

Introduction

It has already been certain that the pandemic caused by the coronavirus, as an unexpected external shock, will affect both the global and domestic economy in several segments, which will mean a greater divergence from the October forecast. Given the constant change in circumstances, the magnitude of the effects is difficult to assess, but the segments on which the pandemic is reflected are clear. In terms of health risks and measures taken to alleviate them, a drastic reduction in global demand is expected, as well as significant drop in prices of primary commodities on the world market, temporary disruption of global and regional supply chains, changes in population behavior, tightening of global financial conditions and risk aversion of the investors.

Globally, the central banks have reacted very quickly to this unexpected shock by easing monetary policy, lowering interest rates and providing additional liquidity. Although the shock is uneconomical and likely to slightly jeopardize the long-term potential for economic growth, its effects are expected to be very pronounced in short run, with the biggest recession in 2020 being expected after the major depreciation. These are the reasons for the central banks' efforts to ease financial conditions, provide liquidity support and maintain credit flows in the economy.

The National Bank acted in the same way, reducing the interest rates at the beginning of the year, activating unconventional measures, providing additional liquidity and regulatory flexibility. Namely, in conditions of solid foreign reserves and low inflation, the policy rate was reduced twice - at the beginning of the year in January and the second time in March - for a total of 0.5 percentage points, thus reducing it to the level of 1.75%. Also, the National Bank has adopted additional measures to support the economy, thus enabling reduction of the denar reserve requirement basis, for the amount of newly approved and restructured loans to the affected sectors. At the same time, in mid-April, an additional liquidity of Denar 8,000 million was provided through the CB bills instrument. The National Bank also made changes to regulatory requirements, while keeping a cautious approach, simultaneously providing targeted and temporary support to the affected segments.

Hence, the April forecast for the Macedonian economy takes place in a completely changed environment. Current estimates for the first quarter are mainly in line with expectations, but the outbreak of the pandemic will undoubtedly have adverse effects by the end of the year. As part of the April scenario, the peak of the pandemic and its economic effects will be concentrated in the second quarter, with the gradual normalization being assessed for the second half of the current year. The deteriorating global environment will have adverse effects on the export sector, the inflow of remittances into the economy, as well as on other financial flows. At the same time, the measures taken to stop the spread of the coronavirus would significantly affect consumption and investment, with greater restraint among economic entities being expected in the coming period.

In the period between the two forecasts, there have been significant changes in the projections of the main indicators of the external economic environment, reflecting the negative effects associated with the pandemic of the new viral infection. Thus, the projections for the growth of **foreign effective demand** for 2020 have significantly been revised downwards compared to October expectations, largely as a result of expectations for a decrease in the German economy, while for 2021 higher growth is expected than before. By dynamics, in 2020, foreign effective demand is expected to decline by 5%, and then in 2021 strong economic recovery and growth of 4.9% is projected. Regarding the **foreign effective inflation**, a downward correction has been made for the whole projection period, given a downward revision of inflation in all countries. At the same time, after the slowdown in inflation in 2020 to 0.6%, in 2021 moderate acceleration is expected which would reach 1.3%. The latest expectations for the future movement of prices of **primary commodities** on world stock exchanges for 2020 and 2021 also indicate downward revision of almost all prices compared to the October projections, especially for 2020.

Given the specificity of the shock, and thus the expected synchronized decrease in global activity, as well as the measures taken to deal with the pandemic, the April forecast for the growth of the Macedonian economy have changed significantly compared to October. A 3.5% drop in GDP is projected, followed by a recovery of 4.7% for next year (as opposed to October expectations for 3.8% and 4% growth, respectively). Regarding the activity structure, with the exception of the public consumption, which for 2020 has been revised upwards, the other expenditure components of GDP are expected to decrease in 2020. Within the domestic demand, the biggest negative contribution is expected from investments, where high levels of uncertainty and financial conditions tightening would have a strong effect. Lower consumer propensity, as a result of uncertainty about future changes in disposable income, disturbed confidence, but also greater restraint, primarily in terms of spending on durable and semi-durable products will lead to a reduction in private consumption in 2020. Regarding the market during the second quarter, when the most pronounced negative effects on economic activity are expected, a certain adjustment of wages and employment is assumed. However, these adjustments are assessed as temporary and will be mitigated by the announced fiscal measures, so that for the whole of 2020 the effects of the labor market crisis, in general, are assessed as neutral. The decrease in foreign demand and deteriorated global production chains and logistics will have an impact on exports, which would decrease in 2020. It is expected that the reduced export activity, in conditions of decline in domestic demand, will cause a decrease in the import of goods and services, which would cause decrease also in the net exports and small positive contribution to growth. In 2021, given the normalization of the economic environment, the recovery of the economy would be supported by all sources of growth, with the domestic demand having positive, while net exports a negative contribution to growth. The uncertainty about projections is pronounced, given that the recovery is largely conditioned by the coping with the coronavirus, implementing measures to deal with it, as well as the necessary time to restore confidence and stabilize expectations. For 2022, the assessment for the annual growth rate of the domestic economy of about 4%, envisaged in the October scenario, remains.

Regarding the future price trajectory in the domestic economy, the latest forecasts point to stable prices in 2020, without inflationary pressures. The appearance of the coronavirus is a serious unexpected shock, which affects both the demand and the supply side, through supply chain disruptions, difficult production and transport. Also, in such circumstances there is a significant reduction in the prices of primary commodities, especially energy. **Currently, by incorporating such assumptions, our estimates point to an inflation rate of around 0% for 2020, which is a significantly lower downward revision, compared to the October inflation forecasts of 1.5%.** In 2021, the inflation rate will accelerate to 1.5%, but in 2022 it will stabilize at about 2%. In the international markets there is still an exceptional volatility of the prices of primary commodities, and thus uncertainty about their future dynamics and effects on the domestic economy, especially in the long run.

The latest assessments or the credit market in the forecast period indicate a temporary slowdown in the dynamics of credit activity in 2020 and its return to the path of solid growth rates in the next period. In 2020, the projected decline in economic activity as a result of the impact of the unexpected non-economic shock would cause greater restraint from borrowing, which together with changes in banks' risk perceptions and slower growth of funding sources would affect the credit activity dynamics. Despite solid growth in the first quarter of the year, lending activity would temporarily slow down by the end of the year. Taking into account the National Bank measures to maintain the commercial banks' credit cycle of and support the affected sectors through favorable loans from the Development Bank, the annual credit growth would stay at 3% (8% according to October projections). With the normalization of the conditions and stabilization of expectations, it is expected that credit activity in the next two years will grow faster. Credit growth for the period 2021-2022 would average 6.5% (8% according to the October projection for the period 2021-2022). The estimations for the credit growth dynamics are based on expectations for stabilization of the situation in the domestic economy by the end of 2020, normalization of the deposit base growth dynamics in the coming period and favorable capital and liquidity position of banks. According to estimates for a decline in economic activity in 2020, and given the performance of total deposits in the financial system in the first quarter of the year, total deposits would grow in 2020, at a rate of about 2.3% (8.5% with the October forecast). In the next two years, when

assessing the normalization of economic growth and further maintenance of the high propensity to save in banks, annual deposit growth is expected to average about 7% (8.5% with the October forecast for the period 2021-2022).

The projection of the balance of payments points to a deepening of the current account deficit in 2020 to 3.2% of GDP. The deepening reflects the expectations of lower surpluses in secondary income and in the trade in services, while other components are expected to improve moderately. The environment of increased global uncertainty, disturbed confidence and restrictive measures to protect and prevent the spread of the virus would lead to a significant downward adjustment of remittances, and thus the supply of foreign currency in the economy and reduce the positive balance with the secondary income. Regarding the foreign trade, in a situation where one of the main channels of global shock transmission is the synchronized reduction of global demand and disruption in global production and logistics chains, it is expected to reduce the activity and to temporarily cease the operation of some export-oriented facilities in the second quarter, with the signals of such adjustment having been evident in March already. All this is expected to reflect in a relatively large drop in export of goods, which together with the expected downward adjustment of domestic demand, will have a corresponding impact on the import of goods. The downward correction of imports will be further pronounced also because of the severe fall in world oil prices, which will cause a significant narrowing of energy deficit. It is expected that the larger decrease in imports compared to the decrease in exports in 2020 will lead to a narrowing of the trade deficit. With the gradual exhaustion of the effects of the above factors, in the coming period (2021-2022) stabilization and improvement in the current account deficit is expected, which would equal 1.6%, on average, of GDP in 2021 and 2022, respectively (same as and in the October forecast). **From the aspect of the financial account, it is expected that in the period 2020-2022 current transactions will be financed through the external borrowings by the Government and foreign direct investments.** During the three-year period under observation, the financial flows will fully cover the current account deficit, ensuring further foreign reserves growth. Foreign reserves adequacy indicators show that they have been in the safe zone throughout the forecast horizon.

In general, for the period 2020-2022, compared to the October observations, the latest estimates point to pronounced but temporary effects of the pandemic on the domestic economy and rapid but only partial recovery. Currently, the risks of the health crisis are markedly lower. In particular, the risks relate to the possibility of infection endurance and the measures in the second half of the year, the possible occurrence of a second wave of infection and reactivation of public health protection strategies, as well as changes in the behavior of economic agents in terms of their consumer and investment decisions, which in turn would lead to a longer-term disruption of production and demand chains. These risks also affect the global environment and the domestic economy. On the other hand, the formalization of our country's membership in the NATO Alliance, as well as the European Commission's decision to start negotiations for full EU membership, which took place in March this year are still a positive risk for the projection, especially in the medium term. The National Bank is constantly monitoring developments, as well as the potential risks from the environment to the domestic economy, in order to respond adequately by adjusting policies and taking other, additional measures, if necessary.