MACEDONIA: Change is in the air

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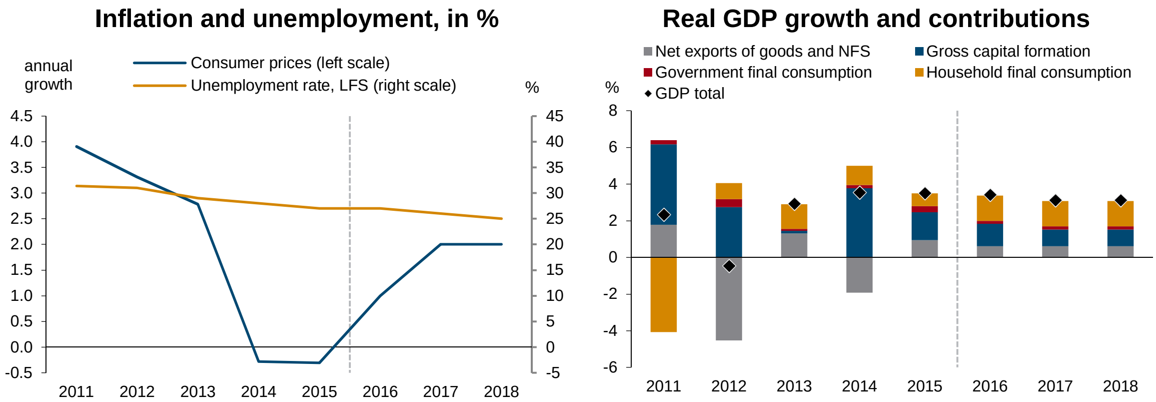
Growth over the medium term should settle at just above 3%, with investment and exports as the driving forces. As democratisation takes hold, political stability should in all likelihood firm up and growth accelerate somewhat, especially if growth in the region as a whole picks up speed.

Figure 48 / Macedonia: main macroeconomic indicators



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

Economic performance continues to improve with decent prospects in the medium term. Last year's growth rate was 3.5%, and for the next few years growth rates above 3% are forecasted. The unemployment rate has continued to decline, though at 27% it is still among the highest in the region and almost anywhere. Growth has been driven by investment and consumption. Like in most of the region, consumption is almost 90% of GDP. But investment at 25% of GDP is much higher than in most other countries in the region. The trade deficit is high, though exports are also higher, as a share of GDP, compared to the region average. Finally, on most rankings of institutional development and business friendliness, Macedonia does better too.

The political climate, however, has been worsening with a legitimacy crisis erupting last year. The reason is that the current government coalition has been in power for quite some time and there is abundant evidence that it has become unusually corrupt, that is has shown blatant disregard for the rule of law, and that is has tempered with elections. There have been quite a few early elections since 2008 which failed to produce a change. The dissatisfied opposition took to the streets last year and an agreement was forged with the mediation by the EU that new early elections will be held before the end of April this year – now postponed until June. Subsequent negotiations had been contentious, as was to be expected, so it is not clear whether these elections will be held as scheduled. The outcome, if indeed there are elections, is hard to predict. Given the evidence of the government's misbehaviour, the opposition should win. However, given that the economy and employment are improving, change may not happen. That, if it does happen, will not mean stabilisation, because the governing parties will only tighten the grip on the country, while all the grievances will remain unheeded.

The refugee crisis may help the government in the upcoming elections. One of the main routes of the refugees who are on the way to Germany and Scandinavia goes through Macedonia. That has created problems on the border with Greece and may also create problems on the Serbian border in the future. The refugees do not incite too much dissatisfaction because they are just in transit. That may change if borders start closing all over Europe and within the Balkans too. In any case, the risk to stability, real or fanciful, will tend to work for the government and against change in trying times.

Exports of goods and services are increasing as are public investments. Originally, the policy framework was designed to support export-based growth. The fixed exchange rate is still in place; however, the tight fiscal policy, which used to be adhered to almost up to the outbreak of the global financial crisis in 2008-2009, has been relaxed with some support for wage growth and even more for public investments. This was possible because debt levels, whichever one cared to look at, were relatively low and sustainable. In addition, monetary policy, which used to be quite tight in order to support the fixed exchange rate, could be relaxed due to very low interest rates in the euro area. So, both fiscal and monetary policy have been supportive, at least compared to their tightness before the crisis. It could be argued that as much as it was unfortunate before the crisis, the tight policy mix could be relaxed in the aftermath and thus support investments, growth, and the labour markets.

Structural reforms and pro-business measures have been introduced already before the crisis. Unlike most countries in the region, which tended to erode their competitiveness with real exchange rate appreciation, this was not the case with the Macedonian economy. Indeed, wages stagnated for years before the crisis, often because those in the public sector were frozen as part of the programmes with the IMF. With a depressed labour market, that meant that real wages tended to decline relative to those in the region. In addition, as part of the strategy of reliance one external demand, measures to support foreign investments were constantly introduced. Macedonia is not the best location, as this is a small, landlocked country in a depressed and volatile region, so it is hard to see that investors will rush to put their money there. In any case, the pro-business measures that had been taken before and preserved competitiveness, i.e. no need for structural reforms in the middle of a crisis, did help growth and investments.

Change would be helpful to internal stability and could rekindle the stalled process of EU integration. The economy is strong enough that it could sustain some much-needed democratic change. Also, inter-ethnic relations are calm enough for that to be sustainable. In addition, the new government could have a chance to reset the relationship with the EU and with Greece in particular. However, for the current government too much is at stake to be ready to accept that change is what is needed.

Investment should continue to be the driving force of growth assuming political stability is preserved.

Table 17 / Macedonia: selected economic indicators

	2011	2012	2013	2014	2015 [1]	2016	2017 Forecast	2018
Population, th pers., mid-year	2,059	2,061	2,064	2,067	2,080	2,085	2,090	2,095
Gross domestic product, MKD mn, nom.	464,186	466,703	501,891	525,620	565,900	591,000	622,000	654,000
annual change in % (real)	2.3	-0.5	2.9	3.5	3.5	3.4	3.1	3.1
GDP/capita (EUR at exchange rate)	3,700	3,700	3,900	4,100	4,400	4,600	4,800	5,100
GDP/capita (EUR at PPP)	8,800	9,000	9,500	10,100	10,700	.	.	.
Consumption of households, MKD mn, nom.	339,177	340,875	355,959	363,521	366,100	.	.	.
annual change in % (real)	-5.4	1.2	1.9	1.5	1.0	2.0	2.0	2.0
Gross fixed capital form., MKD mn, nom.	109,219	109,071	119,003	123,115	123,000	.	.	.
annual change in % (real)	13.3	6.5	3.5	14.3	4.0	4.0	4.0	4.0
Gross industrial production [2]								
annual change in % (real)	6.9	-2.7	3.2	4.8	4.9	5.0	5.0	5.0
Gross agricultural production [3]								
annual change in % (real)	-0.4	-5.6	6.4	3.0	3.0	.	.	.
Construction industry								
annual change in % (real)	28.5	8.1	43.1	-3.4	35.0	.	.	.
Employed persons, LFS, th, average	645.1	650.6	678.8	690.2	700.0	710	720	730
annual change in %	1.1	0.8	4.3	1.7	1.4	1.0	1.0	1.0
Unemployed persons, LFS, th, average	295.0	292.5	277.2	268.8	260.0	260	250	240
Unemployment rate, LFS, in %, average	31.4	31.0	29.0	28.0	27.0	27.0	26.0	25.0
Reg. unemployment rate, in %, end of period	29.9	25.8	22.8	23.4	22.0	.	.	.
Average monthly gross wages, MKD	30,602	30,669	31,025	31,325	32,200	32,800	33,800	34,800
annual change in % (real, gross)	-2.6	-3.0	-1.6	1.3	3.0	1.0	1.0	1.0
Average monthly net wages, MKD	20,847	20,902	21,145	21,394	22,000	22,400	23,100	23,800
annual change in % (real, net)	-2.4	-2.9	-1.6	1.5	3.0	1.0	1.0	1.0
Consumer prices, % p.a.	3.9	3.3	2.8	-0.3	-0.3	1.0	2.0	2.0
Producer prices in industry, % p.a.	11.9	1.4	-1.4	-1.9	-3.9	1.0	2.0	2.0
General governm. budget, nat.def., % of GDP								
Revenues	31.7	32.1	30.1	29.8	31.0	31.0	31.0	31.0
Expenditures	34.2	36.0	34.1	34.0	34.0	33.0	33.0	33.0
Deficit (-) / surplus (+)	-2.6	-3.9	-4.0	-4.2	-3.0	-2.0	-2.0	-2.0
Public debt, nat.def., % of GDP	32.0	38.3	40.2	45.9	46.0	46.0	46.0	46.0
Central bank policy rate, %, p.a., end of period [4]	4.00	3.73	3.25	3.25	3.25	3.25	3.50	3.50
Current account, EUR mn	-189	-240	-134	-69	0	-380	-400	-430
Current account, % of GDP	-2.5	-3.2	-1.6	-0.8	0.0	-4.0	-4.0	-4.0
Exports of goods, BOP, EUR mn	2,396	2,307	2,375	2,780	3,057	3,240	3,400	3,570
annual change in %	21.0	-3.7	2.9	17.0	10.0	6.0	5.0	5.0
Imports of goods, BOP, EUR mn	4,301	4,315	4,238	4,635	4,867	5,110	5,370	5,640
annual change in %	22.4	0.3	-1.8	9.4	5.0	5.0	5.0	5.0
Exports of services, BOP, EUR mn	1,045	1,067	1,155	1,277	1,380	1,460	1,530	1,610
annual change in %	39.8	2.1	8.2	10.6	8.0	6.0	5.0	5.0
Imports of services, BOP, EUR mn	686	757	780	919	975	1,020	1,070	1,120
annual change in %	11.4	10.5	2.9	17.9	6.0	5.0	5.0	5.0
FDI liabilities (inflow), EUR mn	370	265	302	37	300	.	.	.
FDI assets (outflow), EUR mn	26	134	73	-160	0	.	.	.
Gross reserves of NB, excl. gold, EUR mn	1,802	1,918	1,803	2,221	2,049	.	.	.
Gross external debt, EUR mn	4,847	5,172	5,220	5,992	6,600	6,700	6,800	6,900
Gross external debt, % of GDP	64.2	68.2	64.0	70.3	71.9	70.0	67.0	65.0
Average exchange rate MKD/EUR	61.53	61.53	61.58	61.62	61.61	61.50	61.50	61.50
Purchasing power parity MKD/EUR	25.59	25.08	25.61	25.18	25.48	.	.	.

1) Preliminary and wiiw estimates. - 2) Enterprises with 10 and more employees. - 3) In 2014 wiiw estimate. -
4) Central Bank bills (28-days).

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