

29. THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA

Workers' remittances support stability

Output decline accelerated during first half year

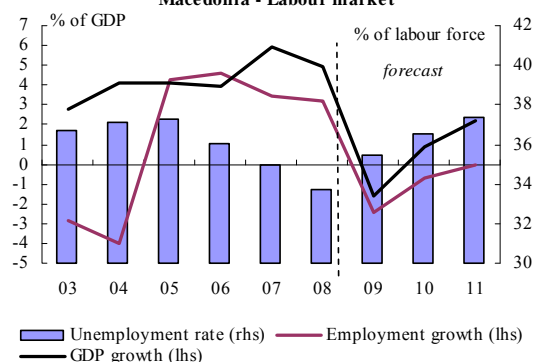
The global financial crisis increasingly affected economic activity from the last quarter of 2008 onwards. Investment dropped markedly end of 2008 in response to declining export prospects and increased uncertainty. Private consumption dropped in the second quarter, reflecting growing uncertainty among households about the near-term future and increasing lay-offs in the manufacturing industry. However, the output decline has remained rather moderate so far, partly thanks to a resilient banking sector but also due to significant government spending at the end of 2008, turning an accumulated fiscal surplus of 2% of GDP into the envisaged end-year deficit of 1% of GDP.

In response to the financial crisis, the government announced two anti-crisis packages, one in December 2008, claiming a volume of some 5% of GDP and another in March in the form of an extended investment programme, envisaging an increase of public investment from some 3% of GDP in the past to 7% of GDP in 2009. However, the actual impact of both packages on public revenue and expenditure so far has been very limited, leaving the end-year spending boom as the main fiscal stimulus. These substantial income transfers and public purchases probably supported domestic demand in the first quarter of 2009, but at the same time kept external imbalances rather high. In view of declining capital inflows, the financing of these imports created pressure on the country's foreign reserves.

Consumer price inflation further decelerated during 2009, from some 4% in December 2008 to slightly negative rates since mid-2009. The main driving factors for the decline in inflation are lower prices for food, energy and transport.

The labour market situation worsened towards the end of 2008, when the slowdown in economic activity was accompanied by a deceleration in employment growth. Furthermore, many of the newly created jobs were low income jobs in the agricultural sector or were related to public construction activities. Unemployment dropped slightly, but still remained at the alarmingly high level of some 34% of the labour force. Youth unemployment stayed at some 54%.

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 recession but protracted structural challenges remain

Overall, economic activity is expected to decline by about 2% in 2009, due to shrinking exports, lower investment and a drop in private consumption. In 2010, the negative impulse from the global crisis is expected to subside, which should allow the economy to expand by around 1½%. 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 2½%, benefiting from the recovery of 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 rather stable, benefiting from relatively low inflation and the stabilising impact of workers' remittances on household income.

In recent years, workers' remittances and other private capital inflows had increased to up to 19% of GDP. During the forecast period, those inflows are expected to return to their previous levels of some 15% of GDP, reflecting the more difficult labour market situation in the 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 probably will be low during the forecasting period. This should support the real income of households.

Labour income is likely to shrink in 2009, resulting from declining employment and low wage growth. During recent years, employment growth has been rather high at some 3% annually. However, many of the newly created jobs were in sectors with low productivity, such as agriculture. In view of the likely still difficult international environment in 2010 and 2011, the country's potential for creating additional jobs or raising real wages will remain limited. Improving the country's labour income thus is closely linked to improving productivity by modernising and deepening the capital stock.

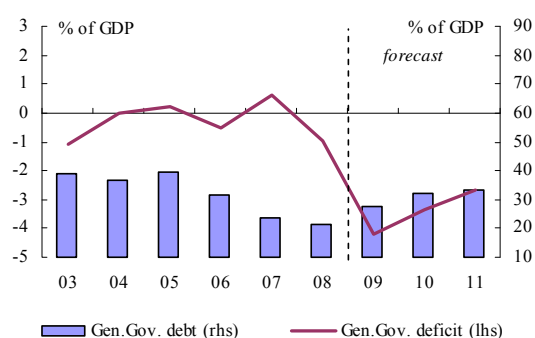
As a result of subdued domestic activity, the current account deficit is likely to decline in 2009, but to remain relatively high. Increasing domestic demand in 2010 and 2011 will keep the external imbalances at a high level.

Public finances are likely to deteriorate

Weaker domestic activity and low inflation imply a significant drop in public revenues. At the same

time, a high share of non-discretionary spending is likely to keep public expenditure high. So far crisis-related spending, such as the need to recapitalise troubled banks, has remained rather limited.

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



As a result, the forecast expects an only moderate increase in the deficit, assuming that revenue shortfalls will be partly compensated by lowering spending for capital investment. Accelerating economic activity in 2010 and 2011 will help to lower the deficit towards 3% of GDP. However, public debt is likely to increase, reaching some 30% of GDP by 2011.

Table II.29.1:

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

	2008		92-05	Annual percentage change					
	bn MKD	Curr. prices		% GDP	2006	2007	2008	2009	2010
GDP	398.6	100.0	-	4.0	5.9	4.9	-2.0	1.5	2.5
Private consumption	312.9	78.5	-	6.0	9.8	6.9	-1.0	1.5	2.1
Public consumption	75.7	19.0	-	1.8	0.4	9.7	4.0	3.0	2.5
Gross fixed capital formation	97.6	24.5	-	11.6	13.1	20.3	-18.0	1.0	2.2
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	-25.0	1.4	4.5
Imports (goods and services)	313.2	78.6	-	10.9	17.4	5.8	-19.7	1.8	2.9
GNI (GDP deflator)	392.9	98.6	-	5.4	1.4	8.7	-1.7	1.4	2.5
Contribution to GDP growth :									
Domestic demand			-	7.0	10.1	11.1	-4.4	2.0	2.6
Stockbuilding			-	0.0	0.5	0.2	0.0	0.0	0.0
Foreign balance			-	-3.1	-4.7	-6.5	2.4	-0.6	0.0
Employment			-	3.2	4.3	3.2	-2.7	-0.5	0.1
Unemployment rate (a)			-	36.0	34.9	33.8	35.6	36.1	36.4
Compensation of employees/head			-	11.7	-4.8	4.5	1.4	0.5	0.9
Unit labour costs whole economy			-	10.8	-6.3	2.8	0.7	-1.4	-1.5
Real unit labour costs			-	6.2	-12.8	-4.2	-0.7	-2.7	-3.8
Savings rate of households (b)			-	-	-	-	-	-	-
GDP deflator			-	4.4	7.5	7.3	1.4	1.3	2.3
Harmonised index of consumer prices			-	3.2	2.2	8.3	-0.6	1.1	2.2
Terms of trade of goods			-	2.4	8.4	-0.4	0.0	0.0	0.0
Trade balance (c)			-	-20.2	-20.3	-26.7	-22.6	-21.9	-21.4
Current account balance (c)			-	-0.9	-7.2	-13.1	-9.6	-9.2	-8.9
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-	-	-	-	-	-	-
General government balance (c)			-	-0.5	0.6	-1.0	-4.0	-3.5	-3.3
Cyclically-adjusted budget balance (c)			-	-	-	-	-	-	-
Structural budget balance (c)			-	-	-	-	-	-	-
General government gross debt (c)			-	36.5	27.6	20.8	25.5	28.3	30.3

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