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## **Macedonia: stability with low growth**

The first half of 2004 has been characterized by a slow recovery of industrial production that had dropped dramatically at the end of last and the beginning of this year. An optimistic forecast could see a stagnation for the year as a whole. GDP may still grow by up to 3% with good results in agriculture and growth in services. But the risks on the side of recession may increase if the recovery stalls once again.

Prices have been falling this year, which is consistent with the lack of growth. These negative tendencies have been the consequence of the tight fiscal and monetary policies that were followed in 2003. Under the pressure of the IMF, a sharp fiscal adjustment was engineered in 2003. Macedonia had followed a prudent fiscal policy from the initial stabilization in 1994 until the near civil war that erupted in 2001. After political stabilization and the election of the new government, public expenditures were slashed to stabilize the budget. In 2003, the fiscal deficit was just above 1% and the intention is to have an almost balanced budget this year.

In addition to that, monetary policy was rather restrictive. Again, in order to support political stabilization, money supply was tight in order to keep the foreign exchange market stable. Macedonia has a fixed exchange rate with the denar pegged to the euro. With the GDP and the fiscal balance moving in a very volatile manner, the peg was seen as the main anchor of stability. It could perhaps be argued that the central bank was too cautious in relaxing its stance once political stability returned and in view of the tightening of the fiscal policy. Thus, recovery was interrupted and deflationary tendencies emerged.

In May, the government was reshuffled, because the former prime minister was elected the president of the republic, and a new governor of the central bank was appointed (the six-year term of the previous governor had expired). Both the government and the central bank will have to take a hard look at the current economic developments and rethink the economic policy that they want to pursue. That will have to be in the context of the new agreement with the IMF that should be negotiated in the course of this year.

Slow recovery has not been conducive to foreign investments. Since 2001, those have been rather low. Public investments are very modest too. Finally, external developments have not been very favourable in the previous period. This year, however, exports are growing as are imports. Macedonia's trade is dependent on the region more than is the case with other Balkan countries. As growth is picking up in the region, external demand should be favourable to Macedonian exports.

The banking sector is sound and increasingly liquid. In the previous period, due to the tight monetary policy and high risks, it did not contribute all that much to the growth of production. The growth of credits is still not as convincing as in some of the other countries in the region, however. With the increased political stability and a more accommodative economic policy, that should change.

With deflation, wages have been growing in real terms. Employment, however, is not increasing and the unemployment rate is quite high. It jumped to close to 37% (LFS measure) due to the cuts in public expenditures last year. Indeed, unemployment is the main economic and social problem. For most of the transition, the successive governments have given precedence to stability and the redistribution of resources over employment and growth. It looks as if the patience of the public is wearing thin and that there is a short-term window of opportunity to change the course and target growth and employment.

On 1 April, the Stabilization and Association Agreement of the EU with Macedonia came into effect. At about the same time, Macedonia submitted its application for full membership in the EU. The EU council has instructed the European Commission to prepare the questionnaire that will enable the EU to decide whether it is ready to open negotiations for full membership of Macedonia. EU accession is one issue on which there is very wide consensus in the country. An increased level of engagement on the part of the EU will, if it comes to that, prove to be essential for the stability and development of this country and of the region as a whole.

Table MK

## Macedonia: Selected Economic Indicators

	1999	2000	2001	2002	2003 <sup>1)</sup>	2003 1st quarter	2004	2004 forecast	2005
Population, th pers., mid-year	2017.1	2026.4	2034.9	2042.0	2050.0	.	.	.	.
Gross domestic product, MKD mn, nom.	209010	236389	233841	243970	253493	.	.	268900	285200
annual change in % (real)	4.3	4.5	-4.5	0.9	3.1	.	.	3	4
GDP/capita (EUR at exchange rate)	1709	1921	1887	1959	2018	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	5700	6010	5850	6030	6340	.	.	.	.
Gross industrial production									
annual change in % (real) <sup>2)</sup>	-2.6	3.0	-2.9	-5.3	4.7	3.4	-26.2	0	3
Construction output, value added									
annual change in % (real)	10.4	-1.1	-14.4	0.6	4.1	.	.	.	.
Consumption of households, MKD mn, nom.	145693	175965	163788	188179	.	.	.	.	.
annual change in % (real)	3.6	11.1	-11.6	.	.	.	.	.	.
Gross fixed capital form., MKD mn, nom.	34710	38332	34716	40448	.	.	.	.	.
annual change in % (real)	-1.4	-3.2	-8.6	.	.	.	.	.	.
LFS - employed persons, th. avg.	545.2	549.8	599.3	561.3	545.1	.	.	.	.
annual change in %	1.0	0.8	9.0	-6.3	-2.9	.	.	.	.
Reg. employees in industry, th pers., avg. <sup>3)</sup>	119.8	114.4	122.5	110.9	107.2	108.5	103.3	.	.
annual change in % <sup>3)</sup>	5.5	-4.5	-4.8	-9.5	-3.3	-8.5	-4.8	.	.
LFS - unemployed persons, average	261.5	261.7	263.2	263.5	315.9	.	.	.	.
LFS - unemployment rate in %, average	32.4	32.2	30.5	31.9	36.7	.	.	36	35
Reg. unemployment rate in %, end of period	.	.	.	.	.	.	.	.	.
Average net monthly wages, MKD	9664	10193	10552	11279	11824	11571	12041	.	.
annual change in % (real, net)	3.6	-0.3	-1.9	5.0	3.6	6.4	2.1	.	.
Retail prices, % p.a.	-1.1	10.6	5.2	1.4	2.4	2	1.7	3	2
Producer prices in industry, % p.a.	-0.1	10.7	2.0	-0.9	-0.3	1.5	-1.5	2	2
Central governm. budget, nat.def., % GDP									
Revenues	24.2	26.7	27.0	28.7	21.3	.	.	.	.
Expenditures	23.8	24.4	29.5	29.3	22.3	.	.	.	.
Deficit (-) / surplus (+), % GDP	0.3	2.3	-2.5	-0.6	-1.0	.	.	.	.
Public debt in % of GDP	.	.	.	.	.	.	.	.	.
Discount rate, % p.a., end of period	8.9	7.9	10.7	10.7	6.5	8.0	6.5	.	.
Current account, EUR mn <sup>4) 6)</sup>	-30.4	-78.5	-272.1	-384.3	-246.6	-101.8	-111.1	-250	-250
Current account in % of GDP	-0.9	-2.0	-7.1	-9.6	-6.0	.	.	-5.8	-5.6
Gross reserves of NB, excl. gold, EUR mn <sup>6)</sup>	428.0	461.5	845.5	692.8	786.9	.	.	.	.
Gross external debt, EUR mn <sup>5) 6)</sup>	1431.9	1545.2	1638.3	1486.3	1417.0	1436.3	1425.3	.	.
FDI inflow, EUR mn <sup>6)</sup>	30.7	189.4	493.2	82.6	83.8	4.4	33.7	.	.
FDI outflow, EUR mn <sup>6)</sup>	0.3	-0.7	1.0	0.1	0.3	0.4	0.1	.	.
Exports of goods, BOP, EUR mn <sup>6)</sup>	1117	1433	1291	1181	1205	272.3	286.4	1300	1400
annual growth rate in %	-3.0	28.3	-9.9	-8.5	2.0	-2.0	5.2	8	8
Imports of goods, BOP, EUR mn <sup>6)</sup>	1582	2182	1879	2035	1959	475.5	465.0	2100	2200
annual growth rate in %	-1.8	37.9	-13.9	8.3	-3.7	-2.4	-2.2	7	5
Exports of services, BOP, EUR mn <sup>6)</sup>	256	344	273	269	289	.	.	.	.
annual growth rate in %	92.4	34.2	-20.5	-1.6	7.5	.	.	.	.
Imports of services, BOP, EUR mn <sup>6)</sup>	217	291	295	295	291	.	.	.	.
annual growth rate in %	16.3	34.1	1.3	0.2	-1.3	.	.	.	.
Average exchange rate MKD/USD	56.90	65.89	68.04	64.74	54.30	57.18	49.05	.	.
Average exchange rate MKD/EUR (ECU)	60.62	60.73	60.91	60.98	61.26	61.31	61.29	62	64
Purchasing power parity MKD/USD, wiiw	16.70	17.70	17.91	18.32	18.18	.	.	.	.
Purchasing power parity MKD/EUR, wiiw	18.19	19.42	19.65	19.80	19.51	.	.	.	.

Notes: 1) Preliminary. - 2) Excluding small enterprises. - 3) From 2001 according to NACE. - 4) Including grants. - 5) Medium- and long-term. - 6) Converted from USD to EUR.

Source: wiiw Database incorporating national statistics; wiiw forecasts.