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Macedonia: slow turnaround

After a relatively bad year, recent figures on the Macedonian economy indicate a slow improvement. Last year's figures have also been revised and they now show a smaller drop in industrial production and close to 3% GDP growth. It is hard to say how these figures are connected to reality, but there is indirect evidence that a certain turnaround has started in the second half of last year. Imports have increased significantly fuelled by the growing availability of credits. This has put the central bank on the alert and it has continued to implement a rather tight monetary policy that has already had some effect on the expansion of credit and consumption. Likewise, fiscal policy has been cautious and that has also contributed to a rather slow acceleration of growth. Exports and investments, the main sources of growth in the tight macroeconomic environment, have not shown a stellar performance at the beginning of this year. Overall, the Macedonian government continues to be preoccupied with stability and has yet to come up with a policy that is more conducive to growth.

In mid-year 2004 the government reached an agreement with the IMF on a new three-year programme. It intends to build on the achieved stability to speed up structural reforms and bring the economy on a higher and sustainable growth path. This strategy has not worked all that well so far, so it remains to be seen what the outcome will be this time. Both the government and the IMF have shied away from a more ambitious change in the macroeconomic set-up that Macedonia has followed for a decade now. The exchange rate will remain firmly fixed to the euro and fiscal policy will be tight. That will not bring faster acceleration of growth in the short run because exports will continue to increase rather slowly and public spending will not be relied on to boost demand.

Structural reforms are to be speeded up. The exceptionally high unemployment, at above 35%, will continue to be the main problem. The reform of the labour market with the aim to increase flexibility, cannot be expected to bring about fast increases in employment. The reform of public administration will also put some additional pressure on the labour market. Finally, the restructuring of the privatized enterprises will push productivity but not employment in the short run.

The product market is not very innovative and competition could be increased. For instance, the structure of exports has not been changing in about the past ten years. Also, Macedonia is not very competitive in the region, where still about one third of its trade is conducted. Wages are higher than in all the neighbouring countries except Greece.

Investment opportunities are limited because of the problem with competitiveness and because of the small size of the market. As a location, Macedonia has some disadvantages because it is landlocked and the access to regional markets is in some cases difficult.

Macedonia's main hopes are with progress in the process of EU integration. The avis, responding to Macedonia's application for membership, should be published by the Commission in early autumn of this year. The expectation is that it will be at least conditionally positive, i.e., that it will contain added requirements for the country to meet in order for negotiations to start. That would certainly bring the needed positive boost to the country, which is still facing a number of internal problems and is particularly vulnerable to external, i.e., regional shocks. A positive avis would stabilize the internal political situation and decrease the risk for investors at a time when significant decisions will have to be made in the neighbourhood, particularly those concerning the constitutional issues in Kosovo. Similar positive effects will be the eventual start of negotiations between the EU and Serbia and Montenegro on their Stabilization and Association Agreement. In general, continuing active presence of the EU in the Balkan region is essential for Macedonia as the country depends on the region to a greater extent than most other countries. In that context, the planned accession to the EU of Bulgaria would be quite beneficial for Macedonia.

Given favourable regional developments, GDP should continue to expand in the next couple of years with inflation remaining low. This is premised on an economic policy slowly moving towards a more relaxed stance as the credibility of the banking sector is improving and the need for some public investments is recognized. The government and the central bank will be pushed in that direction by the growing social pressure and the nearing of the parliamentary elections that are due in about two years' time.

Table MK

Macedonia: Selected Economic Indicators

	2000	2001	2002	2003	2004 ¹⁾	2004 1st quarter	2005	2005 forecast	2006
Population, th pers., mid-year ²⁾	2026.4	2034.9	2020.2	2026.8	2030.0	.	.	.	.
Gross domestic product, MKD mn, nom.	236389	233841	243970	251486	264599	.	.	280700	297800
annual change in % (real)	4.5	-4.5	0.9	2.8	2.9	2.4	.	4	4
GDP/capita (EUR at exchange rate)	1921	1887	1981	2025	2125	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	5170	5000	5210	5370	5650	.	.	.	.
Gross industrial production									
annual change in % (real) ³⁾	3.0	-3.1	-5.3	4.7	-2.2	.	4.8	3	5
Construction output, value added									
annual change in % (real)	-1.1	-14.4	0.6	4.1	.	.	.	.	.
Consumption of households, MKD mn, nom.	175965	163788	188179	191873	.	.	.	.	.
annual change in % (real)	11.2	-11.6	12.4	-1.5	.	.	.	.	.
Gross fixed capital form., MKD mn, nom.	38332	34716	40448	42110	.	.	.	.	.
annual change in % (real)	-1.5	-8.6	17.6	1.1	.	.	.	.	.
LFS - employed persons, th. avg.	549.8	599.3	561.3	545.1	523.0	519.6	.	.	.
annual change in %	0.8	9.0	-6.3	-2.9	-4.1	.	.	.	.
Reg. employees in industry, th pers., avg. ⁴⁾	114.4	122.5	110.9	106.7	101.5	103.3	98.3	.	.
annual change in % ³⁾	-4.5	-4.8	-9.5	-3.8	-4.9	-4.8	-4.9	.	.
LFS - unemployed, th pers., average	261.7	263.2	263.5	315.9	309.3	307.1	.	.	.
LFS - unemployment rate in %, average	32.3	30.5	31.9	36.7	37.2	37.2	.	35	35
Reg. unemployment rate in %, end of period	.	.	.	.	.	.	.	.	.
Average net monthly wages, MKD	10193	10552	11279	11824	12293	12041	12392	.	.
annual change in % (real, net)	-0.3	-1.9	5.0	3.6	4.0	2.1	2.9	.	.
Consumer prices, % p.a.	5.8	5.5	1.8	1.2	-0.4	1.6	-0.4	2	2
Producer prices in industry, % p.a.	10.7	2.0	-0.9	-0.3	0.9	-1.5	1.9	2	3
Central governm. budget, nat.def., % GDP									
Revenues	26.7	22.6	23.8	21.4	21.3	.	.	.	.
Expenditures	24.4	28.0	26.8	22.4	22.1	.	.	.	.
Deficit (-) / surplus (+), % GDP	2.3	-5.5	-3.0	-1.0	-0.8	.	.	.	.
Public debt in % of GDP	.	.	.	.	.	.	.	.	.
Discount rate, % p.a., end of period	7.9	10.7	10.7	6.5	6.5	6.5	6.5	.	.
Current account, EUR mn ⁵⁾⁶⁾	-78.5	-272.1	-379.9	-135.0	-334.0	-85.2	-16.0	-300	-300
Current account in % of GDP	-2.0	-7.1	-9.5	-3.3	-7.7	.	.	-6.6	-6.3
Gross reserves of NB, excl. gold, EUR mn	461.5	845.5	692.8	718.4	665.2	.	.	.	.
Gross external debt, EUR mn ⁷⁾	1606.8	1621.4	1507.9	1417.0	1439.0	1449.5	1486.6	.	.
FDI inflow, EUR mn ⁶⁾	189.4	493.2	82.6	83.8	121.9	33.7	.	.	.
FDI outflow, EUR mn ⁶⁾	-0.7	1.0	0.1	0.3	0.9	0.1	.	.	.
Exports of goods, BOP, EUR mn ⁶⁾	1433	1291	1181	1205	1347	292	357	1400	1500
annual growth rate in %	28.3	-9.9	-8.5	2.0	11.8	7.3	22.0	4	7
Imports of goods, BOP, EUR mn ⁶⁾	2182	1879	2035	1959	2249	472	499	2400	2450
annual growth rate in %	37.9	-13.9	8.3	-3.7	14.8	-0.7	5.7	7	2
Exports of services, BOP, EUR mn ⁶⁾	344	273	269	289	328	62	.	.	.
annual growth rate in %	34.2	-20.5	-1.6	7.5	13.6	10.3	.	.	.
Imports of services, BOP, EUR mn ⁶⁾	291	295	292	291	363	87	.	.	.
annual growth rate in %	34.2	1.3	-0.8	-0.3	24.7	36.3	.	.	.
Average exchange rate MKD/USD	65.89	68.04	64.74	54.30	49.41	49.05	46.80	.	.
Average exchange rate MKD/EUR (ECU)	60.73	60.91	60.98	61.26	61.34	61.29	61.40	62	62
Purchasing power parity MKD/USD, wiiw	19.40	19.63	20.00	19.73	19.77	.	.	.	.
Purchasing power parity MKD/EUR, wiiw	22.55	22.97	23.18	23.11	23.09	.	.	.	.

Notes: 1) Preliminary. - 2) From 2002 according to census November 2002. - 3) Excluding small enterprises, from 2004 new methodology. - 4) From 2001 according to NACE. - 5) Including grants. - 6) Converted from USD to EUR at the official cross exchange rate. - 7) Medium- and long-term.

Source: wiiw Database incorporating national statistics; wiiw forecasts.