61.6	61.6

**Note:**

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**Published by:**

**Erste Group Bank AG**

**Group Research**

**100 Vienna, Austria, Am Belvedere 1**

**Head Office: Wien**

**Commercial Register No: FN 33209m**

**Commercial Court of Vienna**

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