I. Macroeconomic forecasts and risks

The October macroeconomic forecasts indicate a deeper decline of the domestic economy in 2020 and more moderate recovery in the next period compared to the expectations in April. This is mainly a reflection of the current development of the viral infection and changes in the assumptions in terms of the duration of the health-economic crisis. The outbreak of the second wave of the pandemic and the need to reintroduce restrictive, albeit less rigid measures is a factor that has a significant impact on the outlook for both the global and domestic economy. The April forecast incorporated assumptions about relatively rapid handling of the pandemic, gradual normalization in the second half of 2020 and economic recovery in the following year. The new cycle of forecasts assumes a prolonged health and economic crisis until mid-2021, followed by a period of normalization and gradual economic recovery.

In line with such assumptions, the estimates for the external environment are less favorable, with a downward revision of foreign demand in the period 2020-2021, which is expected to have a less favorable impact on exports, cash remittances and foreign direct investments. Consequently, downward revisions of the GDP were made for the entire forecasting period i.e. a decline of 4.9% of GDP is expected for 2020, followed by a gradual recovery and growth of 3.9% in 2021 and 3.6% in 2022 (decline of 3.5% in 2020 and growth of 4.7% and 4% in 2021 and 2022, respectively in the April forecasts). The economic growth will also continue in 2023 with a rate of 4%. Thus, there are no changes in terms of the structure i.e. in this cycle of forecasts it is expected that the decline in GDP in 2020 will result from the domestic demand, while net exports will have a positive contribution, and then in the next period the recovery of the domestic demand will be the main factor of economic growth, with a negative contribution of net exports. **The inflation rate has been corrected upwards for 2020 compared to the April forecasts, thus expecting prices increase of 1.1% (0% in April), amid higher performances, primarily due to domestic factors and disruptions on the supply and demand side during the pandemic, and with corrections in different directions of import prices. With estimates for growth in import prices and a moderate positive output gap in the following period, the inflation rate is expected to gradually accelerate and amount to 1.5% in 2021 and 2% in 2022-2023, similar to the expectations in the April forecasts. Estimates for the external sector developments indicate a moderate widening in the current account deficit in 2020 to 3.7% of GDP, while in 2021, with the gradual weakening of the negative effects of the crisis, a deficit of 2.6% of GDP is expected. A full exhaustion of the effects and stabilization of the current account deficit to an average level of 1.6% of GDP is expected in the period 2022-2023.** Foreign reserves are expected to remain at an appropriate level during the entire forecasting period.

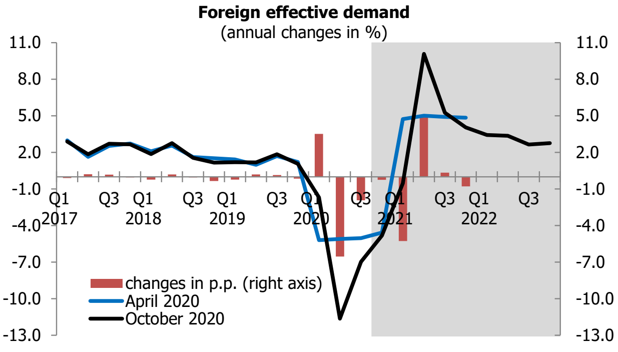
1.1. Assumptions in the external environment forecast[1]

The latest estimates of the effective foreign demand[2] **for 2020 and 2021 have been revised downward compared with the April forecasts.** Thus, it is currently expected that the decline in the foreign effective demand in 2020 will be 6.3% (decline of 5% in April), and its recovery and growth of 4.6% (4.9% in April) is expected in 2021. The downward revision for 2020 is mostly a reflection of estimates for a deeper decline in the economies of almost all our partners, especially in Germany, Greece, Belgium and Italy, while for 2021, mainly due to the expectations for a weaker economic activity in Bulgaria and Serbia. The growth dynamics is expected to continue in 2022, whereby the growth of the foreign demand is expected to be 3.0%.

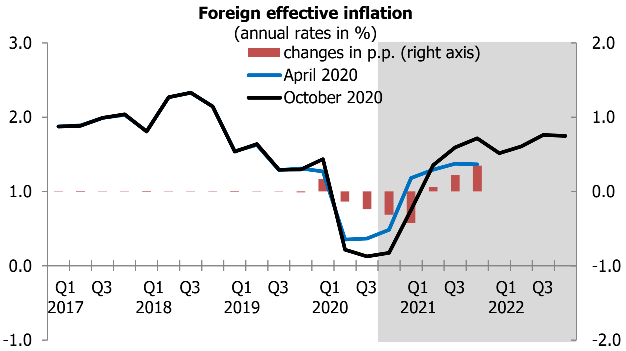
[1] Historical data on foreign demand, foreign inflation, exchange rate of the US dollar/euro and EURIBOR are sourced from Eurostat, while the World Bank statistics is a source of the data on prices of oil, food and metals. The forecasts of foreign demand, foreign inflation, foreign exchange rate of the US dollar and EURIBOR are based on the Consensus Forecast, while the forecasts of the prices of oil, food and metals are based on the forecasts of market analysts. The analysis uses various reports of the IMF, the World Bank, ECB, FAO, OPEC and specialized economic portals.

[2] Foreign effective demand is calculated as the weighted sum of GDP indices of the major trading partners of the Republic of North Macedonia. The calculation of this index includes Germany, Greece, Italy, the Netherlands, Belgium, Spain, Serbia, Croatia, Slovenia and Bulgaria.

The foreign effective inflation is slightly revised downwards for 2020, compared to the forecasts in April i.e. it is expected to be 0.5% (0.6 in April) mostly as a result of expectations for a lower inflation in Croatia. On the other hand, the growth is expected to be 1.4% in 2021, which is a slight correction upwards (1.3% in April) mostly as a result to expectations for lower price pressures in Germany. A deceleration of the growth pace is expected in 2022, with an estimated growth of the foreign effective inflation of 1.7%.



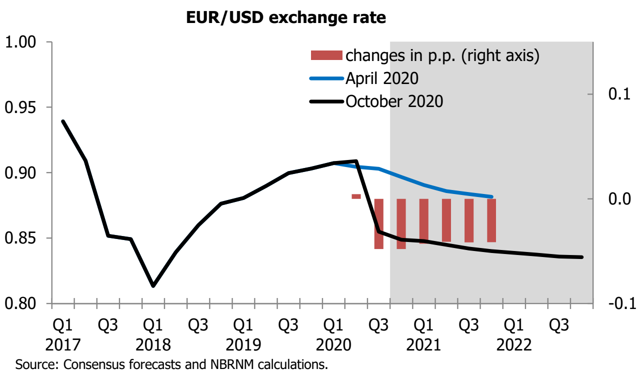
Source: Consensus forecasts and NBRNM calculations.



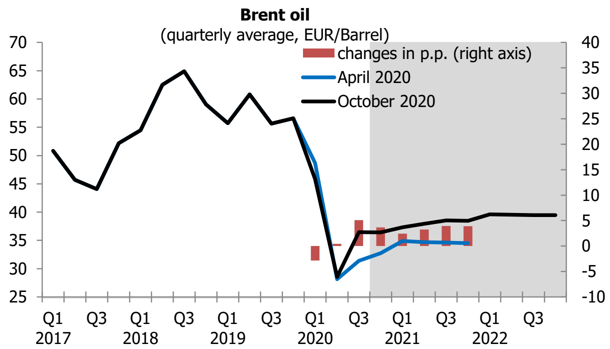
Source: Consensus forecasts and NBRNM calculations.

The latest forecasts for the movement of the euro/US dollar exchange rate for 2020 and 2021 resulted in a downward revision relative to April. Namely, depreciation of the US dollar is currently expected in both years, of 1.5% and 4.1% in 2020 and 2021, respectively (contrary to the appreciation in 2020 of 1.1% and the smaller depreciation in 2021 of 1.9%, forecasted in April). The revisions reflect the investors' expectations for maintenance of the low interest rates in the USA for a longer period of time according to the changes in the framework for implementation of monetary policy[3], and in part also the expectations for larger fiscal stimulus in accordance with the post-electoral policies in the USA. For 2022, it is expected that the value of the US dollar against the euro will continue to decrease, and the fall will equal 0.8%.

The latest estimates for the oil price indicate a minor upward revision relative to April. Namely, it is currently expected that the fall in 2020 will equal 35.6% (fall of 38.4% in April), while in 2021 it is expected a small increase of 3.4%, instead of the envisaged fall of 1.6% in April. The upward revisions are largely a result of the expectetions for reduction of oil production in the USA and the OPEC+ countries, which continued the agreement for limited production on two occasions. For 2022, the estimates indicate a further upward price movement, whereby the growth is expected to amount to 3.8%.



Source: Consensus forecasts and NBRNM calculations.



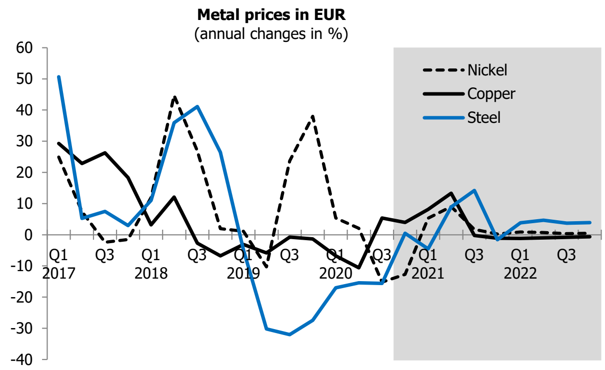
Source: IMF and NBRNM calculations.

Metal prices were revised upwards for the entire forecast horizon compared to the April estimates. Namely, according to the latest estimates it is expected a significanly smaller decline in the prices of nickel and copper in 2020, as well as growth instead of fall in 2021. Such revisions in the

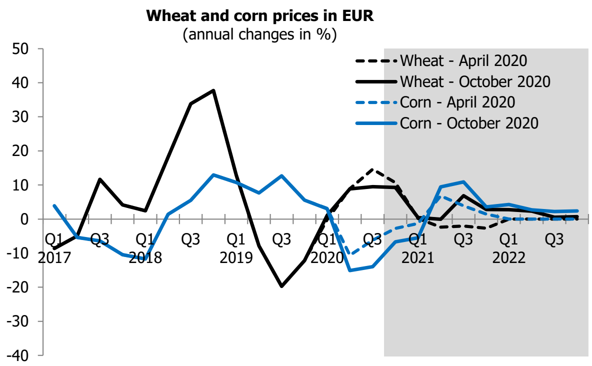
[3] On 27 August 2020, the Fed published updating of the long-term goals and the strategy for implementation of monetary policy and the more significant changes refer to: 1) maximum employment, whereby now the decisions will be based on the estimates for downward deviations from the maximum level of employment, instead of the current practice for deviations from the maximum level in both directions; 2) price stability, whereby the Fed adjusted its strategy for achieving the long-term target - inflation of 2%, thus trying to reach inflation which on average is 2% in a certain time period, i.e. after the periods in which the inflation was constantly below 2%, monetary policy will aim at achieving inflation moderately above 2% in a certain time period.

copper price are largely a result of the growth of the demand by China, as the largest copper consumer, in conditions of faster recovery of the Chinese economy from the crisis caused by the viral infection and the strong fiscal and monetary stimulus in the country, the reduction of global inventories and the concern about the production with some of the producing countries due to the pandemic. The revisions in the nickel price are mainly associated with the increased demand from the industry for steel and for electric cars. In 2022, it is expected stabilization of metal prices and their maintenance at a relatively unchanged level compared to the previous year.

Compared to the April forecasts, the current estimates for the prices of food products have been revised downwards for 2020, and upwards for 2021. Thus, for 2020, there are expectations for slower growth of the wheat price and faster fall in the corn price compared to April. Such movements are largely a result of the expectations for larger production of wheat in Australia, Europe and the Russian Federation and the expectations for record global production of corn, amid still weak demand, especially for industrial needs. On the other hand, the current estimates for 2021 indicate a growth of the price of wheat, instead of the previously forecasted fall, and a faster growth of the price of corn relative to April. For 2022, a small growth of the stock exchange food prices is expected.

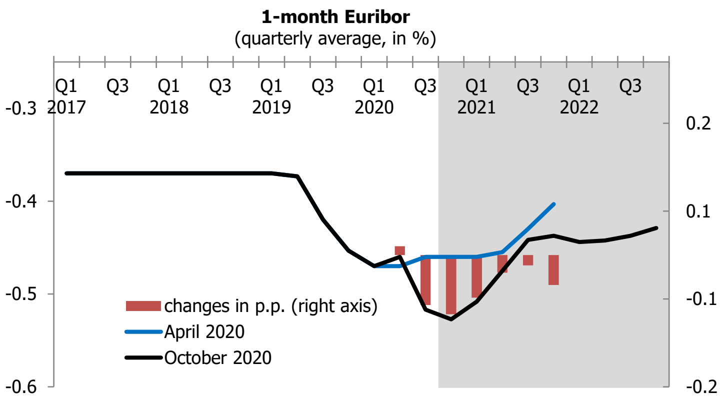


Source: IMF and NBRNM calculations.



Source: IMF and NBRNM calculations.

Minor downward revision has been made of **one-month Euribor interest rates** compared to April, still expecting it to move in the negative zone for the entire forecasting horizon. Namely, it is now expected that the one-month Euribor would average -0.49% in 2020 (-0.47% in April) and -0.47% in 2021 (-0.44% in April). In conditions of negative inflation rates in the euro area in August and September, such revisions mostly reflect the expectations that the ECB will increase the volume and will continue the measure for purchase of assets for urgent economic support due to the pandemic, whch is envisaged to last until the middle of the next year. For 2022, it is expected that the EURIBOR interest rate will be maintained in the negative zone and will amount to -0.44%, on average.



Source: Consensus forecasts and NBRNM calculations.

1.2. Forecast and effects on monetary policy

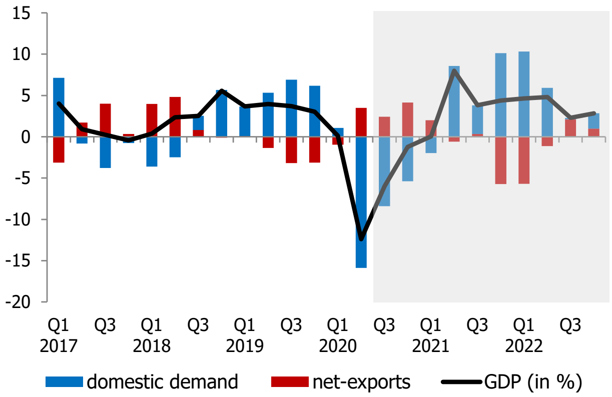
The October macroeconomic scenario for the Macedonian economy suggests stronger negative effects of the current health crisis and more pronounced downward revisions

regarding the April forecast, and without major changes in the perceptions about the structure of growth. Notwithstanding the above, the latest forecasts still indicate stable external position of the economy and foreign reserves, which in the next period will be maintained at an appropriate level. *The prolonged uncertainty and the significantly reduced international movement of passengers due to the pandemic will adversely affect the inflows from remittances which will lead to a larger reduction of the surplus in secondary income this year, but also its slower recovery in the next period. On the other hand, the trade balance is expected to improve in 2020, in conditions of a pronounced reduction of import demand, as a combined effect of the reduction of exports and the fall in domestic demand, coupled with the sharper decline in energy prices. In the next period, according to the recovery of the domestic economy, greater import pressures and deficit expansion are also expected, but they however would not be in volume that could cause disruption to the external balance. Consequently,* ***it is expected a moderate deterioration of the current account deficit this year and its gradual narrowing in the remaining period of forecast.*** *Moreover, observed for the entire period of forecast, the current account deficit will continue to be moderate and* ***mainly financed by the borrowing of the public sector and the inflows from foreign direct investments. The latest assessments of foreign interest rate, as an important external factor for implementing monetary policy, are similar to the April forecasts*** *i.e. the one-month Euribor interest rate will remain in the negative zone for the entire forecast horizon. In addition, as for the ECB policy setup, in conditions of reduced prospects for the future expected growth, according to the autumn wave of spreading of the virus COVID-19 and price decline in the third quarter, the ECB is expected to take additional stimulating measures aimed towards creating liquidity in the system and supporing lending.* ***Risks underlying the baseline macroeconomic scenario are still assessed as markedly downward and are almost entirely related to the COVID-19 pandemic.*** *Currently, the main downward risk is related to the potential reintroduction of restrictive measures to contain virus spread, in response to the current second wave of the pandemic, as well as any slower virus management than currently expected. The possible materialization of these risks can lead to new disruption of the chains of production and demand and to a significant deceleration of the expected dynamics of economic recovery, and thereby to difficulties in the existence of companies and a more pronounced deterioration on the labor market.* ***On the other hand, faster progress in the coronavirus treatment and vaccine development are potential positive risks****. If the coronavirus threat is overcome faster than expected, enhanced confidence could significantly boost global and accordingly, domestic economy. Also, the membership of our country in NATO and the commencement of negotiations for full membership in the EU still pose a positive risk to the forecast, in the medium run.*

The health crisis and the measures undertaken for prevention of the spread of the viral infection and protection of the public health led to a significant reduction of the economic activity in the domestic economy in the first half of 2020, of 6.3%. Moreover, the fall in this period is fully driven by the high negative contribution of domestic demand, amid a positive contribution of net-exports. Observed by components, the export is a component with the largest individual contribution to the GDP fall, in conditions of a fall in foreign demand and the temporarily broken global chains of production and transport, which especially adversely affected the foreign export-oriented facilities, and to a lesser extent the traditional export sectors. A negative contribution to the GDP fall was also made by the components of the domestic demand - private consumption and gross investments, given the high uncertainty and the restraint from consumption and investments, the resuced private transfers and the reduced dynamics in public investments, while public consumption grew according to the increased support for health care. These shifts in exports and domestic demand also led to a fall in imports, whereby net-exports made a positive contribution to the overall GDP. The available high-frequency data and estimates for the third quarter indicate a significant deceleration in the fall, in accordance with the temporary reduction of the strength of the pandemic and the gradual reduction of the previously introduced restrictive measures. Given the deterioration of the situation with the pandemic, the economy is expected to be maintained in the negative zone also in the last quarter of the year, but with a further deceleration in the fall. Hence, for the **entire 2020, a fall in the domestic economy of 4.9% is expected,** amid a negative contribution of domestic demand and a positive contribution of net-exports. Moreover, contrary to the expectations in April for exhaution of the negative effects of the health-economic crisis by the end of 2020 and fast recovery in 2021, now the basic assumption is that the occurrence of the autumn wave of the pandemic with the coronavirus will have prolonged negative effects on the economy also during the next year. According to this assumption, the economic activity will be somewhat weaker in the first half of

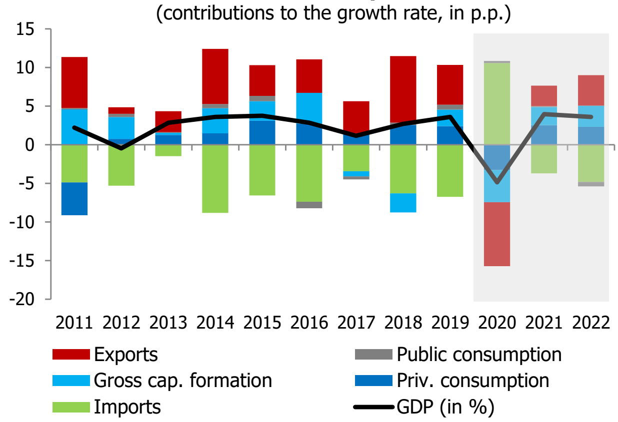
2021, with a stronger recovery in the second half, so that **for the entire 2021 economic growth of 3.9% is expected. Furhermore, for 2022 and 2023, the economic growth is expected to continue at rates of 3.6% and 4%, respectively.** In terms of the structure of growth, domestic demand will be the driver of growth, mainly as a result of the growth of household consumption and investment activity, and net-exports will make a negative contribution. **According to such forecasted path of growth for the next period, and taking into consideration the global expectations, the return of the economy at the pre-crisis level (i.e. at the level of 2019) is expected during 2022.**

Growth decomposition
(contributions to the y-o-y rate, in p.p.)



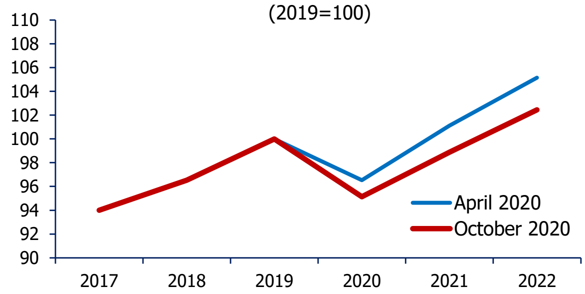
Source: SSO and NBRNM calculations.

Growth decomposition
(contributions to the growth rate, in p.p.)



Source: SSO and NBRNM calculations.

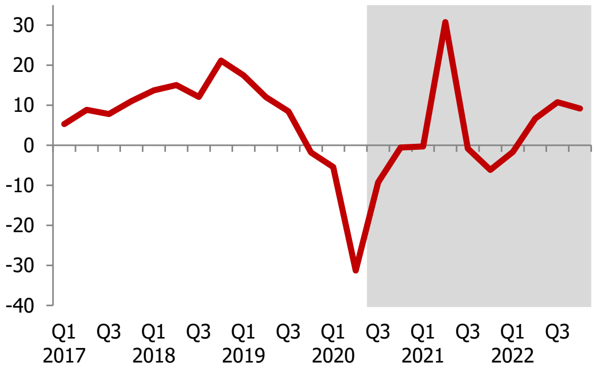
Real GDP level
(2019=100)



Source: State Statistical Office and NBRNM calculations.

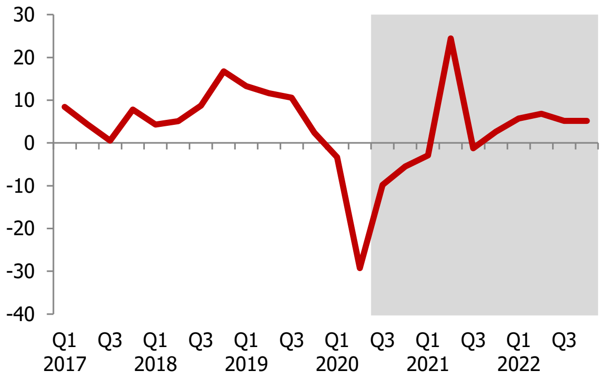
Analyzed by GDP component, it is expected that the real export of goods and services will be one of the main factors for the economic contraction in 2020. The fall in the export of goods and services which was registered in the first half will continue until the end of the year in conditions of an estimate for a decline in the foreign demand and the increased uncertainty due to the new autumn wave of the pandemic, but at a significantly slower pace. Thus, it is estimated that the existing export-oriented facilities, mainly in the automotive industry, whose activity was significantly reduced in the second quarter when some of them were temporarily closed, will gradually normalize production, a similar pace is also expected in the traditional export sectors. In the next two years, the exports are expected to gradually recover. Namely, with the recovery of the global value chains and the gradual exhaustion of the negative effects of the crisis, it is expected that the foreign export facilities will continue to operate at full capacity. At the same time, an increased export activity is also expected in the traditional sector, in conditions of a recovery of the foreign effective demand and a positive stimulus from the expectations for predominantly growth of metal prices. Hence, in 2021, moderate growth of exports and decelertion of the growth is expected in 2022, whereby on cumulative basis, exports would be a major factor for the GDP growth in this period.

Exports of goods and services
(y-o-y changes, in %)



Source: SSO and NBRNM calculations.

Imports of goods and services
(y-o-y changes, in %)



Source: SSO and NBRNM calculations.

Reduction and negative contribution to GDP for 2020 is also expected in the domestic demand. In 2021, it is expected to partially recover in conditions of estimates for still present restraint from consumption and investments in the first half of 2021. The forecasts assume normalization of the context **and further positive contribution of domestic demand in 2022.**

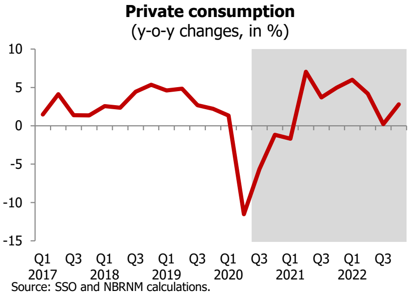
Regarding the individual components of domestic demand, it is expected that the highest negative contribution in 2020 will be made by **gross investments,** in conditions of a decline in the first half, further risk aversion and restraint from new investments in the private sector, weaker realization of public investments, fall in the global economic activity and smaller inflows in the foreign direct investments. On the other hand, in the period 2021-2022, it is expected solid growth of gross investments and their positive contribution to the GDP growth. Moreover, it is assumed a stronger recovery of the investment activity from the second half of 2021, amid a gradual increase in the confidence and expectations for growth of private investments, in accordance with the estimates for further growth of corporate lending, which also covers the economic government measures for favorable credit lines, intensification of government infrastructure projects, growth of foreign demand and of exports and increased foreign direct investments.

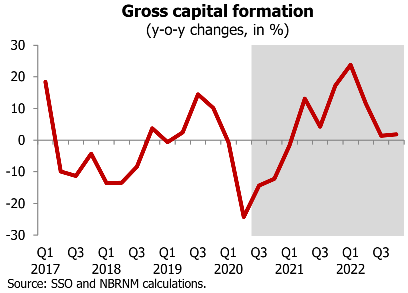
The great uncertainty about the development of the pandemic during 2020 led to increased restraint from consumption and fall in **private consumption.** These effects are, to some extent, mitigated through the fiscal measures undertaken to support the economy and consumption, as well as the changes in the policy of the central bank aimed at supporting credit flows and liquidity. Hence, in 2020 almost all factors of disposable income, with the exception of private transfers, are expected to be maintained in the positive zone, which in part represents a spillover effect of the discretionary measures for increasing wages in some of the employees in the public sector and increasing pensions, towards the end of 2019 and the beginning of 2020. At the same time, in 2020 the growth of lending to households is expected to continue in line with the favorable financial conditions, according to the measures of the National Bank for mitigating the adverse effects of the pandemic. In 2021, household consumption is expected to partially recover, whereby the uncertainty arising from the second wave of the pandemic and the restraint from consumption are expected to be present until the middle of the year, and then a period of normalization and recovery will follow. Hence, in the period 2021-2022 solid growth rates of private consumption are forecasted, with expectations for higher propensity to spend, in conditions of growth of disposable income and further credit support by banks. Namely, with the strengthening of the economic activity, moderate positive movements in the number of employees, wages and the pension bill, as well as significant growth of private transfers, are expected according to the recovery of the global growth and the reduction of restrictions.

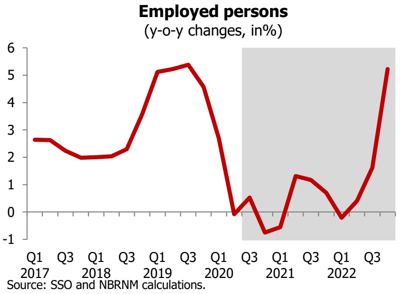
Regarding the **public consumption**[4], growth is expected in 2020, according to the increased spendings which arise from the current health crisis and gradual consolidation of expenditures in the period 2021-2022, which assumes their small growth in 2021 and fall in 2022. Hence, its cumulative effect on the economic activity in the period of forecasts will be minimally negative.

[4] Public consumption forecasts are based on the information from the second Budget Revision for 2020 from November 2020, the draft - Budget for 2021 and the Fiscal Strategy 2021-2023 from July 2020 coupled with information from the Ministry of Finance about the path of long-term fiscal consolidation for 2021-2025, from November 2020.

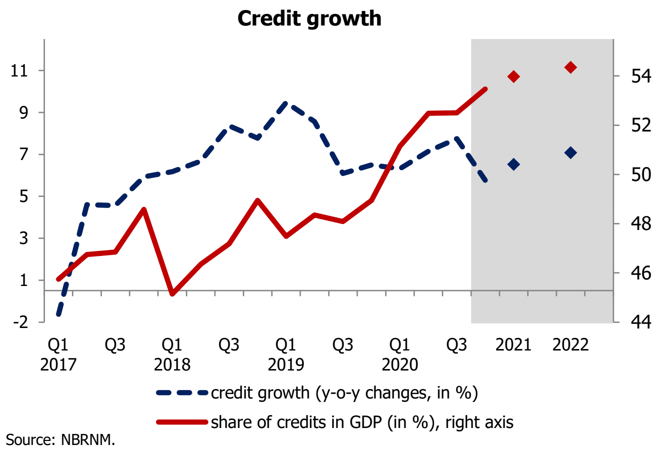
In conditions of a fall in exports and domestic demand, in 2020 a significant fall in **import demand** is also expected. Thus, in 2020, net-exports are expected to make a positive contribution to the GDP growth. In the next two years, given the dynamics of recovery of exports, as well as the growth of domestic demand, it is expected moderate growth of import demand in 2021 and slight acceleration in the growth in 2022, whereby net-exports will make a negative contribution to the total growth in the period 2021-2022.







The latest credit market assessments in the forecast horizon point to solid credit activity in 2020 followed by moderate acceleration of growth rates in the next three years. According to the solid growth of loans in the first three quarters, with the support of the measures taken by the National Bank for mitigating the negative effects on the economy caused by the COVID-19 pandemic, it is expected to continue until the end of the year. Thus, at the end of 2020 the growth rate of loans is estimated that it will equal 5.3% (6% at the end of 2019). In the next three years, gradual acceleration in the lending activity is expected, at an average rate of 6.3% in the period 2021-2022 and 7.6% in 2023, in conditions of growth of the domestic economy, stabilization of the expectations and increased demand for loans by the households and the corporate sector. The restraint from consumption and investments during 2020 and the economic measures taken to increase the liquidity of companies and support the income of households, enabled maintenance of the positive movements in deposits, which for the entire 2020 are expected да increase by 4.4% (9% in 2019). The economic recovery expectations in the upcoming period will result in growth of the deposit base at faster rates of about 6.9% on average in 2021-2022 and additional 8.2% in 2023.



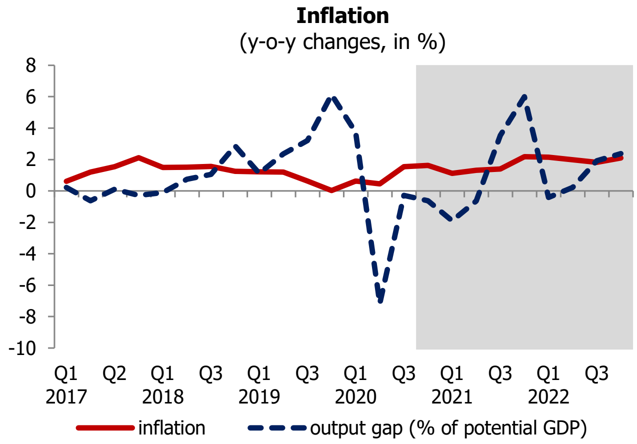
A moderate widening of the current account deficit in 2020 by 0.4 p.p. of GDP, to 3.7% of GDP, which is entirely due to the deterioration expectations for current transfers. Namely, restrictive measures to prevent the spread of the virus significantly decreased the international movement of passengers, which complemented by the prolonged uncertainty results in decreased remittances sent through informal channels. However, this effect is mitigated to some extent by diverting the transmission of this remittances through formal channels. On the other hand, the balance of goods and services is expected to move in line with the improvement of the current account deficit due to the favorable expectations for both the trade deficit and the trade balance. A downward adjustment of both the export and the import side is expected in the foreign trade, as well as narrowing of the trade deficit. Such downward adjustments are expected amid negative pressure on export from reduced foreign demand and temporarily disrupted production chains, as well as corresponding reduction of the import demand complemented by lower import pressures from the fall of the domestic demand as well as from the lower prices of crude oil on the world stock market. Significant downward correction of energy prices, as well as lower consumption due to the reduced population movement and weaker economic activity are expected to cause significant narrowing of the energy deficit amid simultaneous slight expansion of non-energetic balance. In the prmary income, the deficit is forecast to narrow in accordance with the expected deterioration of the activity of domestic companies with foreign investments amid growing uncertainty and deteriorating economic environment. The trade surplus is expected to improve, due to the pronounced downward adjustment in import compared to the downward adjustment in export of services. **In 2021, the current account deficit is expected to improve by 1.1 percentage points of GDP to 2.6% of GDP.** The gradual exhaustion of the effects of the pandemics is expected to contribute to surplus growth in secondary income, amid partial stabilization of the situation and partial recovery of global and domestic economy. Trade deficit is expected to widen, amid higher income pressures due to the domestic economy recovery, but also due to material imports of the export sector, which is expected to grow in 2021. High import pressures would lead to certain deterioration of the balance of services, and the expected increase in the newly created value of foreign companies in domestic economy would act on widening the deficit in the primary income. **Financing of the current account deficit in the period 2020-2021 is mostly expected to rely on the Government's long-term borrowings,** through the Eurobond and long-term borrowings from international financial institutions, **as well as foreign direct investments.** On the other hand, given the pronounced uncertainty and slower stabilization of expectations and confidence, net outflow in currencies and deposits is expected. **Further narrowing of the current account is expected for the period 2022-2023 to an average of 1.6% of GDP,** in terms of complete exhaustion of pandemic risks, global stabilization of the situation and recovery of the domestic economy, amid further improvement of the secondary income and stabilization of balance of goods and services. **Public sector debt, as well as inflows from foreign direct investment** are considered the main sources of financing the current account deficit, while their volume would enable additional growth of the foreign reserves. **Foreign reserves are expected to be maintained at an appropriate level throughout the forecast horizon.**

Balance of Payment forecast (% of GDP)

	2015	2016	2017	2018	2019	2020	2021	2022	2023
Current account	**-2.0**	**-2.9**	**-1.0**	**-0.1**	**-3.3**	**-3.7**	**-2.6**	**-1.7**	**-1.5**
Balance of goods & services	-16.2	-15.2	-14.1	-12.8	-14.3	-12.9	-13.3	-13.0	-12.9
Goods, net	-20.1	-18.8	-17.8	-16.2	-17.4	-16.4	-16.6	-16.4	-16.3
Services, net	3.8	3.5	3.7	3.5	3.1	3.5	3.3	3.4	3.4
Primary income, net	-3.2	-4.0	-4.0	-4.2	-4.6	-3.2	-3.3	-3.6	-4.0
Secondary income, net	17.4	16.4	17.0	16.9	15.6	12.5	14.0	14.9	15.3
Private sector, net	16.9	15.4	15.9	15.9	15.2	11.7	13.4	14.3	14.7
Capital account	**0.1**	**0.1**	**0.2**	**0.1**	**0.1**	**0.0**	**0.0**	**0.0**	**0.0**
Financial account	**0.1**	**-6.3**	**0.5**	**-5.0**	**-6.0**	**-3.2**	**-3.1**	**-3.3**	**-3.9**
FDI, net	-2.2	-3.3	-1.8	-5.6	-3.2	-1.6	-3.0	-3.3	-3.5
Portfolio Investment, net	-0.7	-4.4	0.2	-3.0	1.3	-2.6	-0.4	0.4	0.0
Other Investment, net	3.1	1.4	2.1	3.6	-4.1	1.0	0.3	-0.4	-0.4

Source: NBRNM.

The average inflation rate for the whole 2020 is estimated to be 1.1% (0.8% in 2019) amid price growth in food component and core inflation, with shifts in both the supply and demand side for certain market segments due to the pandemic. The price of the energy component will have negative contribution amid strong decline in world oil prices, an effect that is partially offset by the increased excise tax for certain oil products and rising electricity prices in domestic economy. In the next two-year period, the import prices will grow and their positive effect on domestic economy is expected, while on the demand side no stronger pressures are expected, given the moderately averaged, positive production gap. Hence, a positive contribution of all three components is predicted in 2021 **with the inflation rate in 2021 acceleration to 1.5%. In 2022, further acceleration of around 2% is expected and maintenance of the same price growth in 2023 as well.** Main risk to the inflation forecast remains associated with exceptionally high uncertainty about the future dynamics of the primary commodities market prices, especially oil, as well as the uncertainty about the future global economic growth caused by the health and economic crisis and the effect on the prices of primary commodities on the one hand and the limit on supply due to the restrictive measures, on the other hand.



Source: SSO and NBRNM calculations.

1.3. Comparison with the previous forecast

The latest April macroeconomic forecasts point to significant changes in relation to the April vintage. Thus, the economic growth forecast in the period 2020-2022 is revised downwards compared to April, reflecting the lower performances and assessments on prolonged adverse effects of the COVID-19 pandemic in the next period. Regarding the prices movements, an upward revision at the inflation rate is made for 2020, mainly due to the higher performances in domestic prices of food and energy , while the forecast for 2021 and 2022 remained unchanged compared to April. Prolonged effects of the COVID-19 pandemic are expected to result moderately higher averaged current account deficit in the period 2020-2022, compared to the April forecast, due to deteriorating expectations for secondary income surplus, while the average primary income deficit is lower according to the current forecast. Regarding the balance of goods and services, the expectations for services are better due to the higher trade deficit in goods, so in total the expectations for these three years have not changed significantly compared to April.

Forecast of selected macroeconomic variables

	2020 forecast		2021 forecast		2022 forecast
	Apr.	**Oct.**	**Apr.**	**Oct.**	**Oct.**
GDP, %	**-3.5**	**-4.9**	**4.7**	**3.9**	**3.6**
Private consumption	-4.3	-4.3	6.1	3.4	3.3
Gross capital formation	-10.4	-12.8	9.8	8.1	9.1
Public consumption	6.6	2.2	-1.5	0.8	-3.8
Exports of goods and services	-17.1	-11.7	25.0	4.1	6.1
Imports of goods and services	-15.4	-11.9	21.6	4.5	5.7
Inflation	**0.0**	**1.1**	**1.5**	**1.5**	**2.0**
Current account deficit, % of GDP	**-3.2**	**-3.7**	**-1.8**	**-2.6**	**-1.7**

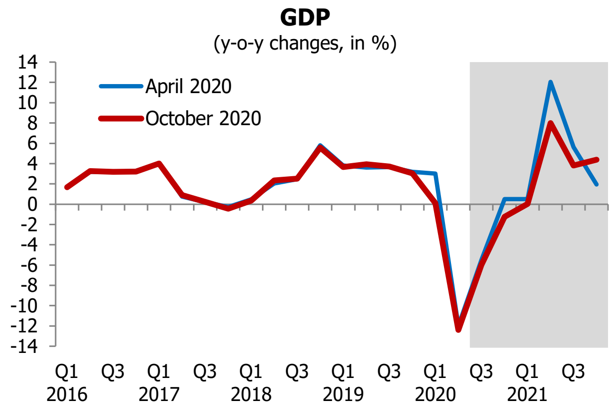
Source: NBRNM.

The resurgence of infection rates in autumn both globally and domestically led to a deterioration of the prospects for the Macedonian economy compared to the April forecasts. Therefore, unlike in April when a gradual overcoming of the crisis was expected by the end of this year, it is currently estimated that the negative economic effects will remain in the first half of 2021. **This assumption, along with the weaker performances in the first half of the year, led to a downward revision of the GDP forecast for 2020, so the current forecast is that the decline will be 4.9%, compared to 3.5% in April. Also, in this cycle of forecasts, downward revision was made for the assessments of growth of domestic economy in mid-term, from 4.7% to 3.9% for 2021 and from 4% to 3.6% for 2022.** However, on a cumulative basis, no major adjustments were made on terms of GDP structure, but only in the magnitude of changes. Thus, the domestic demand is still expected to be main driver of GDP decline in 2020 with a more negative contribution compared to April. This is mainly due to the larger downward adjustment in the rate of decline of gross investments, given the slower realization of the planned public investments and prolonged negative effects of the crisis on the confidence of the private sector investors. Based on the weaker performances in the first three quarters and the new data from the second budget revision, downward adjustment is also made to the growth rate and this year's positive contribution of public consumption. On the other hand, the assessment of the private consumption has not changed in 2020 and is expected to have a negative contribution to the decline in GDP as forecasted in April, which given mostly upward shifts in its basic determinants (except private transfers), leads to greater restraint of the population in consumption due to the great uncertainty caused by the pandemic.

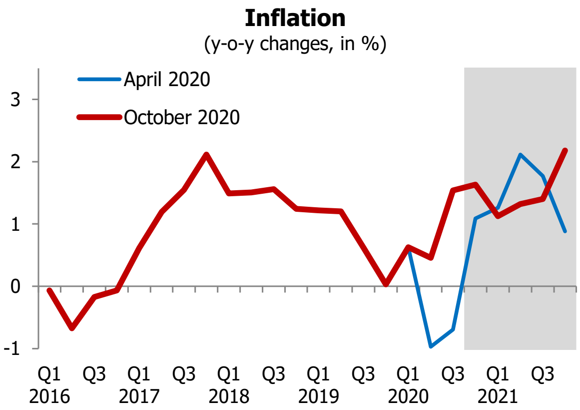
A lower decline in real exports of goods and services is currently expected in 2020 in terms of the components of net export demand, given the faster recovery and better performances than expected in both new export-oriented companies and part of the traditional sector. In line with the assessed export dynamics, moderate upward revision is made in the decline in real import of goods and services this year.

Seen on a net basis, the larger upward adjustment in export than in import will lead to a slightly larger positive contribution in net export towards the annual GDP change for 2020, compared to April, which would partially offset the larger negative contribution from domestic demand.

According to the assumption for prolonged negative effect of the global pandemic in 2021, a more moderate recovery of domestic demand is expected, and consequently its lower positive contribution to the GDP growth compared to April. In such unfavorable conditions, major revision was made in private consumption which would achieve lower growth rate making its positive contribution to the GDP growth smaller compared to the previous forecast. At the same time, the assessment of the gross investments growth is revised downwards, resulting in small downward changes in the assessed positive contribution of this component to the overall growth as well. On the other hand, the new assumptions on public consumption indicate more moderate consolidation, i.e. its small growth, as opposed to the April forecast for small decline, so it will affect the support of the economy next year too. Regarding the external sector, there were downward revisions to the growth of the real export and import of goods and services in 2021, reflecting the expectations for lower foreign effective demand, as well as more moderate pressures from domestic demand, and thus their more moderate recovery during the forecast horizon. Therefore, on a net basis, the net export is expected to make a smaller negative contribution to the GDP growth compared to the April assessment.

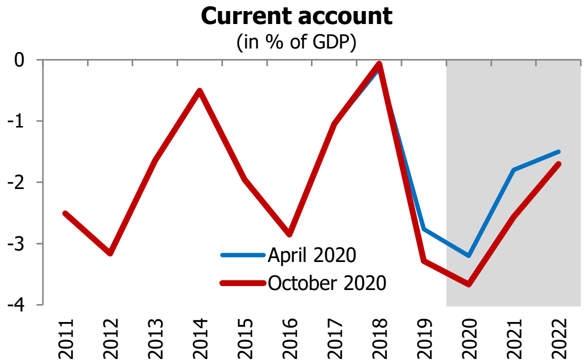


Source: SSO and NBRNM calculations.



Source: SSO and NBRNM calculations.

The inflation rate forecast for 2020 has been revised upwards, and it is now expected to be 1.1%, versus 0% in April. The upward forecast is mainly due to domestic factors, which led to higher inflation in the first three quarters of the year, opposite to the similar movements in foreign effective inflation and adjustments in different direction in the import prices compared to April. Upward corrections were performed in all individual components of inflation, of which the most significant is the revision of the growth of food inflation, mainly influenced by higher price realizations caused by certain disturbances in the supply and demand amid pandemic. The energy component suffered a more significant upward revision, in line with its small decline, reflecting the effect of the increase in the electricity price in the third quarter (already visible in the current higher performances), the increase of the excise tax for certain oil derivatives at the beginning of the year, as well as estimates for a lower annual decline of the oil price on the world markets compared to April. At the same time, a smaller upward revision was performed in core inflation. On the other hand, the forecast of the inflation rate in 2021 remains unchanged, and is still expected to be 1.5%. However, by components, there is an upward correction in energy inflation, amid positive effects from the previous year and growth estimates, instead of decline of the world oil prices. In contrast, food and core inflation estimates for next year have been revised downwards compared to April.



Source: NBRNM.

The last October forecast shows a slightly higher current account deficit for the period 2020-2022 compared to the expectations in April of 2.6% of GDP versus a contribution of 2.1% in GDP according to the April forecast. **There is a more pronounced change in 2020 and 2021, while the expectations for 2022 remain close to April. The correction for 2020 is 0.5 p.p. of GDP, while the expectations for current account deficit for 2021 are now higher by 0.8 p.p. of GDP,** due to the changed conditions and still present pandemic which is expected to continue in the next year, despite the expectations for exhaustion of the negative effects from the virus spread in 2021 according to the April forecasts. The changed expectations are due to the forecasted lower surplus in secondary income, amid smaller informal remittances in both years. In the trade deficit in goods, the change in 2020 is in line with the slightly deeper deficit, while in 2021 there is no significant correction in expectations. In terms of the components, higher deficit in non-energy balance is forecasted for both years, amid slight downward correction in energy component. There are more favorable expectations for the export activities in the current year compared to April, amid significantly lower decline in export compared to the same period, but also a more moderate recovery in the upcoming years. The correction in the import of goods is appropriate in both years, with more moderate downward movements in 2020 and milder import pressures in 2021. On the other hand, the shifts in the surplus of services are more favorable compared to the April forecast, in accordance with better performances and more pronounced downward adjustment in export of services, and now we expect higher net inflows in this category during the three years. **A slightly higher deficit of 0.2 p.p. of GDP is forecasted on the current account, compared to the April expectation. Analyzing financial flows, lower net inflows are expected for 2020-2022 cumulatively, compared to the April forecast.** The changes stem from the higher outflows in short term categories, especially in foreign currency and deposits as well as a slight downward correction in foreign direct investments in 2021 and 2022, due to the slower dynamics of exhaustion of effects of the pandemic and appropriately increased uncertainty. On the other hand, the current assessments point to a higher external borrowing of the state in 2020 and 2021, in order to obtain necessary funds for fighting the long-term effects of the health and economic crisis.

Comparison of GDP and inflation forecasts for North Macedonia from various organisations

Organisation	Month of publication	Real GDP growth, %			Inflation (average rate, %)		
		2020	2021	2022	2020	2021	2022
IMF	October 2020	-5.4	5.5	4.5	0.9	1.3	1.6
World Bank	October 2020	-4.1	3.6	3.5	0.5	1.6	2.0
European Commission	November 2020	-4.9	3.8	3.5	0.9	1.2	1.5
EBRD	September 2020	-5.0	3.0	-	-	-	-
Consensus Forecast	October 2020	-5.1	4.7	-	0.6	1.8	-
Ministry of Finance	November 2020	-4.4	4.1	4.6	1.0	1.5	-
National Bank of the Republic of North Macedonia	October 2020	-4.9	3.9	3.6	1.1	1.5	2.0

Source: IMF, World Economic Outlook, October 2020; World Bank, Western Balkans Regular Economic Report No.18, Fall 2020; European Commission European Economic Forecast, Autumn 2020; EBRD Regional Economic Prospects, September 2020; Consensus Forecast, October 2020; Ministry of Finance, 2020 2nd Budget revision, November 2020 and 2021 Draft Budget, November 2020; and the National Bank of the Republic of North Macedonia.

Alternative macroeconomic scenario

The occurrence of the second wave of COVID-19 pandemic and the need to re-establish rigorous restrictive measures to stop it, was assessed as highest risk by all international institutions in recent global growth report. This risk has partly started to come true since mid-October, both in our country and globally, given the rapid spread of the virus, but so far without introducing rigorous restrictive measures as those in the second quarter. The emphasis is mainly on measured aimed at sectors with greater degree of social interaction, in order to protect the public health on the one hand and minimizing the negative effects towards the economic operations on the other hand. However, a possible slower management of the virus than the current forecasts may lead to negative overflow to other economic sectors, which have not been directly affected by the announced restrictive measures. In addition, the increased number of infected people and people in self-isolation could create a pressure on the normal operation of companies, which in eventual tightening of the financial conditions would increase the likelihood of insolvency and closing businesses, with long-term negative effects on the labor market. The international mobility if population would be difficult for a longer period, and maybe even be more rigorously limited, and the uncertainty and restraint of economic entities would be more pronounced.

Hence, **the alternative scenario linked to the current cycle of macroeconomic forecasts assumes significantly stronger negative effects of the autumn wave of the pandemic towards foreign effective demand, smaller inflows from informal remittances and foreign direct investments, more pronounced restraint of domestic economic entities amid prolonged uncertainty, as well as prolonged but also more pronounced negative effects on the labor market, compared to the baseline scenario for the period 2021-2022.**

Namely, any stricter restrictions to prevent the virus spread will contribute to a deteriorated outlook of the recovery pace, which is why both, global trade and global production chains would be under attack, which would adversely reflect on the foreign demand for Macedonian export products.

To cover this effect, the estimated effects by IMF[5] on the global growth are taken into consideration within their alternative pessimistic scenario, i.e. we assume lower growth of foreign effective demand by 3 p.p. in 2021 and higher growth by 0.5 p.p. in 2022 and 2023. The downward correction of foreign effective demand in 2021 would have a direct negative effect on the export, as well as on foreign direct investments and overall investment activity.

The estimated direct effect of the lower foreign demand on the total GDP point to weaker economic growth by about 1 p.p. in 2021 compared to the growth in the baseline scenario.

Of course, in addition to the foreign direct effect from the weaker foreign demand, deteriorated prospects and growing uncertainty could affect domestic demand, through greater restraint from consumption and investments (domestic and foreign), through the labor market and on the available income. Hence, the alternative scenario assumes further stagnation of the employees and real wages in 2021 and weaker recovery in 2022, opposite the slight growth in both years in the baseline scenario. The global weaker economic activity, especially in Europe, as well as the prolonged travel restrictions, are expected to hamper the recovery of the foreign remittances, because of which a stagnation of net inflows from private transfers in 2021 is expected (as a percentage of GDP) and gradual recovery in 2022, applying the same assumptions on the level of foreign direct investments.

If such assumptions are realized, we could expect slower recovery of the domestic economy in 2021, i.e. weaker economic growth by about 2p.p. compared to the baseline scenario, amid weaker positive contribution from personal consumption, investments and exports of goods and services in particular, partially offset by the lower negative contribution by imports.

[5] World Economic Outlook, October 2020.

Hence, **lower GDP growth in the alternative scenario will result from the lower positive contribution of domestic demand, while net export will have lower negative contribution.**

Amid unchanged assumptions on world prices of primary products, in a case of negative output gap, **the pressures on inflation will remain more moderate, and the inflation rate slightly lower in 2021, compared to the baseline scenario.**