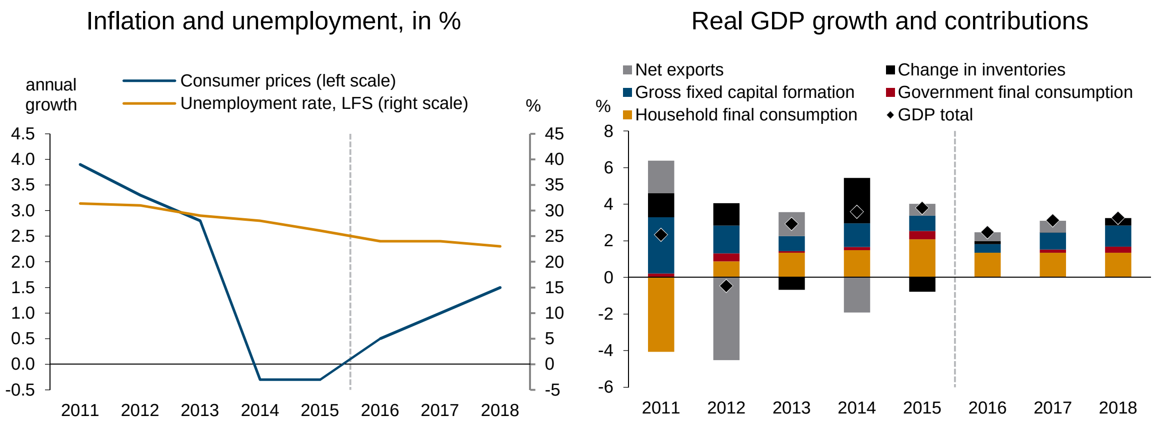
MACEDONIA: Instability slows down investments

VLADIMIR GLIGOROV

At present, the economy is not suffering from a misaligned exchange rate or financial problems. Thus, once the political crisis has been resolved, the country should return to growth rates of around or above 3% in the medium term.

Figure 35 / Macedonia: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

The persistent crisis of legitimacy has started to bite into economic activity. In the last few years, i.e. after the 2008-2009 crisis, investments, not the least public ones, and exports have been driving growth and employment. In addition, wages have been growing because the country did not enter into the 2008/2009 crisis with a misaligned real exchange rate. With stable prices and an improved current account, monetary policy could be relaxed while fiscal policy could be expansionary because public debt development looked sustainable given declining interest rates and the speed-up of recovery. Finally, the financial sector looked sound even despite the strong presence of Greek banks (especially the National Bank of Greece). With that, employment increased, the unemployment rate declined, and the growth performance was among the best in the Balkans.

The government, however, was seen as biased towards the governing parties in terms of employment and income distribution, which is why there were three early elections held since 2008. The last one, in 2014, was considered as being rigged and then that was substantiated with leaked phone conversations and other compromising material. That led to a legitimacy crisis with the opposition, primarily the ethnic

Macedonian one, calling for criminal investigations in addition to the resignation of the government and early elections. That initiated a yearlong crisis which finally ended with an agreement to hold early elections at the beginning of December 2016. The agreement was not easy to forge, and the United States and the EU had their inputs for better or worse.

The upcoming elections have been agreed under specific conditions, which however do not seem to be adhered to by the government as intended. There are criminal charges on the one hand and the issue of free and fair elections on the other. The December date is the third attempt; two previous elections – supposed to take place last March and then in June – failed because the opposition felt that it had been denied access to the media, it complained about the voters register, and was outraged by the attempt of the President to pardon government officials, starting with the Prime Minister, of criminal charges even before they were brought in front of a court. It is not clear whether any of these deficiencies are going to be corrected before the voters go to the polling booths in December.

This prolonged political instability started to influence economic activity already late last year, but more visibly in the first half of 2016. Growth has slowed down to slightly more than 2%, though it might recover somewhat in the second half of the year. Whether it does, may depend on three factors.

One is the decreasing private investments. When it still looked as if the crisis could be resolved relatively quickly, investments continued unabated. The prolonged crisis, however, not only supports a delay in investment decisions, it also is not reassuring about the eventual resolution. While initially the private sector and foreign investors, who play an important part in the country, expected that the government would weather the legitimacy crisis quickly and successfully, that is not the mainstream forecast now. The government is seen as business-friendly, but it is not expected to regain the needed legitimacy even if it survives the challenge in the elections. So, declining private investments may not be just due to delayed decisions, but may lead to disinvestments. Therefore, a resolution of the crisis and the legitimacy of the electoral results are crucial.

The second problem is declining public investments. At the beginning of the year, an interim government was installed. And though it is behaving as the continuation of the government it was supposed to take over from, it faces difficulties in financing the public investment projects that have been started or new ones. In addition, the IMF and other international financial institutions, and also the EU, worry about the growing public debt and warn against the continuation of public spending.

The third problem is the worry of the central bank that growing uncertainty may initiate an outflow of foreign currency, which would be a problem for the fixed exchange rate regime to which it is committed for more than 20 years now. So, it decided to hike, ever so slightly, the policy rate just when the economic activity slowed down. In addition, it is worried about the increase in household loans, though private debt, both corporate and that of households, is not high by any measure in Macedonia. As a result, there is some fiscal and monetary tightening, though those are perhaps not all that strong. Still, given deflationary pressures and expectations, it is not something that is in any way called for.

Fundamentally, the economy is not suffering from either a misaligned exchange rate or financial problems and it should return to growth rates of above 3% once the political crisis is resolved. So, assuming that the elections prove stabilising, medium-term growth rates in excess of 3% should be expected.

Table 18 / Macedonia: Selected economic indicators

	2012	2013	2014	2015 1)	2015 January-June	2016 January-June	2016 Forecast	2017 Forecast	2018 Forecast
Population, th pers., mid-year	2,061	2,064	2,067	2,070	2070	2070	2,085	2,090	2,095
Gross domestic product, MKD mn, nom.	466,703	501,891	527,631	558,240	269,587	288,844	575,000	599,000	628,000
annual change in % (real)	-0.5	2.9	3.6	3.8	3.6	2.1	2.5	3.1	3.3
GDP/capita (EUR at exchange rate)	3,700	3,900	4,100	4,400	.	.	4,500	4,700	4,900
GDP/capita (EUR at PPP)	9,000	9,500	10,100	10,600	.	.	.	.	.
Consumption of households, MKD mn, nom. 2)	340,875	355,959	364,039	377,683	189,219	193,414	.	.	.
annual change in % (real)	1.2	1.9	2.1	3.0	2.4	2.8	2.0	2.0	2.0
Gross fixed capital form., MKD mn, nom.	109,071	119,003	123,549	129,095	.	.	.	.	.
annual change in % (real)	6.5	3.5	5.5	3.6	.	.	2.0	4.0	5.0
Gross industrial production 3)									
annual change in % (real)	-2.7	3.2	4.8	4.9	0.8	5.6	5.0	5.0	5.0
Gross agricultural production 4)									
annual change in % (real)	-5.6	6.4	1.7	3.0	.	.	.	.	.
Construction industry									
annual change in % (real)	8.1	43.1	-3.4	40.8	16.4	41.8	.	.	.
Employed persons, LFS, th, average	650.6	678.8	690.2	706.0	698.4	717.6	720	730	740
annual change in %	0.8	4.3	1.7	2.3	1.7	2.7	2.0	1.0	1.0
Unemployed persons, LFS, th, average	292.5	277.2	268.8	248.9	248.9	229.6	230	220	200
Unemployment rate, LFS, in %, average	31.0	29.0	28.0	26.1	26.1	24.3	24.0	24.0	23.0
Reg. unemployment rate, in %, end of period	25.8	22.8	23.4	22.1	22.1	21.2	.	.	.
Average monthly gross wages, MKD	30,670	31,025	31,325	32,171	31,879	32,553	33,000	33,700	34,500
annual change in % (real, gross)	-3.0	-1.6	1.3	3.0	3.1	2.5	2.0	1.0	1.0
Average monthly net wages, MKD	20,902	21,145	21,394	21,904	21,696	22,165	22,500	23,000	23,600
annual change in % (real, net)	-2.9	-1.6	1.5	2.7	2.7	2.5	2.0	1.0	1.0
Consumer prices, % p.a.	3.3	2.8	-0.3	-0.3	-0.3	-0.3	0.5	1.0	1.5
Producer prices in industry, % p.a.	1.4	-1.4	-1.9	-3.9	-3.2	-4.1	-3.0	0.0	2.0
General governm. budget, nat.def., % of GDP									
Revenues	32.1	30.1	29.7	31.0	.	.	31.0	31.0	31.0
Expenditures	36.0	34.1	33.9	34.4	.	.	33.0	33.0	33.0
Deficit (-) / surplus (+)	-3.9	-4.0	-4.2	-3.4	.	.	-2.0	-2.0	-2.0
Public debt, nat.def., % of GDP	38.3	40.2	45.7	46.6	43.3	45.8	47.0	47.0	47.0
Central bank policy rate, %, p.a., end of period 5)	3.73	3.25	3.25	3.25	3.25	4.00	4.00	4.00	4.00
Current account, EUR mn	-240	-134	-69	-127	-129	-181	-370	-390	-410
Current account, % of GDP	-3.2	-1.6	-0.8	-1.4	-2.9	-3.9	-4.0	-4.0	-4.0
Exports of goods, BOP, EUR mn	2,307	2,375	2,780	3,042	1,450	1,588	3,220	3,380	3,550
annual change in %	-3.7	2.9	17.0	9.4	12.6	9.5	6.0	5.0	5.0
Imports of goods, BOP, EUR mn	4,315	4,238	4,635	4,867	2,317	2,502	5,110	5,370	5,640
annual change in %	0.3	-1.8	9.4	5.0	5.0	8.0	5.0	5.0	5.0
Exports of services, BOP, EUR mn	1,067	1,155	1,277	1,369	633	664	1,450	1,520	1,600
annual change in %	2.1	8.2	10.6	7.2	8.8	4.9	6.0	5.0	5.0
Imports of services, BOP, EUR mn	757	780	919	1,027	472	475	1,080	1,130	1,190
annual change in %	10.5	2.9	17.9	11.6	0.4	0.7	5.0	5.0	5.0
FDI liabilities (inflow), EUR mn	265	302	37	172	113	170	200	.	.
FDI assets (outflow), EUR mn	134	73	-160	1	-1	55	55	.	.
Gross reserves of NB, excl. gold, EUR mn	1,918	1,803	2,221	2,049	2,024	1,899	.	.	.
Gross external debt, EUR mn	5,172	5,220	5,992	6,291	6,416	6,915	6,750	6,800	6,900
Gross external debt, % of GDP	68.2	64.0	70.0	69.4	70.8	74.0	72.0	70.0	68.0
Average exchange rate MKD/EUR	61.53	61.58	61.62	61.61	61.59	61.68	61.5	61.5	61.5
Purchasing power parity MKD/EUR	25.08	25.61	25.18	25.43	.	.	.	.	.

1) Preliminary. - 2) Half-year data including NPISH. - 3) Enterprises with 10 and more employees. - 4) In 2015 wiiw estimate. - 5) Central Bank bills (28-days).

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