29. THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA

A mild recession, followed by a mild recovery

Output decline remained moderate

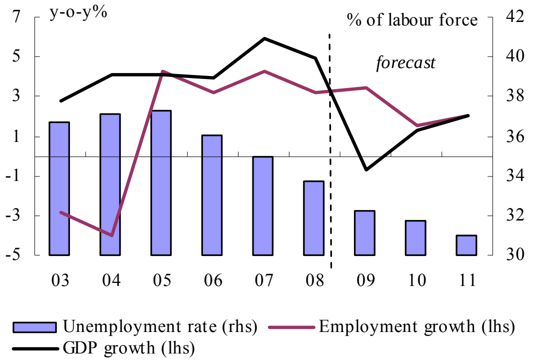
So far, the impact of the global financial crisis has remained rather moderate, with output declining by only about 0.7% in 2009. Private consumption remained rather resilient, benefiting probably from a reduction in the savings rate and slightly increasing private transfers, rising to 17% of GDP. Furthermore, increased public transfers helped to stabilise domestic income and demand. Investment dropped markedly during 2009 in response to sharply declining export demand and continued uncertainty. The financial sector's lending slowed down markedly, but due to a practically non-existing exposure to toxic assets, the direct impact of the global financial crisis has remained minor.

In response to the financial crisis, the government adopted so far four anti-crisis packages: one in December 2008, claiming a volume of some 5% of GDP, another in March 2009 in the form of an extended investment programme which envisages an increase in public investment from some 3% of GDP in the past to 7% of GDP in 2009, a third package in September and another support package in March 2010. However, the actual impact of all four packages on public revenue and expenditure so far has been very limited: Total government spending actually dropped by nearly 1 pp. of GDP, while revenues declined by 2½ pps., bringing the fiscal deficit from 1% of GDP in 2008 to 2.7% in 2009. Within the various spending categories there was a strong shift, with increasing public sector wages and transfers, and reduced capital spending.

Consumer-price inflation was slightly negative during most of 2009, leading to an average decline of consumer prices by 0.8% for the whole year. In the first months of 2010, inflation remained low, as the continued decline in food prices helped to compensate rising costs for housing and transport.

Official labour-market data point to a continued increase in overall employment, despite significant job losses in those industries primarily affected by the global crisis, namely steel and textile. However, employment at municipalities and in the trade sector appears to have increased markedly. The former is probably due to increased public spending, the latter probably due to strengthened registration procedures. Unemployment continued to drop slightly, but still remained at the alarmingly high level of some third of the labour force. Youth unemployment stayed at some 55%.

Graph II.29.1: **The former Yugoslav Republic of Macedonia - Labour market**



The exchange rate of the Denar has remained largely unchanged against the euro at a level of 61.4 MKD/EUR. The Central Bank intends to maintain its current informal peg to the euro.

A moderate recovery but protracted structural challenges remain

In 2010, the main shock of the global crisis is expected to subside, which should allow the economy to expand by around 1¼%. The main sources for this recovery will be private and public consumption, while exports are likely to remain sluggish. In 2011, economic activity is expected to increase by some 2%, benefiting from the recovery in the country's export markets.

Given the uncertainties related to the global economy, domestic demand and, in particular, real disposable income will be key factors for the country's growth dynamics. Overall, real disposable income is expected to remain fairly stable, benefiting from relatively low inflation and the stabilising impact of workers' remittances, even though labour income is likely to stagnate.

In recent years, workers' remittances and other private capital inflows have increased to more than 18% of GDP. During the forecast period, these inflows are expected to return to previous levels of some 15% of GDP, reflecting the more difficult labour market situations in host countries. Nevertheless, this source of income is expected to remain at a very significant level. As long as international prices for energy and raw materials remain moderate, inflation will probably remain low during the forecast period. This should support the real income of households.

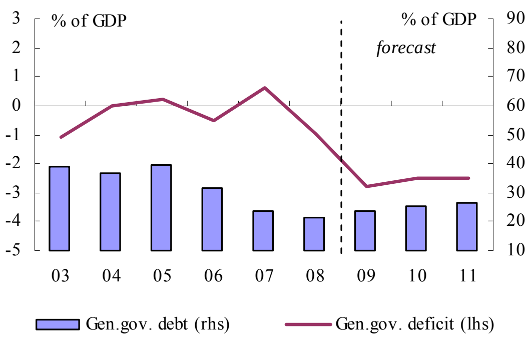
Labour income is likely to stagnate in the near future resulting from low growth of employment and wages. During recent years, employment growth has been rather high at some 3% annually. However, a significant share of those additional jobs are a result of a stricter registration procedure and do not necessarily reflect newly created employment. In view of the likely still difficult international environment in 2010-11, the country's potential for creating employment or raising real wages will remain limited. Improving the country's labour income is thus closely linked to improving productivity by modernising and deepening the capital stock.

The current-account deficit is likely to deteriorate, due in particular to increasing equipment investment in 2010 and 2011.

Public finances are likely to remain under control

Based on the country's track-record of respecting fiscal targets, the forecast expects public sector deficits to decline from 2¾% of GDP in 2009 to 2½% in 2010 and 2011. The budget for 2010 and programmes for 2011 envisage a significant increase in public spending. However, accelerating domestic activity and improved efficiency in tax collection should help to reconcile both targets. The forecast expects that in case of spending constraints, the authorities will reduce capital spending, as has happened in the past at similar occasions. However, as a result, the quality of public spending might deteriorate further.

Graph II.29.2: **The former Yugoslav Republic of Macedonia - Public finances**



Protracted fiscal deficits and rather low nominal GDP growth will lead to a marked rise in public sector debt, reaching some 27% of GDP by 2011.

Table II.29.1:

Main features of country forecast - THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA

	2008			Annual percentage change					
bn MKD	Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP	398.6	100.0	-	4.0	5.9	4.9	**-0.7**	**1.3**	**2.0**
Private consumption	312.9	78.5	-	6.0	9.8	6.9	**0.2**	**1.0**	**2.0**
Public consumption	75.7	19.0	-	1.8	0.4	9.7	**-4.7**	**-1.5**	**-0.5**
Gross fixed capital formation	97.6	24.5	-	11.6	13.1	20.3	**-9.2**	**4.0**	**6.0**
of which : equipment	40.1	10.1	-	8.0	22.7	-	**-**	**-**	**-**
Exports (goods and services)	209.6	52.6	-	8.4	14.3	-4.3	**-8.2**	**5.5**	**7.0**
Imports (goods and services)	313.2	78.6	-	10.9	17.4	5.8	**-10.7**	**4.0**	**6.1**
GNI (GDP deflator)	392.9	98.6	-	5.4	1.4	8.7	**-0.7**	**1.5**	**2.0**
Contribution to GDP growth :	Domestic demand		-	7.0	10.1	11.1	**-3.0**	**1.4**	**2.9**
	Inventories		-	0.0	0.5	0.3	**-1.9**	**0.0**	**-0.1**
	Net exports		-	-3.1	-4.7	-6.5	**4.1**	**-0.2**	**-0.9**
Employment			-	4.6	3.5	3.2	**3.4**	**1.5**	**2.0**
Unemployment rate (a)			-	36.0	34.9	33.8	**32.2**	**31.7**	**31.0**
Compensation of employees/head			-	-	-	7.5	**1.0**	**0.7**	**0.9**
Unit labour costs whole economy			-	-	-	5.7	**5.3**	**1.0**	**0.9**
Real unit labour costs			-	-	-	-1.4	**2.5**	**-1.1**	**-2.2**
Savings rate of households (b)			-	-	-	-	**-**	**-**	**-**
GDP deflator			-	4.4	7.5	7.3	**2.8**	**2.1**	**3.2**
Harmonised index of consumer prices			-	3.2	2.3	8.3	**-0.8**	**1.3**	**2.0**
Terms of trade of goods			-	2.4	8.4	-0.7	**0.0**	**-0.2**	**-0.2**
Trade balance (c)			-	-20.2	-20.3	-26.9	**-21.4**	**-21.9**	**-22.3**
Current account balance (c)			-	-0.9	-7.2	-13.1	**-4.2**	**-6.2**	**-7.9**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-	-	-	-	**-**	**-**	**-**
General government balance (c)			-	-0.5	0.6	-1.0	**-2.7**	**-2.5**	**-2.5**
Cyclically-adjusted budget balance (c)			-	-	-	-	**-**	**-**	**-**
Structural budget balance (c)			-	-	-	-	**-**	**-**	**-**
General government gross debt (c)			-	31.4	23.4	21.4	**23.7**	**25.4**	**26.7**

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.