VI. Macroeconomic forecasts and risks

In late February 2022, while the COVID-19 pandemic was still raging, the global economy faced yet another strong and unexpected uneconomic shock - Russia's military invasion of Ukraine and the imposition of harsh economic sanctions against Russia by the western countries. The economic consequences of these developments have been seen through the strong growth in commodity prices, deteriorating economic outlook and diminished general confidence.

Hence, these April forecasts are accompanied by extreme uncertainty conditioned by the duration and intensity of the war in Ukraine, as well as the effects of current and future sanctions against Russia. The shock will be mainly seen in high stock prices of food and energy, which will lead to higher import price pressures and estimates for higher inflation rates, as well as deterioration of trade balance, especially energy, which would cause widening of the current account deficit. A slowdown in exports is also expected, given the economic contraction in foreign partners, disrupted supply chains, and high production costs, especially energy. Increase in food and energy prices will affect the real disposable income and together with the greater restraint would cause lower household consumption and restraint from investments in fixed assets. Economic measures aimed to protect the living standard and to financially support the companies would somewhat mitigate the negative effects of the current crisis. **Given the need to build fiscal space to deal with possible new shocks, the measures should be targeted and temporary, and to provide support for the growth potential of the economy.**

The current macroeconomic scenario is based on the assumptions of worsening global environment due to the war in Ukraine this year, slower economic recovery, and strong growth in commodity prices, intensification of energy crisis and supply chain disruptions. In such circumstances, it also assumes that the confidence and propensity for consumption and investment will decrease and that the financial conditions will tighten faster. Fiscal consolidation will continue, at a more moderate pace though, given the emerging needs to mitigate the economic consequences of the crisis. Regarding the pandemic, it is expected that its effect on the economy will begin to vanish from the second quarter of this year, and therefore the baseline scenario does not include any new strains of the coronavirus. For the next year, in line with the global expectations for calming the war in Ukraine and consequently, stabilizing the commodity markets, more favorable economic shifts are expected, both globally and domestically.

In accordance with the new less favorable assumptions for the external and domestic economic conditions, for 2022, lower economic growth rates are expected for 2022-2023 compared to the October estimates and unchanged estimates on the medium-term growth. Thus, in the current forecast cycle, growth is expected to slow down in 2022 to 2.9% (3.9% in October), followed by growth of 3.6% in 2023 (4% in October) and 4% in 2024. In terms of structure, economic growth is still expected for the coming period entirely due to domestic demand, but currently with estimates for lower positive contribution to growth, while net exports would still have a negative contribution, but more pronounced in 2022, and more moderate in 2023. **Significantly higher performance in the first quarter of the year and strong upward revisions in external input assumptions about energy and food prices, as well as foreign effective inflation, contribute to an upward inflation revision for 2022, and it is currently estimated to be 8.8%.** However, import pressures would gradually be exhausted and in 2023 would move downwards. **Hence, for 2023 it is expected that the inflation rate will decrease and average 3%. In the medium term, inflation is expected to stabilize around the historical average of 2%. External sector expectations forecast significant expansion of the current account deficit in 2022, to 8% of GDP, amid significant price pressures on the import side, especially in energy and food.** The war in Ukraine has put additional pressure on commodity prices, which would remain high year-on-year, but also caused shortages of important raw materials and continuing disruptions to global supply chains. **For 2023, there are expectations for downward correction of commodity prices, especially in some energy sources, but the forecast indicates their stabilization at a significantly higher level than before the conflict, which would narrow the current account deficit to 4.5 % of GDP. For 2024, there**

are expectations for exhaustion of the negative effects of the war and mitigation of price pressures on imports, as well as a more comprehensive global recovery that would reduce the current account deficit to 2.3% of GDP. Foreign reserves are expected to remain appropriate throughout the forecast horizon.

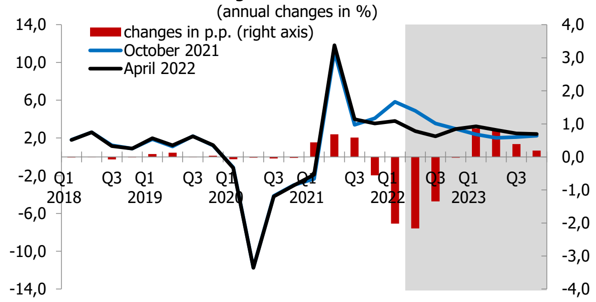
The risks to such a scenario are assessed as downward and depend mainly on the protraction and intensity of the war in Ukraine, as well as on the future sanctions against Russia, especially those aimed at the energy sector. Moreover, the risk of continuation of the COVID-19 pandemic still exists, namely the emergence of new virus strains and waves as well as the risk of faster and more rigid tightening of monetary policies in developed countries. On the other hand, a positive risk is the possible relocation of the automotive industry from Ukraine and Russia to our country, which would lead to higher foreign direct investment, higher exports and higher economic growth rate, and in the medium term, to more favorable effects due to the country's membership in NATO and the possible start of the EU accession negotiation talks, as well as the implementation of the Growth Acceleration Plan for 2022 - 2026.

6.1. Assumptions in the external environment forecast[1]

According to the latest estimates, **foreign effective demand**[2] has been revised downwards for 2022 and upwards for 2023, compared to the October forecasts. Thus, the current estimates point to higher foreign effective demand of 2.9% and 2.8% in 2022 and 2023, respectively, as opposed to the expectations in October for growth of 4.3% and 2.2%, respectively. Such revisions are largely the result of estimates for lower economic activity of Germany[3] in 2022 and higher in 2023 compared to October.

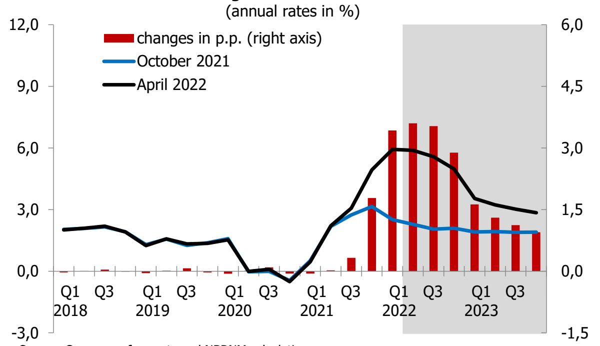
An upward revision for the **foreign effective inflation**[4] was also made for the entire forecast horizon. Current estimates show a growth of 5.7% and 3.2% in 2022 and 2023, respectively (2.3% and 1.9%, respectively in October). The upward revision is due to the expectations for higher inflation in almost all our import partners, with the greatest average contribution of Germany, Bulgaria, and Poland for the two years.

Foreign effective demand
(annual changes in %)



Source: Consensus forecasts and NBRNM calculations.

Foreign effective inflation
(annual rates in %)



Source: Consensus forecasts and NBRNM calculations.

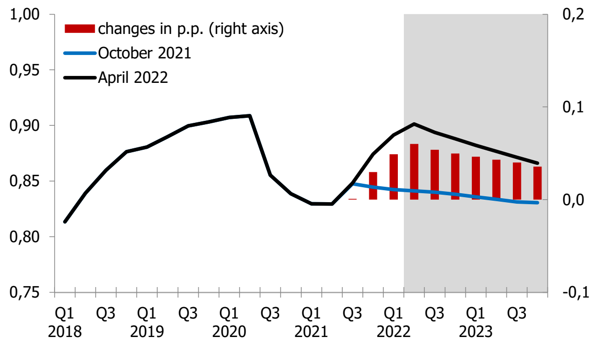
In the latest estimates for the movement of the euro/US-dollar rate, a significant upward revision has been made for 2022 compared to the October forecast, currently expecting a considerable strengthening of the US dollar against the euro of 5.7% (0.3% in October). This shift mainly

[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.
[3] Forecast for growth in Germany of 2.5% and 2.6% in 2022 and 2023, respectively, compared to 4.4% and 1.8%, in October.
[4] The foreign effective inflation is calculated as the weighted sum of consumer price indices of the countries that are major partners of the Republic of North Macedonia in the field of import of consumer goods. The calculation of this indicator includes Bulgaria, Germany, Greece, Spain, France, Italy, Austria, Slovenia, Poland, Croatia, and Serbia. Inflation in Poland, Croatia, and Serbia has been adjusted for the changes in the exchange rate.

reflect the expectations for faster monetary tightening by the Fed, given the improved economic performance and higher inflation in the US, but also increased interest from investors in the US dollar, amid high uncertainty related to the war in Ukraine. On the other hand, a downward correction was made for 2023, expecting a 2.2% fall of the US dollar against the euro (expected decline of 0.9% in October).

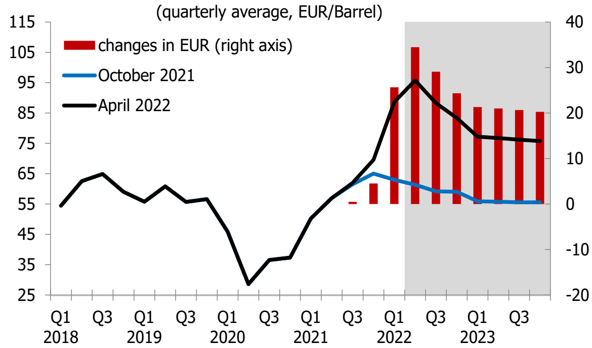
In the April forecast cycle, oil price were expected to increase significantly in 2022 compared to the October forecasts. Thus, for 2022, there are expectations for growth of oil prices of 49.1% (3.8% in October), mainly due to the escalation of the war in Ukraine, which caused a shortage on the supply side due to the ban on import of Russian oil by the United States and the United Kingdom, while retaining the decision for a moderate monthly increase in oil production by OPEC + member countries. On the other hand, for 2023, there are expectations for a larger downtrend of the price from the October forecasts, i.e. a decline of 14.1% (decline of 8.2%).

EUR/USD exchange rate



Source: Consensus forecasts and NBRNM calculations.

Brent oil
(quarterly average, EUR/Barrel)

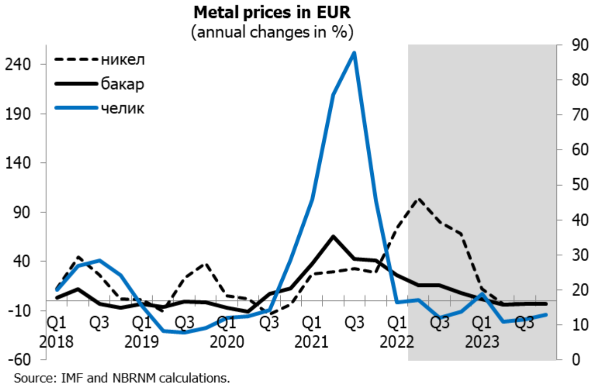


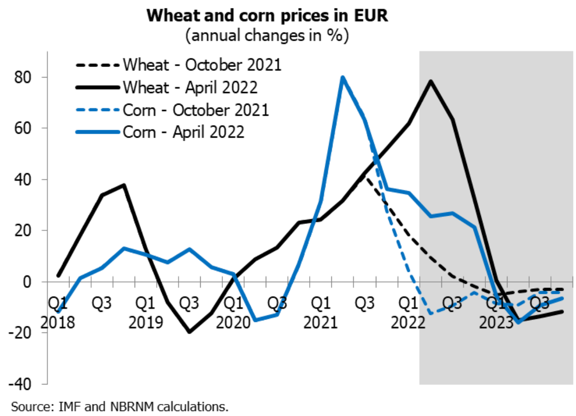
Source: IMF and NBRNM calculations.

An upward revision of the copper and nickel price estimates was also made for the entire forecast horizon. Currently, there are expectations for significantly higher growth of copper and nickel prices in 2022 compared to the October forecasts, while for 2023 a small growth is forecast rather than a small fall in the nickel price, and a slightly lower fall in the copper price from previously expected in October. The increase in the prices of these metals, especially nickel, are due to the expected shortage of supply, given the possible supply disruptions by Russia, amid growing demand from the electric car industry. **The steel price corrections are divergent**, with a more moderate price decline expected in 2022, largely reflecting the lower supply estimates due to the escalation of the war in Ukraine, and higher in 2023 than previously expected in October.

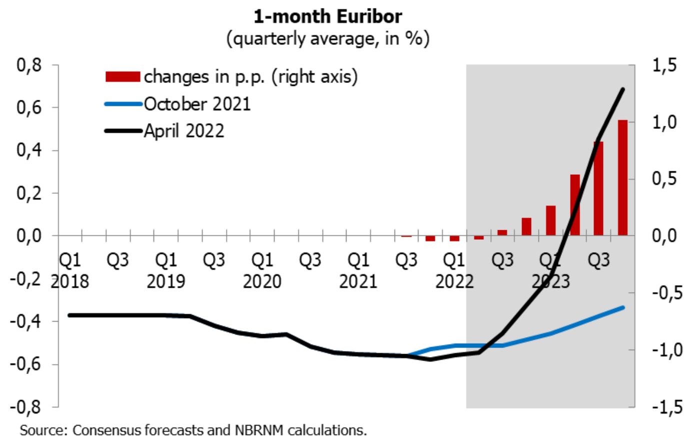
Compared to the October forecasts, the current estimates for food prices have been revised upwards for 2022 and downwards for 2023. Significantly higher growth of the wheat price is expected than in October and high growth, instead of a decline, of the corn price in 2022. The upward revisions mainly reflect the expectations for possible supply disruptions in the Black Sea due to the military conflict between Ukraine and Russia[5]. On the other hand, a faster drop in prices is expected for 2023 compared to the October forecasts.

[5] Ukraine and the Russian Federation jointly account for about 30% of global wheat exports. The port of Odessa and the Black Sea serve as the main channels for international grain deliveries from Ukraine, and the country is also among the leading exporters of barley, corn, sunflower, and other oilseeds. Source: FAO publication: AMIS, March 2022.





According to the latest assessments, the **one-month EURIBOR**, was revised upward for the entire forecast horizon, especially for 2023. It is estimated that the one-month EURIBOR in 2022 will remain in the negative zone with an average rate of -0.47% (-0.51% in October), while starting from the second quarter of 2023, it is expected to pass in the positive zone and to average 0.27% for the whole year (-0.4% in October). Such developments are largely due to investors' expectations for a gradual monetary policy tightening by the ECB at the end of the current year.



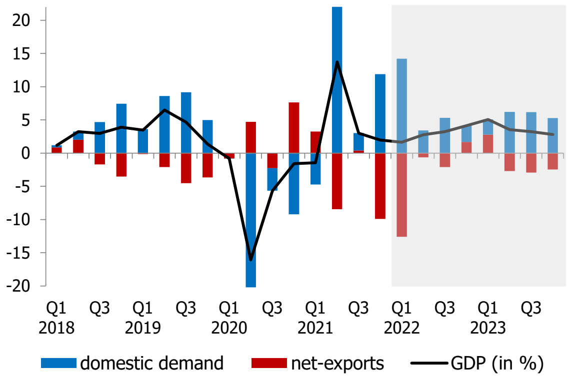
6.2. Forecast and effects on monetary policy

The baseline macroeconomic scenario for the Macedonian economy has been partially modified compared to the October expectations, in line with the onset of the war in Ukraine in late February this year and the imposition of sanctions against Russia, which further disrupted supply chains, worsened energy crisis, intensified pressures and damaged trust. In such circumstances, the global environment is extremely uncertain and unpredictable, with pronounced downward risks to growth and upward risks to inflation. The current forecasts point to appropriate level of foreign reserves, reflecting the good foreign reserves management and creating space for successful management of emerging shocks. *Such developments would slow down the previously expected post-pandemic economic recovery, while skyrocketing commodity products, especially energy. The energy crisis and the war in Ukraine highlighted the energy import dependence of the domestic economy (entirely on oil derivatives and gas, and partly on electricity), which caused strong pressures on the import side, especially in the first quarter of 2022, reflecting mainly the inventory growth amid uncertainty about future supply and prices. In such circumstances,* ***a significant widening of the current account deficit is expected in 2022. The***

stabilization of commodity markets and the overall external environment would significantly improve current account deficit in the next year and gradually narrow it in the medium term. The current account deficit in the period 2022 - 2023 will be mainly financed through government borrowing and foreign direct investment. The foreign interest rate, as an important exogenous determinant of the domestic monetary policy stance, is expected to move upwards and significantly change its pace. *The one-month EURIBOR would have a steady growth and from the second half of 2023 would move to the positive zone, mainly due to the expectations for more restrictive monetary policy by the ECB, amid assessments of longer-term inflationary pressures than previously expected.* ***Risks to the baseline macroeconomic scenario are assessed as markedly downward and related to the external environment.*** *The main downside risks stem from the protraction and intensity of the war in Ukraine and the effects of the current and future sanctions against Russia. In this context, one of the more significant risks is the percentage of harvest in Ukraine this summer, as well as the introduction of EU sanctions with an adverse effect on the energy sector, which would mainly contribute to even higher growth in food and energy prices. This would increase inflationary pressures and further deepen the energy crisis, which could lead to a recession in some of the trading partners, which are primarily highly dependent on Russian gas, such as Germany. Risks associated with the economic effects of the course of pandemic are still present, especially with the current developments in China, which is committed to a zero COVID strategy, and the possibility of new riskier coronavirus strains, which would return containment measures and lead to more pronounced distortions of trade flows and discrepancies between supply and demand. Also, the possible faster and stronger tightening of global financial conditions, amid more restrictive monetary policies of developed countries, could adversely affect countries that depend on external financing or have increased public debt. In this forecast cycle, too, there are other global risks influenced by geopolitical tensions (the war in Ukraine has highlighted the polarization of world economic powers), information and security, social and climate factors. On the other hand, a positive external risk is the possible rapid resolution of the war in Ukraine and the alleviation of price pressures on world stock markets and the sooner rebound of confidence and propensity for consumption and investment. From the domestic positive risks, the possible relocation of production from Ukraine and Russia to our country would increase foreign direct investment, exports, labor market mobility, and GDP growth. Also, in the medium term, more favorable effects on the economic activity of our country's membership in NATO and the start of the negotiation process for full EU membership are possible, as well as the implementation of the investment and development plan of the country for the period 2022 - 2026.*

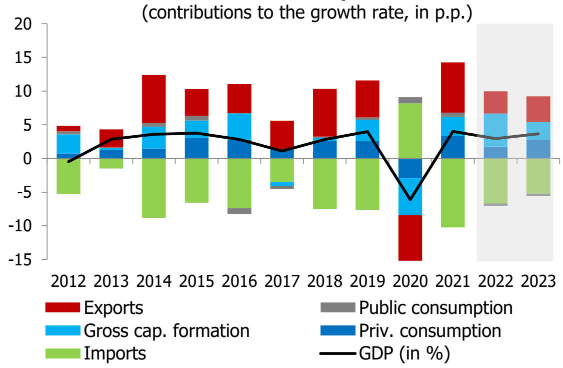
After the recovery of the economic activity in 2021 with a growth rate of 4%, the available high-frequency data and assessments in the first quarter of 2022 indicate further economic recovery, yet with a slower annual growth. This pace partly reflects the cautious behavior of the domestic companies, in terms of imports of higher amount of energy, raw materials and equipment and machinery, protection against possible future increasing prices and greater disturbances in supply chains, in conditions of high uncertainty of the war in Ukraine, which would be partly offset by the high growth in gross investments due to increased inventories. Namely, unfavorable effects of the war in Ukraine which followed up the COVID-19 pandemic, the disrupted supply chains and energy crisis, deteriorated the post-pandemic recovery path of the global growth, whereby slower economic growth of the foreign demand and increased import price pressures are expected in 2022, mainly through further increase in commodity prices, especially energy. Such circumstances, in conditions of high import energy dependence of the domestic economy, would lead to increased costs of production, which would adversely affect the terms of trade and the trade balance. The increased uncertainty and high prices are also expected to adversely affect the economic agents' spending and investment decisions. **Consequently, a slowdown in the growth of the domestic economy to 2.9% is expected in 2022, amid higher negative contribution of net exports (higher growth of imports than exports) and smaller negative contribution of domestic demand, mainly due to slower growth in private consumption.** Under the assumption for temporary negative effects of the war in Ukraine and calming of the COVID-19 pandemic during 2022, positive movements are already expected in the next period, both in the external environment through further growth of foreign demand and reduced import price pressures, and in the domestic economy through increased economic agents' confidence, more positive developments in the labor market and strengthening of the real disposable income. Hence, **the growth in 2023 would accelerate to 3.6%, mainly under the influence of the growth of exports, private consumption and investments, while in the medium term it would equal 4%.** Structurally observed, the domestic demand is expected to have a positive contribution on the forecast horizon, compared to the contribution of net exports, which will be negative.

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



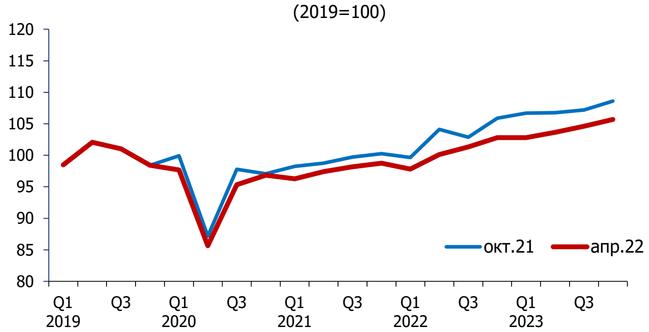
Source: SSO and NBRNM calculations.

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



Source: SSO and NBRNM calculations.

Real GDP level
(2019=100)

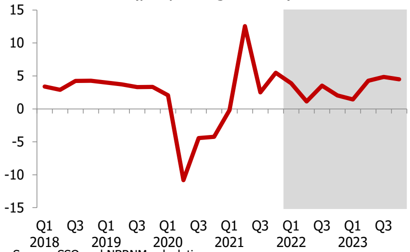


Source: State Statistical Office and NBRNM calculations.

Within **the domestic demand**, in the period 2022-2023, **gross investments** are expected to make the largest positive contribution to the growth. Moreover, in 2022, acceleration of the growth rate of gross investments is expected, which largely stems from the behavior of the economic entities in the first quarter of 2022, when higher import of energy, raw materials and equipment and machinery was registered, which would lead to increased inventories and high growth of gross investments, similar to the previous quarter. More moderate growth rates are expected in the following quarters, amid increased uncertainty of the war conflict in Ukraine, moderately lower foreign direct investments, slower growth of foreign demand and exports and weaker realization of the public investments, on the one hand, as well as further credit support through soft credit lines, on the other. With the stabilization of the crisis in Ukraine, in 2023, gradual restoration of the confidence and increased propensity to invest in private investors, as well as enhanced construction activity are expected, especially in the residential and energy sector, in conditions of further support through lending, higher inflows of foreign direct investments, further growth of foreign demand and exports, as well as more intensive realization of the public investments. Hence, further growth is expected in 2023, yet more moderate given the high base effect from the previous year.

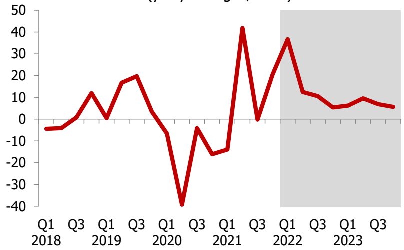
Household consumption would grow this year and the next, with a positive contribution to the growth of domestic demand. Moreover, the estimates are that in 2022 the growth will be weaker compared to the growth in 2021, given the increased uncertainty, rising prices and stagnation of real disposable income. Such shifts in disposable income are primarily based on the weaker projected movements on the labor market, where no significant recovery in employment is expected after the stagnation in the previous year, amid estimated reduced purchasing power of households, i.e. small decline in real wage amid rising inflation, although their rapid growth is expected, which is partly related to the increase in the minimum wage. In addition, real fall in private transfers from abroad is expected, amid significant slowdown in the nominal growth, given their strong recovery last year. The real growth is expected to accelerate only in pensions, primarily due to amendments to the Law on Labor Relations[6], discretionary measure for pension subsidies to mitigate the price shock (denar 1000 in March, April and May for about 330.000 pensioners) and changes in the methodology for pension adjustment[7]. Given the reduction of the usual sources of financing, the needs of the population for consumption are expected to be partly supplemented by lending and by using part of the savings, which registered a continued solid growth during the pandemic. Moreover, it is estimated that the package of measures aimed to protect the living standard and to support the population, will partly mitigate the adverse effects on household consumption[8]. Accelerated growth rate of private consumption is expected in the following year, due to the assessments for increased confidence, further credit support from banks and real growth of disposable income. Namely, stronger recovery of the labor market is expected, amid accelerated forecast growth of employees and real wage growth, growth in cash inflows from abroad and further increase in the balance of pensions.

Private consumption
(y-o-y changes, in %)



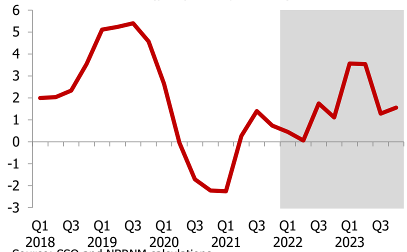
Source: SSO and NBRNM calculations.

Gross capital formation
(y-o-y changes, in %)



Source: SSO and NBRNM calculations.

Employed persons
(y-o-y changes, in%)



Source: SSO and NBRNM calculations.

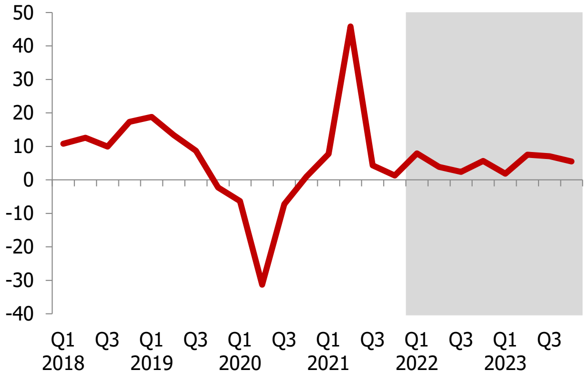
After the strong recovery of the export activity in 2021, further growth trend is expected in the following period, but at a more moderate pace. Thus, in conditions of weaker growth in foreign demand, moderate deceleration of **the real growth of exports i**s expected in 2022, which would intensify in 2023, and it is estimated to be one of the most significant drivers of the overall economic growth in the last two years. Moreover, the war in Ukraine is not expected to have a strong direct effect, given the insignificant trade link with the Ukrainian and Russian economy. Namely, part of the domestic producers, especially in metal industry, have successfully bridged the problems by redirecting the export to other markets, which along with the exceptionally favorable terms of trade, positively affect their export. On the other hand, the high energy intensity and import-dependence, amid high energy prices, will act as a limiting factor for full use of the positive impulses from the high export prices by the metal industry. At the same time, further growth in the export facilities in the automotive industry is expected, which registered solid movements in the beginning of the year, despite the disruptions in the supply chains, in part due to the increasing demand caused by lifted restrictions, along with the relaxation of pandemic pressures. Given the assumption for temporary effects of the war conflict, retention of the solid exports growth is expected in 2023, amid further growth of foreign effective demand, maintained high global prices of metal and reduced price pressures on the production costs, due to the decline in the prices of energy. Positive expectations for exports in the area of automotive industry and announced investments in new produce lines will also contribute to the forecasted growth. However, the uncertainty over the duration of the war conflict in Ukraine and possible additional sanctions by the EU, with effect on the energy sector, which would additionally disrupt the global supply chain and transport and would deteriorate the foreign demand for domestic products, represent risks to the dynamics of the future export activity.

[6] The changes refer to the mandatory pension at the age of 64 according to article 104 of the Law on Labor Relations, which is effective as of 14 July 2021, according to which the statements on continuing the employment agreement could be submitted as of 31 August 2021, with the deadline for these continued agreements being 31 June 2022.

[7] Form September 2022,the adjustment of the age pension will be calculated by the change to the consumer price index in the amount of 50% and the change to the average wages paid to all employees in the Republic of North Macedonia in the amount of 50% (the adjustment was previously calculated only on the basis of changes in the consumer price index) The pension shall be adjusted every year on 1 of March and 1 of September according to the percentage which is calculated as the sum of the growth in the consumer price index in the previous half of the year and the percentage of the increase in the average wages paid to all employees in the Republic of North Macedonia in the previous half of the year, compared to the half of the year that precedes.

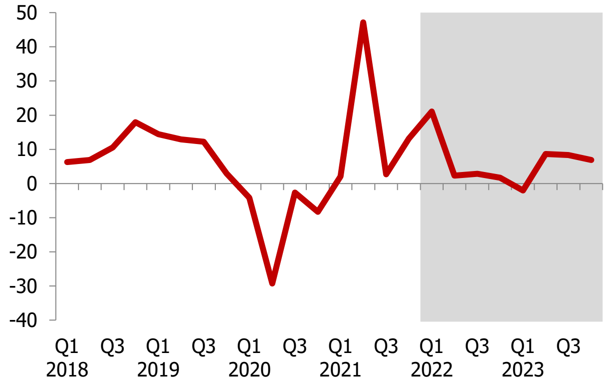
[8] The package of measures, besides the pension subsidies, also includes a similar measure of direct financial aid for the most vulnerable categories of population, measures for subsidizing the prices of electricity and heating, extended use of the preferential VAT rate of 5% for electricity until the end the year, reduction of the VAT rate for food and repealing of the customs rates, limitation of the trade margins and ban on the exports of certain food products, decrease in the excise duty and the VAT of energy and delay in the green duties for derivatives. For more information see the following link.

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.

After the significant budget stimulus in the previous two years for dealing with the pandemic, in the period 2022-2023, in line with the fiscal plans, certain consolidation of costs and reduction of real **public consumption** is expected[9], whereby on average, it would have a negative contribution to the expected GDP growth.

After the significant growth in 2021, the growth rate of the **real import of goods and services** would slow down in the next two years. Moreover, relatively high growth is estimated in 2022, which is due to the increased imports in the first quarter, especially of raw materials, energy and machinery and equipment, as a kind of preventive behavior by companies and protection from possible increasing prices of raw materials and stronger disruptions in the supply chains in the next period, due to the war conflict in Ukraine, in circumstances when the domestic industrial sector is highly dependent on import. Moderate growth rates are expected in the period ahead, in conditions of increasing exports and domestic consumption. Moreover, given the stronger expected growth of imports than the exports, it is estimated that net exports will make a negative contribution to the overall economic growth in the forecast horizon, more pronounced in 2022.

The latest credit market forecasts indicate moderate deceleration in the credit activity in 2022 and stabilization of the growth rates in the next two years. Although the trend of rapid annual growth of loans continued in the first quarter of 2022, yet a moderate slowdown of the growth rate is expected by the end of the year, which will equal 7.7% (8.3% at the end of 2021). The deceleration mainly stems from the expected weaker economic activity and more moderate growth of the deposit base. With the acceleration of the domestic economic activity and gradual restoration of the confidence, the lending to the private sector is expected to continue at similar growth pace (7.6% on average for the period 2023 - 2024). Analyzing deposits, as the main source of financing the credit activity of the domestic banking system, the estimates for 2022 point to decelerated growth, mostly due to the performances in the first quarter under the influence of the energy crisis and the military conflict in Ukraine, as well as the unfounded speculations about the denar stability and the banking system. Hence, at the end of 2022 the annual growth of deposits is expected to equal 5.0%, after which with the stabilization of the flows, in 2023 the growth rate is expected to accelerate to 7.3% with a continuous rapid growth, with a forecasted annual growth rate of 7.7% in 2024.

The current account deficit in 2022 would extend by 4.5 percentage points of GDP annually, whereby it would reach 8% of GDP, and is caused mostly by the significant deterioration in the trade balance, due to the deepening of the energy deficit under the influence of the pronounced price shock of the energy stock prices, amid simultaneously lower deficit in non-energy component. Slightly lower deficit is also expected in the balance of secondary income and services, while the reduction of the primary income deficit is the only factor that contributes to lower deficit in current transactions. Foreign trade expectations point to a pronounced upward adjustment on the import side, mainly under the influence of higher stock prices of primary commodities, which despite the solid growth of exports would

[9] Public consumption forecasts are based on available data from the 2022 Budget from December 2021 and Revised Fiscal Strategy 2022-2024 (with prospects until 2026) from December 2021.

widen the trade deficit, entirely due to the energy component. Significant deterioration in the terms of trade is a result of the strong upward price adjustment of energy, especially prices of natural gas and electricity, as well as most of the commodities, primarily food, which is partially neutralized with favorable terms of trade in metal prices. The Russian invasion of Ukraine, accompanied by introduction of the sanctions against Russian export and further hampering of the functioning of global supply chains, led to historically rising prices of primary commodities, especially energy and food, due to the importance of these two economies in the supply of the European market with oil, natural gas and key food products. After the full recovery of transfers in 2021, following the pandemic shock in 2020, certain decrease in the surplus in this category is expected in 2022 on an annual basis. The perceptions for the surplus in the exchange of services are also exacerbated, due to the expectations for higher imports in this category, which is especially visible in other services. On the other hand, the reduction of the economic activity in conditions of increasing and prolonged uncertainty would lead to worsened economic results of the companies with foreign capital and a corresponding narrowing of the primary income deficit. **In 2023, the current transactions deficit is expected to significantly improve by 3.5 percentage points of GDP to 4.5% of GDP.** The calming of the Russian-Ukrainian conflict would stabilize the supply of energy and food, whereby the prices would adjust downward adequately, which would lead to a renewal of the supply chains, especially in the automotive industry. This would positively affect the trade deficit, in conditions of increasing export component and stabilization of imports on an annual basis. Moreover, narrowing of the trade deficit is expected, mainly as a result of the reduction of the energy deficit, but with a positive contribution of the non-energy component. The balance of services would also register higher surplus on an annual basis. On the other hand, the secondary income would register a moderate narrowing of the positive balance, while the improved domestic and global economy perceptions would lead to higher primary income deficit, caused by good performance of foreign companies in domestic economy. **The financial net inflows in the period 2022-2023 fail to fully cover the current account deficit, so the remaining part would be financed through foreign reserves.** In this period, the financing would be mostly through foreign direct investments, as well as long-term government borrowing. In conditions of unfavorable terms of trade and expected high trade deficit, part of the financing would be through trade credits. On the other hand, net outflows in category currency and deposits would be registered in this period, yet more moderate. **In 2024, further improvement of the current account deficit is forecasted and its reduction to 2.3% of GDP,** in conditions of gradual exhaustion of the negative effects of the war in Ukraine, recovery of the global economy and stabilization of the prices of primary commodities and supply chains, which would lead to a more significant improvement in the balance of goods and services. Foreign direct investments would remain at a solid level, whereby the total financial inflows would be sufficient to finance the current account deficit and further growth of the foreign reserves. **It is important to note that throughout the forecast horizon, foreign reserves are expected to remain appropriate.**

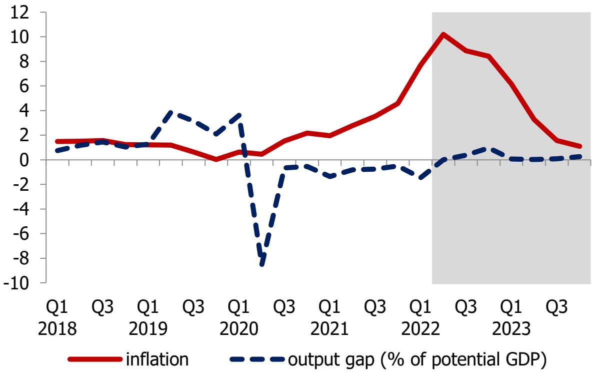
Balance of Payment forecast (% of GDP)

	2017	2018	2019	2020	2021	2022	2023	2024
Current account	**-1.0**	**-0.1**	**-3.3**	**-3.4**	**-3.5**	**-8.0**	**-4.5**	**-2.3**
Balance of goods & services	-14.1	-12.7	-14.3	-13.0	-16.0	-20.2	-16.1	-13.2
Goods, net	-17.8	-16.2	-17.3	-17.0	-20.2	-24.1	-20.4	-18.0
Services, net	3.7	3.5	3.0	4.0	4.3	3.9	4.4	4.7
Primary income, net	-4.0	-4.2	-4.6	-3.9	-4.8	-3.9	-4.2	-4.5
Secondary income, net	17.0	16.8	15.7	13.4	17.2	16.1	15.7	15.4
Private sector, net	15.9	15.8	15.3	12.4	16.1	15.2	15.0	14.8
Capital account	**0.2**	**0.1**	**0.1**	**0.1**	**0.0**	**0.0**	**0.0**	**0.0**
Financial account	**0.5**	**-5.0**	**-6.1**	**-4.2**	**-5.5**	**-6.8**	**-3.6**	**-2.7**
FDI, net	-1.8	-5.6	-3.2	-1.5	-3.7	-3.2	-3.4	-3.4
Portfolio Investment, net	0.2	-3.0	1.3	-2.7	-1.0	-4.1	-1.0	0.3
Other Investment, net	2.1	3.6	-4.2	0.0	-0.8	0.5	0.8	0.3

Source: NBRNM.

In 2022, the inflation would reach 8.8% in the conditions of accelerated growth in all inflation components. Namely, the inflationary pressures that started in the second half of 2021, primarily on the supply side due to the high rise in import prices, continued and intensified in the first quarter of 2022. As a result of the substantial growth of electricity and gas prices, the regulated price of electricity and heat for households increased in January already, while concerning the prices of oil derivatives, it was decided to be adjusted more frequently, instead of the previous two-week dynamics. Assessing further disruptions in global supply chains and reduced supply due to the war in Ukraine and sanctions on Russia, it is expected that pressures from energy sources and food import prices will last almost until the end of the year. Then there would be some slowdown, which would adequately reflect on the growth of domestic food and energy prices. The accelerated growth of core inflation, in the absence of pressures from domestic demand, would result from estimates for endurance of higher energy prices and increased production costs and transfer to final prices of products and services, as well as accelerated growth of foreign inflation. It is estimated that this increase in the general level of prices would be higher if measures were not taken to mitigate the price shock, in order to protect the living standards of the population. With the stabilization of the global primary commodity markets, it is expected that the pressures from the import prices on the domestic prices will decrease, **predicting that the inflation in 2023 will slow down to 3%, and further to 2% in 2024.** According to the projected downward path of import prices of food and energy sources, in 2023 slowdown in the growth of food inflation and decline in domestic energy prices is expected. As expecteded for having no pressures from domestic demand and slower growth of foreign effective inflation, the core inflation would slow down, as well. The main risks in terms of the inflation forecast, relate to the extremely high volatility of the prices of primary products in world markets, particularly related to the uncertainty and duration of the military conflict in Ukraine and possible additional sanctions aimed at the energy sector, as well as possible further adverse effects of the corona crisis on their supply and demand.[10].

Inflation
(y-o-y changes, in %)



Source: SSO and NBRNM calculations.

6.3. Comparison with the previous forecast

In the April forecasts cycle, significant changes have been made compared to the October cycle, especially for 2022. The economic growth forecast for the period 2022 - 2023 has been revised downwards, while at the inflation rate, the revisions are upward. No corrections to the expectations for GDP growth and inflation on a medium run were made. The corrections made, especially notable in 2022, mainly reflect the effects of the military conflict in Ukraine, which would be felt in our country through the reduced economic activity of European countries, which would be most affected, through significantly higher commodity prices and reduced confidence of the economic entities. The expected effects of the crisis in Ukraine will lead to higher current account deficits, especially in 2022, mainly due to the more negative trade balance, primarily due to the deepening of the energy deficit, in conditions of high dependence on energy imports. In the financial flows, significantly higher net inflows in 2022 are expected than previously

[10] In addition, from the aspect of domestic factors, an upward risk is the possible increase of the regulated price of electricity, in accordance with the announcements for application of a changed methodology for determining the price for households and small consumers that are on the regulated electricity market from July 1. 2022 and the projected dynamics for the gradual increase of VAT on electricity supply, which was postponed until the end of 2022.

planned, mostly due to the projected higher external borrowing by the Government, with almost unchanged net inflows in 2023 compared to the October forecast.

Forecast of selected macroeconomic variables

	2022 forecast		2023 forecast	
	Oct.	Apr.	Oct.	Apr.
GDP, %	**3.9**	**2.9**	**4.0**	**3.6**
Private consumption	3.5	2.6	3.6	3.8
Gross capital formation	11.7	15.0	7.6	7.0
Public consumption	-2.1	-2.1	0.3	-2.6
Exports of goods and services	3.8	5.0	9.6	5.4
Imports of goods and services	5.5	6.8	8.8	5.3
Inflation	**2.4**	**8.8**	**2.0**	**3.0**
Current account deficit, % of GDP	**-3.8**	**-8.0**	**-2.4**	**-4.5**

Source: NBRNM.

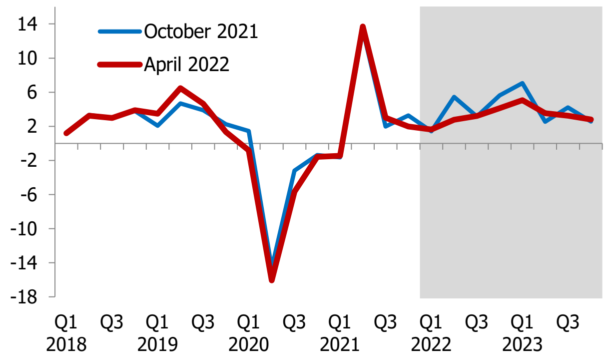
The military conflict in Ukraine and the imposed sanctions against Russia have shifted the projected path of recovery of the global economy from the pandemic-driven crisis, especially of the European countries, as our most important trade partners, further disruption of supply channels and primary products markets, thus strengthening thew inflationary pressures, simultaneously rising the global uncertainty, which adversely affected the latest expectations for the domestic economy. **In conditions of unfavorable external environment and disturbed confidence of economic entities, a downward revision of the forecast for GDP growth in 2022 was made, which is currently projected to be 2.9%, compared to the growth projection of 3.9% in October.** The downward revision also reflects the continuing negative impact of the energy crisis on the regular production process both globally and domestically, which was considered temporary before the war started. Assuming that the adverse effects of the crisis acute phase caused by the military conflict in Ukraine would be of limited duration and would not affect the long-term foundations of the economy, it is still expected that next year there will be some deviation from the projected post-pandemic recovery path of the domestic economy, with **the estimate for GDP growth in 2023 being slightly revised downwards to 3.6% (4.0% in October).** Concerning the structure, during the forecast period, correction was made in almost all expenditure components of GDP, but the growth structure still remains the same, i.e. in both years the growth arises from domestic demand, and net exports have a negative contribution. Thereby, the forecast for net exports in 2022 underwent a significant revision, indicating a larger negative contribution to GDP. Regarding the international trade components, this correction is due to the larger upward revision in the imports growth rate than the exports one. The upward movement in imports is due to the significantly higher performance in the first quarter than previously expected, when high import of energy, raw materials and machinery and equipment were registered due to the evident uncertainty related to the future price movements of primary commodities and possible additional disruption in supply chains due to military conflict in Ukraine. On the exports side, more favorable trade conditions are currently expected, amid estimates of strong growth in world metal prices that would cause intensified export activity. They will be partially offset by the latest estimates of slower growth in foreign demand and higher energy prices, which increase manufacturing costs and act as limiting factors for production and exports.

From the aspect of domestic demand, for 2022 a slightly lower positive contribution is expected compared to the previous forecast due to the downward correction in private consumption, upward revision in investments and unchanged real growth rate of public consumption. The downward revision of the annual growth rate of household consumption is due to the lower real disposable income, mainly reflecting the effects of higher inflation and smaller increase in the number of employees, amid expectations for stronger nominal growth, primarily in wages and pensions, as well as the downward correction in the real credit growth forecasts, in line with the reduced economic activity for this year. In addition, the mounting uncertainty and deteriorated general conditions are expected to result in lower consumption. On the other hand, real pensions are the only factor for which the assessments are revised upwards compared to

October, due to the direct financial support of pensioners by the state in the second quarter of the year, as well as the adjustment of pension growth. In the area of investments, the upward correction of the growth rate is mainly a reflection of the estimates for significantly higher growth in the first quarter due to the behavior of economic agents to create inventories, amid high uncertainty about the future movement of commodity prices and availability of supply channels, contrary to expectations for slower realization of planned public investments and the negative effects of the war crisis on investor confidence.

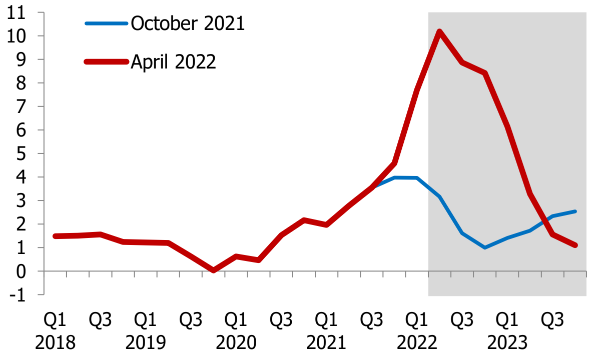
The downward revised estimate of GDP in 2023 of 0.4 pp, reflects the lower projected domestic demand due to expectations for a decline in public spending according to the new fiscal forecasts, instead of the previously estimated minimum growth, and lower investment growth, mainly due to the higher comparison base from the previous year, but also due to more moderate growth of exports and lending from the October assessments. Private consumption would have a slightly higher growth rate than in October, but on a lower comparative basis, maintaining the same positive contribution to GDP growth as in October. Regarding the external sector, also in this forecasts round, more moderate growth in both components of the foreign trade compared to October forecasts is expected. Moreover, it is expected that net exports will make a smaller negative contribution to the GDP growth, compared to the October assessment, as a reflection of the smaller downward revision in imports than exports, in conditions of stronger import pressures from domestic demand.

GDP
(y-o-y changes, in %)



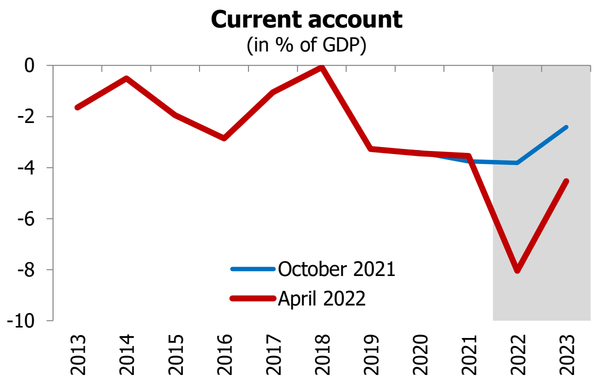
Source: SSO and NBRNM calculations.

Inflation
(y-o-y changes, in %)



Source: SSO and NBRNM calculations.

The inflation rate forecast for 2022 has been revised upwards, and it is now expected to be 8.8%, compared to 2.4% in October. The upward correction, in conditions of assessed lower demand pressures, is due to the higher performance since the beginning of the year, as well as the expectations for more significant upward shifts in foreign effective inflation and import prices by the end of the year. Namely, the energy crisis from the end of 2021 and the military aggression against Ukraine from the end of February this year, amid the supply and demand mismatch caused by the pandemic, led to more pronounced import price pressures. From the aspect of the composition, the upward correction is a reflection of the projected higher growth of all components of inflation, especially in the energy and food component of inflation, in accordance with the projected significant growth of prices of primary commodities during this year. Minor upward correction was made in core inflation, which in terms of estimates for absence of output gap, is due to significantly higher performance in the first quarter of the year, the upward revision of foreign effective inflation and the expectations for a transmission effect of high energy prices on other prices. Some of these factors are expected to endure also in the next year, making a moderate upward correction in the projected inflation rate for 2023, i.e. it is expected that it will equal 3% in October forecast cycle.



Source: NBRNM.

In this forecast round, a higher current account deficit is projected in the period 2022 - 2024, from an average of 2.6% of GDP in October to 5% of GDP with the current forecast, in a significantly less favorable external environment due to the war in Ukraine. **The change is particularly pronounced in 2022, after which in the next two years the deviation will gradually decrease, as the expectations for price movements of primary products stabilize.** The upward correction in 2022 is 4.2 pp GDP, due to the emerging risks of the conflict in Ukraine and sanctions on Russia, which created huge upward pressures on stock prices, but also further hampered the functioning of global supply chains, which were already facing a lack of resources and products. Consequently, the most significant changes have been made in the trade balance, by deepening the deficit due to increased import pressures, especially in energy imports. In line with deteriorated global expectations, a slightly lower surplus is expected in the services balance for this year. On the other hand, the deteriorated outlook for the domestic economy will contribute to a lower deficit in primary income, given the simultaneously slight improvement in the balance of secondary income, which is in line with the better performance in the previous year. For the period 2023 - 2024, the current forecast predicts a higher average deficit in the current account by 1.5 pp of GDP compared to the October forecasts, which is entirely due to the higher deficit in the balance of goods and services, in conditions of higher energy prices compared to the assumptions made in the previous projection cycle, although the effect would be gradually exhausted. **Regarding the financial flows, observed cumulatively for the period 2022 - 2024, higher net inflows than projected in the October forecasts is expected.** The changes in the expectations result from the higher external borrowing by the Government in this period, as well as the upward correction in trade credits, which in conditions of higher trade deficit would have a positive effect on the financing of current transactions.

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

Organisation	Month of publication	Real GDP growth, %		Inflation (average rate, %)	
		2022	2023	2022	2023
IMF	April 2022	3.2	2.7	6.9	3.6
World Bank	May 2022	2.7	3.1	5.5	2.0
European Commission	November 2021	3.9	3.7	2.1	1.8
EBRD	March 2022	3.0	3.0	-	-
Consensus Forecast	March 2022	3.3	3.2	7.0	3.5
Ministry of Finance	December 2021	4.6	5.2	2.4	2.0
National Bank of the Republic of North Macedonia	April 2022	2.9	3.6	8.8	3.0

Source: IMF, World Economic Outlook, April 2022; World Bank, Western Balkans Regular Economic Report, Spring 2022; European Commission European Economic Forecast, Atumn 2022; EBRD Regional Economic Prospects, March 2022; Consensus Forecast, April 2022; Ministry of Finance, Revised Fiscal Strategy 2022-2024, December 2021; and the National Bank of the Republic of North Macedonia, April 2022.

Annex: Alternative macroeconomic scenario with more severe and long-standing consequences of the war in Ukraine

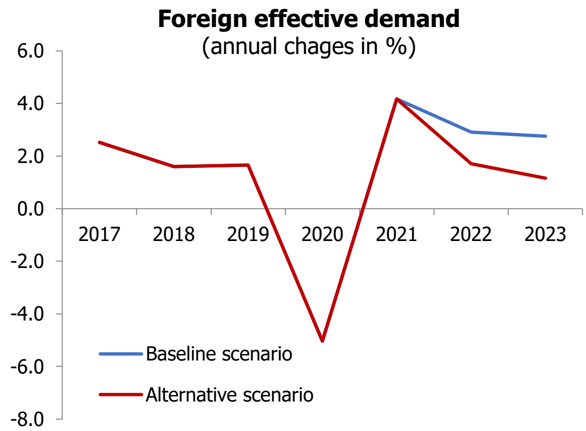
Over a long period, the macroeconomic forecasts are accompanied by extremely high unpredictability, with pronounced unfavorable risks. Therefore, in addition to the baseline scenario, special attention is paid to alternative scenarios, which show the forecasts sensitivity to changes in assumptions. Within this forecast cycle, despite the prolonged pandemic, a particularly pronounced source of risk is the uncertain development of the military conflict in Ukraine and its consequences.

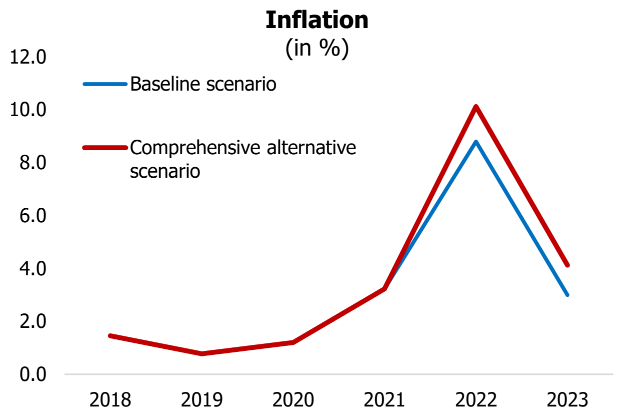
The alternative scenario envisages intensification of sanctions against Russia in the second half of 2022, additional embargo on energy imports from this country, as well as its further distancing from the global financial and trade system[11]. In such circumstances, there are several transmission channels to the world economy, mainly evident through **further pronounced growth in commodity prices**, further **supply chain disruptions**, unfavorable trade flows and more pronounced **tightening of global financial conditions** and difficult access to finance. This context also implies enhancing the effects through the confident channel, given the effect of uncertainty on risk-taking.

The incorporation of these alternative assumptions in the projections is reflected in reduced demand for domestic export products, deteriorating exchange conditions, reduced confidence of domestic and foreign investors and their greater risk aversion, as well as cyclical performance of remittances. In such circumstances, the recovery of the domestic labor market during 2022 - 2023 will be delayed and will be slower compared to the baseline scenario.

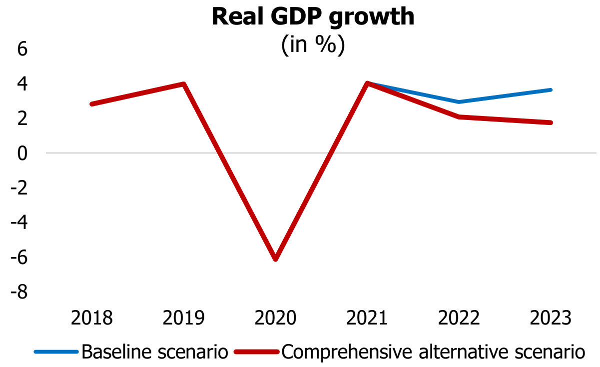
If all aforementioned assumptions are realized, one can expect slower recovery of the domestic economy, i.e. slower economic growth by 1.3 pp on average in 2022 - 2023, compared with the baseline scenario, amid a lower positive contribution from private consumption – exports of goods and services, partially mitigated by the smaller negative contribution by imports. Hence, the **smaller GDP growth in the alternative scenario will result from the smaller positive contribution of domestic demand, while net exports will make a smaller negative contribution.**

Although the alternative scenario presupposes worse economic prospects for both our trading partners and the domestic economy, it still points to higher inflation than the baseline scenario. This is due to the fact that the risks materialization will lead to increase in the world prices above the expected levels according to the baseline scenario. If there is a further tightening of geopolitical relations and growth of economic polarization, the alternative scenario assumes higher prices of primary products, in both years of the baseline scenario. The synchronized growth of these prices, as well as the deterioration in the supply chains, will spill over into higher inflation among our foreign partners. With such expectations, despite the smaller stimulus from domestic demand, domestic inflation would be higher by about 1 pp, on average, for 2022 - 2023.

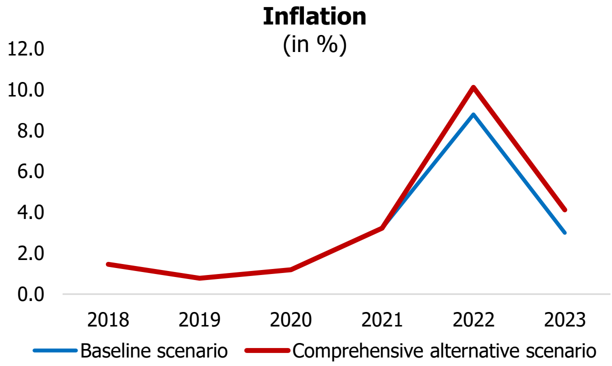




[11] The assumptions about the external environment included in the alternative scenario are based on the latest IMF World Economic Outlook Report, April 2022.



Source: NBRNM.



Source: NBRNM.