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## Macedonia: Downside risks

***Growth prospects in Macedonia are still somewhere around 2% this year with some acceleration next year and beyond. The main driver is private investment which should recover due to relatively low private debt. The main risk is the possible contagion effect from the Greek crisis. There are still slim prospects for the start of negotiations with the EU.***

The optimistic forecasts from a few months back have been scaled down due to increased uncertainty in the external environment. Much will still depend on the ability of the government to sustain its policy stance. This has been characterized by more active fiscal policy and also more relaxed monetary policy than was characteristic in the pre-crisis period. Together with recovering foreign direct investments and strong growth of exports, that has led to a rather shallow and short-lived recession in 2009 and a recovery in 2010 and 2011, with growth of around 3.5% in the latter year.

However, current prospects are for a slowdown of growth to just above 2% with downside risks in 2012. The constraint on growth is not public spending as public debt is rather low at around 35% of GDP. However, the costs of borrowing at international commercial markets are high and probably prohibitive. The external constraint is also not as strong as in some other countries in the neighbourhood, as foreign debt is around 65% of GDP. Finally, overall private debt, of households and corporations, is rather low and should not require too much effort at deleveraging. Still, credit conditions are tight mostly because of the reluctance of the banks to extend credits due to higher uncertainty.

In that, one major concern is the state of the largest bank, Stopanska banka, which is owned by the National Bank of Greece. Though it is not easy to assess the risks of contagion that the possible increased problems of Greek banks may have on Stopanska banka, there is no doubt that in a worst case scenario, when the Greek banking sector bankrupts because the Greek state declares a moratorium on its foreign debts, the banking sector in Macedonia may be faced with balance sheet problems. In any case, strong support of credit expansion cannot be expected in the current circumstances.

As the country's currency is on a strict peg with the euro since 1994, with only one bout of devaluation in 1997, it has pinned its growth strategy on increased exports, preferably financed by foreign investments. That has resulted in a somewhat subdued growth record in the past 15 or so years, but has also strengthened the macroeconomic stability in adverse circumstances as has been evidenced in the current global crisis. Still, the space for more relaxed policy is rather limited and has probably been exhausted in the past three years.

This growth strategy has led to persistent high unemployment which fell only slightly before the crisis and has declined somewhat even in the past few years, but the slowdown of growth will take its toll in falling employment. With the unemployment rate at 30%, that is bad news, though social sustainability has proved to be rather high irrespective of depressed labour market conditions.

Political stability is also not threatened as the current government was re-elected with a comfortable margin in the early elections held in late spring of the last year. There are persistent problems between Macedonians and Albanians that resulted in the postponement of the regular census, but those have been manageable for the most part.

Macedonia has been a candidate country for EU membership since 2006 and has yet to start the negotiations with the EU due to Greece's objection to its use of the name Macedonia and the consequent veto in the EU Council to the start of negotiations. So, the EU Commission regularly recommends an immediate start of negotiations, and the EU Council cannot take that decision. At the moment there is no sign that this stalemate will be broken in the near or even more distant future.

Table MK

## Macedonia: Selected Economic Indicators

|  | 2006     | 2007   | 2008   | 2009   | 2010   | 2011 <sup>1)</sup> | 2012   | 2013   | 2014   |
|--|----------|--------|--------|--------|--------|--------------------|--------|--------|--------|
|  | Forecast |        |        |        |        |                    |        |        |        |
| Population, th pers., mid-year                                 | 2040.2   | 2043.6 | 2046.9 | 2050.7 | 2055.0 | 2060               | 2065   | 2070   | 2075   |
| Gross domestic product, MKD mn, nom. <sup>2)</sup>             | 320059   | 364989 | 411728 | 410734 | 424762 | 456800             | 481300 | 510600 | 544300 |
| annual change in % (real) <sup>2)</sup>                        | 5.0      | 6.1    | 5.0    | -0.9   | 1.8    | 3.5                | 2.3    | 3      | 3.5    |
| GDP/capita (EUR at exchange rate)                              | 2600     | 2900   | 3300   | 3300   | 3400   | 3600               | .      | .      | .      |
| GDP/capita (EUR at PPP - wiiw)                                 | 7200     | 7700   | 8400   | 8500   | 8700   | 9100               | .      | .      | .      |
| Consumption of households, MKD mn, nom. <sup>2)3)</sup>        | 250309   | 279880 | 330399 | 314376 | 319975 | 346000             | .      | .      | .      |
| annual change in % (real) <sup>2)3)</sup>                      | 7.5      | 8.1    | 7.4    | -4.7   | 1.6    | 4                  | 2      | 2      | 2      |
| Gross fixed capital form., MKD mn, nom. <sup>2)</sup>          | 56485    | 71557  | 86403  | 81872  | 82968  | 94800              | .      | .      | .      |
| annual change in % (real) <sup>2)</sup>                        | 7.7      | 17.1   | 5.4    | -8.3   | -1.0   | 10                 | 4      | 4      | 4      |
| Gross industrial production <sup>4)</sup>                      |          |        |        |        |        |                    |        |        |        |
| annual change in % (real)                                      | 5.9      | 3.9    | 5.1    | -8.7   | -4.8   | 3.3                | 5      | 5      | 5      |
| Gross agricultural production (EAA)                            |          |        |        |        |        |                    |        |        |        |
| annual change in % (real)                                      | 7.0      | -2.2   | 5.4    | -2.3   | 8.0    | .                  | .      | .      | .      |
| Construction output, hours worked                              |          |        |        |        |        |                    |        |        |        |
| annual change in % (real)                                      | -11.9    | 9.7    | -9.6   | -2.1   | 5.8    | 10                 | 5      | 5      | 5      |
| Employed persons - LFS, th, average                            | 570.4    | 590.2  | 609.0  | 629.9  | 637.9  | 650                | 660    | 670    | 680    |
| annual change in %   | 4.6      | 3.5    | 3.2    | 3.4    | 1.3    | 1.9                | 1.5    | 1.5    | 1.5    |
| Unemployed persons - LFS, th, average                          | 321.3    | 316.9  | 310.4  | 298.9  | 300.4  | 292                | .      | .      | .      |
| Unemployment rate - LFS, in %, average                         | 36.0     | 34.9   | 33.8   | 32.2   | 32.0   | 31                 | 31     | 31     | 31     |
| Unemployment rate, reg., in %, end of period                   | .        | .      | .      | .      | .      | .                  | .      | .      | .      |
| Average gross monthly wages, MKD <sup>5)</sup>                 | 23036    | 24136  | 26229  | 29922  | 30225  | 30830              | .      | .      | .      |
| real growth rate, % (net wages) <sup>5)</sup>                  | 3.9      | 5.5    | 1.9    | 25.0   | 1.4    | -2                 | .      | .      | .      |
| Consumer prices, % p.a.  | 3.2      | 2.3    | 8.3    | -0.8   | 1.6    | 3.9                | 3      | 3      | 3      |
| Producer prices in industry, % p.a. <sup>6)</sup>              | 6.8      | 2.5    | 10.1   | -7.2   | 8.7    | 11.1               | .      | .      | .      |
| General governm. budget, nat.def., % GDP <sup>7)</sup>         |          |        |        |        |        |                    |        |        |        |
| Revenues   | 32.5     | 32.8   | 33.1   | 31.3   | 31.1   | 30.0               | .      | .      | .      |
| Expenditures   | 33.0     | 32.2   | 34.1   | 33.9   | 33.6   | 32.5               | .      | .      | .      |
| Deficit (-) / surplus (+)                                      | -0.5     | 0.6    | -0.9   | -2.7   | -2.5   | -2.5               | -1     | -1     | -1     |
| Public debt, nat.def., in % of GDP                             | 38.8     | 32.3   | 27.9   | 31.7   | 35.6   | 35.0               | 34     | 33     | 32     |
| Central bank policy rate, %, p.a., end of period <sup>8)</sup> | 5.74     | 4.77   | 7.00   | 8.50   | 4.11   | 4.00               | .      | .      | .      |
| Current account, EUR mn  | -23.4    | -421.2 | -862.2 | -457.1 | -150.4 | -410               | -450   | -400   | -400   |
| Current account in % of GDP                                    | -0.4     | -7.1   | -12.8  | -6.8   | -2.2   | -5.5               | -5.8   | -4.8   | -4.5   |
| Exports of goods, BOP, EUR mn                                  | 1914.0   | 2472.2 | 2692.6 | 1932.6 | 2492.8 | 3240               | 3890   | 4670   | 5370   |
| annual growth rate in %  | 16.5     | 29.2   | 8.9    | -28.2  | 29.0   | 30                 | 20     | 20     | 15     |
| Imports of goods, BOP, EUR mn                                  | 2915.5   | 3653.3 | 4455.1 | 3492.2 | 3960.7 | 4950               | 5940   | 7130   | 8200   |
| annual growth rate in %  | 16.6     | 25.3   | 21.9   | -21.6  | 13.4   | 25                 | 20     | 20     | 15     |
| Exports of services, BOP, EUR mn                               | 479.1    | 597.3  | 692.0  | 617.6  | 693.8  | 830                | 955    | 1051   | 1156   |
| annual growth rate in %  | 14.9     | 24.7   | 15.9   | -10.8  | 12.3   | 19.6               | 15     | 10     | 10     |
| Imports of services, BOP, EUR mn                               | 461.7    | 569.1  | 682.8  | 601.1  | 644.4  | 710                | 781    | 859    | 962    |
| annual growth rate in %  | 3.4      | 23.3   | 20.0   | -12.0  | 7.2    | 10.2               | 10     | 10     | 12     |
| FDI inflow, EUR mn   | 344.8    | 506.0  | 399.9  | 145.0  | 159.1  | 210                | 200    | 250    | 300    |
| FDI outflow, EUR mn  | 0.1      | -0.9   | -9.5   | 8.1    | 1.4    | 0                  | 0      | 0      | 0      |
| Gross reserves of NB, excl. gold, EUR mn                       | 1311.3   | 1400.1 | 1361.0 | 1429.4 | 1482.7 | 1801.9             | .      | .      | .      |
| Gross external debt, EUR mn                                    | 2503.4   | 2841.1 | 3304.2 | 3780.4 | 4133.8 | 4800               | .      | .      | .      |
| Gross external debt in % of GDP                                | 47.9     | 47.6   | 49.2   | 56.4   | 59.9   | 64.7               | .      | .      | .      |
| Exchange rate MKD/EUR, average                                 | 61.19    | 61.18  | 61.27  | 61.27  | 61.52  | 61.53              | 61.5   | 61.5   | 61.5   |
| Purchasing power parity MKD/EUR                                | 21.93    | 23.15  | 23.93  | 23.59  | 23.83  | 24.37              | .      | .      | .      |

Note: Gross industrial production and producer prices refer to NACE Rev. 2. Gross agricultural production refers to Economic Accounts for Agriculture (EAA).

1) Preliminary and wiiw estimates. - 2) According to ESA'95 (FISIM reallocated to industries, including non-observed economy, real growth rates based on previous year prices). - 3) Including Non-Profit Institutions Serving Households (NPISHs). - 4) Enterprises with 10 and more employees. - 5) From 2009 including allowances for food and transport. - 6) Domestic output prices. - 7) Refers to central government budget and extra-budgetary funds. - 8) Central Bank bills (28-days).

Source: wiiw Database incorporating national statistics. Forecasts by wiiw.