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## **Macedonia: relying on fiscal stimulus**

Growth was already decelerating by the third quarter of 2008. Preliminary data for the fourth quarter suggest a further slowdown in both industrial production and foreign trade. Personal consumption has also declined, as have investments. Inflation has decelerated dramatically, while deflationary tendencies became apparent at the beginning of 2009. Some people have been withdrawing their bank deposits in domestic currency – but not in foreign currencies. Credit activity, however, has declined significantly. Reportedly workers are being laid off; however, for want of reliable data the labour market's reaction to that development cannot be assessed. Overall, the crisis has not spared Macedonia.

The response has been somewhat hard to decipher to date. Whereas the central bank has been rather pessimistic suggesting that a stand-by agreement with the IMF would be desirable, the government has been bullish suggesting that Macedonia will weather the global crisis unscathed. There were suggestions that international investors will relocate their operations to Macedonia owing to diminishing prospects elsewhere. Ultimately, the government submitted, and parliament approved, a draft budget envisaging significant increases in public spending. The budget was predicated on an assumed GDP growth of 4.5% accompanied by moderate inflation and a high current account deficit equivalent to about 14% of GDP; the latter figure reflects the expectations of high foreign investment inflows.

Early indications are that those assumptions were unrealistic. Indeed, if anything, the crisis has come to Macedonia sooner than expected. Exports have declined sharply because many of them comprise metals and raw materials, for which there is no market at present. Imports have also dropped owing to an overall decline in consumption. Furthermore, deflationary pressures have proven stronger than initially expected.

The government cannot be expected to come up with new programmes to deal with the crisis because of the presidential elections scheduled for March. Once the elections are over, there may be an attempt to take a second look at the crisis and the government's ability to overcome things by increasing public spending. The key problem with current government strategy is that it does not reveal the source of the funds required to cover increased public expenditures. In addition, adverse developments in both foreign trade and the current account in general may increase the pressure on the exchange rate. Macedonia has a very strict fixed exchange rate regime; if the financial inflows from abroad dry up, the country may come under strong pressures to devalue. Indeed, one of the contentious issues between the government and the central bank is the degree to which monetary

policy should be restrictive. The bank is reluctant to ease matters by cutting interest rates, while the government is pressing for a relaxation of monetary policy.

These policy intentions and dilemmas will prove academic, if Macedonia has to turn to the IMF and request a stand-by programme. Judging by the stand-by programme in neighbouring Serbia, it is highly unlikely that the IMF will condone lax fiscal policy. None the less, with or without the IMF, it is hard to see whether any significant scope exists for increases in public spending.

Should some degree of fiscal stimulus still prove possible, GDP growth may not turn negative. However, the odds are on its turning negative and recession becoming a real possibility. In the medium term, it is hard to expect any swift improvement owing to the slow rate of recovery throughout the region, on which Macedonia depends more than most of its neighbours. As in the region as a whole, a shift in development strategy is essential; that in turn will call for structural adjustment and so dampen the country's medium-term prospects.

Table MK

## Macedonia: Selected Economic Indicators

	2003	2004	2005	2006	2007	2008 <sup>1)</sup>	2009	2010	2011
	Forecast								
Population, th pers., average <sup>2)</sup>	2026.8	2032.5	2036.9	2040.2	2045.0	2048	.	.	.
Gross domestic product, MKD mn, nom.	251486	265257	286619	310915	353786	410146	418000	431000	453000
annual change in % (real)	2.8	4.1	4.1	4.0	5.9	5.3	-1	0	2
GDP/capita (EUR at exchange rate)	2000	2100	2300	2500	2800	3300	.	.	.
GDP/capita (EUR at PPP - wiiw)	5300	5800	6400	6900	7800	8700	.	.	.
Consumption of households, MKD mn, nom.	191873	209075	222726	243131	272886	310300	320000	330000	347000
annual change in % (real) <sup>2)</sup>	-1.5	8.0	5.7	6.0	9.4	5	0	0	2
Gross fixed capital form., MKD mn, nom.	42110	47286	48868	56485	71557	80600	81000	83000	88000
annual change in % (real) <sup>2)</sup>	1.1	10.9	-5.4	11.6	12.0	4	-2	0	3
Gross industrial production									
annual change in % (real) <sup>3)</sup>	4.1	-2.2	7.1	3.6	3.7	6.7	-3	0	3
Gross agricultural production									
annual change in % (real)	4.5	6.8	0.3	4.8	-3.0	6.9	.	.	.
Construction industry									
annual change in % (real)	-4.9	-1.0	-20.5	-11.9	9.7	.	.	.	.
Employed persons - LFS, th, average	545.1	523.0	545.3	570.4	590.2	610.7	.	.	.
annual change in %	-2.9	-4.1	4.3	4.6	3.5	3.5	.	.	.
Unemployed persons - LFS, th, average	315.9	309.3	323.9	321.3	316.9	311.5	.	.	.
Unemployment rate - LFS, in %, average	36.7	37.2	37.3	36.0	34.9	33.8	34	33	33
Reg. unemployment rate, in %, end of period	.	.	.	.	.	.	.	.	.
Average gross monthly wages, MKD	19950	20771	21330	23036	24136	25997	.	.	.
real growth rate, % (net wages)	3.6	4.4	2.0	3.9	5.5	2	.	.	.
Consumer prices, % p.a.	1.2	-0.4	0.5	3.2	2.3	8.3	3	3	3
Producer prices in industry, % p.a. <sup>4)</sup>	-0.3	0.9	3.2	7.3	2.5	10.3	.	.	.
General governm. budget, nat.def., % GDP <sup>5)</sup>									
Revenues	33.4	33.2	35.2	33.5	33.8	34.5	.	.	.
Expenditures	34.5	33.2	35.0	34.0	33.2	33.8	.	.	.
Deficit (-) / surplus (+), % GDP	-1.1	0.0	0.2	-0.6	0.6	-1.0	-2	-2	0
Public debt in % of GDP	.	.	.	.	.	.	.	.	.
Discount rate of NB, % p.a., end of period	6.5	6.5	6.5	6.5	6.5	6.5	.	.	.
Current account, EUR mn	-168.2	-362.7	-121.3	-44.9	-414.8	-912	-478	-563	-592
Current account in % of GDP	-4.1	-8.4	-2.6	-0.9	-7.2	-13.6	-7	-8	-8
Exports of goods, BOP, EUR mn	1203.2	1345.0	1642.9	1902.7	2441.5	2700	2400	2400	2500
annual growth rate in %	1.9	11.8	22.2	15.8	28.3	11	-10	0	5
Imports of goods, BOP, EUR mn	1956.2	2259.3	2501.4	2923.1	3616.3	4700	4700	4900	5100
annual growth rate in %	-3.9	15.5	10.7	16.9	23.7	30	0	5	5
Exports of services, BOP, EUR mn	335.3	363.7	416.2	477.3	594.3	650	600	600	600
annual growth rate in %	.	8.5	14.4	14.7	24.5	9	-5	0	5
Imports of services, BOP, EUR mn	341.4	407.2	440.8	455.1	568.7	710	700	700	700
annual growth rate in %	.	19.3	8.3	3.2	25.0	25	-5	0	5
FDI inflow, EUR mn	100.4	260.7	77.2	344.8	506.0	300	.	.	.
FDI outflow, EUR mn	0.3	1.0	2.3	0.1	-0.9	0	.	.	.
Gross reserves of NB, excl. gold, EUR mn	685.3	653.3	1028.0	1311.3	1400.1	1552.5 <sup>ix</sup>	.	.	.
Gross external debt, EUR mn	1472.9	2070.6	2518.1	2495.2	2840.2	3360.3 <sup>ix</sup>	.	.	.
Gross external debt in % of GDP	35.9	47.9	53.7	49.1	49.1	.	.	.	.
Average exchange rate MKD/EUR	61.26	61.34	61.30	61.19	61.18	61.27	61.2	61.2	61.2
Purchasing power parity MKD/EUR	23.42	22.65	21.96	21.94	22.28	23.12	.	.	.

Note: The term 'industry' refers to NACE classification C+D+E.

1) Preliminary and wiiw estimates. - 2) In 2008 wiiw estimate. - 3) Enterprises with more than 10 employees. - 4) Based on domestic output prices. - 5) Refers to central government budget and extra-budgetary funds.

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