

29. THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA

Economic recovery increasingly jeopardised by political constraints

GDP growth slowed down significantly in 2016 as investment tumbled. The economic fundamentals for strengthening domestic demand and exports remain sound. However, downside risks to the positive outlook stem from the enduring political crisis as institutional capacities for implementing structural reforms are impeded, and debt stabilisation remains elusive in the face of sustained fiscal deficits and borrowing needs of public enterprises.

Economic expansion slows down in 2016 as investors await end to political stalemate

Hit by a deteriorating investment climate, GDP growth decelerated markedly in 2016, to 2.4%, from 3.8% in 2015, according to first estimates. The expansion was driven by private consumption and exports. Total investment declined by 4.3% as business confidence was dampened by the protracted political crisis, which also constrained the government's ability to implement public infrastructure projects. The external balance made a small positive contribution to the output expansion in spite of accelerated import growth. Fuelled by an extension of government-sponsored programs, job creation remained dynamic. The unemployment rate dropped further amidst a decline in the labour force.

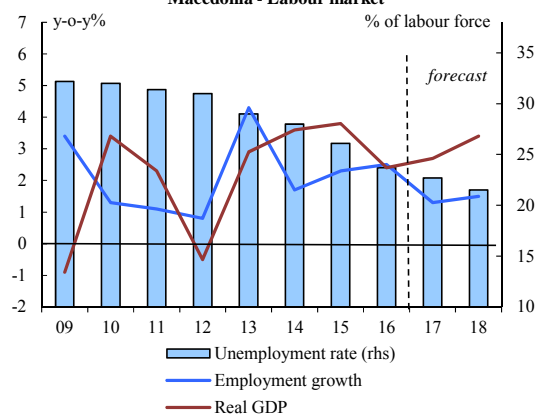
Solid fundamentals for domestic demand and external sector drive balanced recovery

Real GDP growth is expected to pick up again this year and next, accelerating to 2.9% in 2017 and further to 3.2% in 2018. The economy is likely to benefit from firming domestic demand and robust export growth. Employment is likely to strengthen further, based to a large extent on public sector programmes, yet at a slower pace given the heightened uncertainty in the business environment. Disposable income is projected to increase, with solid, but more subdued growth in real net wages, and firming inflows of private transfers, once the political situation normalises. Export growth would remain buoyant, carried by established foreign investors that step up production in recently expanded capacities. Import growth is likely to remain more subdued, as plans for new production capacities are put on hold. The merchandise trade balance is set to improve further, driving the expected narrowing in the current account deficit, which would remain covered by inflows of foreign direct investment.

With firming prices for imported energy and raw materials feeding into food and household costs,

consumer prices are expected to rise, albeit moderately. The conditions for an expansion of corporate credit are positive, if investor confidence is restored and banks' liquidity remains ample.

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



Downside risks to the forecast prevail

These projections depend on a solution to the political crisis, which negatively affects household and consumer confidence, and limits the government's ability to implement much-needed structural reforms and execute budgeted capital expenditure. Investment and private consumption may be further impeded by lower inflows of foreign direct investment and private transfers. The economic expansion is increasingly conditional on the production of established foreign companies (almost half of all exports originated from there in 2016), while spill-over effects to domestic companies remain limited. This constitutes a risk to the sustainability of high growth rates.

Fiscal policy sets over-optimistic deficit targets

At 2.6% of GDP, the general government deficit remained largely below the revised target (4.0%) in 2016, as the government heavily restrained capital spending. This was partly in response to legal restrictions on public investment as elections were scheduled. This year and next, fiscal policy is expected to continue supporting domestic demand,

as the medium-term strategy foresees further increases in social transfers and a considerable pipeline of infrastructure projects to be executed until 2019, while no increase in taxation is projected. As there is widespread consensus on these priorities, no significant fiscal restraint compared to current projections is expected in case of a new government. To reach the targeted deficit levels of 3.0% (2017) and 2.6% (2018) of GDP given planned spending increases, the government expects a significant rise in public revenue, based on robust economic growth. However, the envisaged revenue increases are optimistic in view of the 2016 outcome, possibly putting at risk again the implementation of capital projects as mid-year budget rebalancing may become necessary.

Mounting fiscal risks are jeopardising debt stabilisation

Hence, reaching the fiscal targets remains uncertain as long as the government does not define concrete measures in support of consolidation. Moreover, as state-owned companies borrow to execute public infrastructure projects, the financing needs of the public sector, may become more difficult to satisfy and may

necessitate higher transfers from the government budget. The government already faces (moderately) rising interest costs. These dynamics could feed into sustained fiscal deficits, driving a further rise in general government and public debt. On the positive side, the structure of public debt has improved, mitigating rollover and foreign exchange risks. The need to finance much-needed infrastructure and to refinance looming repayments, while stabilising debt levels will remain a major challenge.

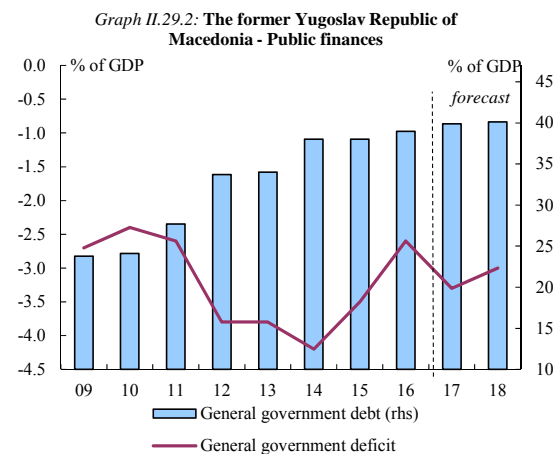


Table II.29.1:

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

	2015			Annual percentage change						
	bn MKD	Curr. prices	% GDP	97-12	2013	2014	2015	2016	2017	2018
GDP	558.2		100.0	2.8	2.9	3.6	3.8	2.4	2.9	3.2
Private Consumption	382.1		68.5	3.1	1.9	2.2	3.7	4.2	2.7	2.6
Public Consumption	93.1		16.7	1.2	0.5	3.0	2.1	1.6	1.7	1.7
Gross fixed capital formation	129.1		23.1	3.0	3.5	4.0	3.6	-4.6	3.5	4.3
of which: equipment	-		-	-	-	-	-	-	-	-
Exports (goods and services)	272.4		48.8	7.4	6.1	16.5	6.7	11.5	10.2	8.7
Imports (goods and services)	363.0		65.0	7.5	2.2	14.1	5.2	7.6	6.7	6.4
GNI (GDP deflator)	540.6		96.8	-	2.7	4.2	2.5	1.2	2.9	3.2
Contribution to GDP growth:										
Domestic demand				3.4	2.3	3.0	3.8	2.0	2.8	2.9
Inventories				0.6	-0.7	2.1	0.2	-0.3	-0.6	0.0
Net exports				-1.2	1.3	-1.5	-0.2	0.6	0.7	0.3
Employment				-	4.3	1.7	2.3	2.5	1.8	1.9
Unemployment rate (a)				33.7	29.0	28.0	26.1	23.7	22.4	20.9
Compensation of employees / head				-	-4.2	8.4	1.2	-0.2	1.1	1.6
Unit labour costs whole economy				-	-2.8	6.4	-0.3	-0.1	0.0	0.3
Real unit labour cost				-	-7.0	4.9	-2.1	-6.0	-3.6	-3.6
Saving rate of households (b)				-	-	-	-	-	-	-
GDP deflator				3.0	4.5	1.4	1.9	6.3	3.7	4.0
Consumer-price index				2.5	2.8	-0.3	-0.3	-0.2	0.8	2.3
Terms of trade goods				-	-0.8	4.8	2.7	-3.2	-0.1	-0.1
Trade balance (goods) (c)				-20.6	-22.8	-21.7	-20.2	-19.3	-17.5	-16.7
Current-account balance (c)				-5.3	-1.6	-0.5	-2.1	-3.1	-2.2	-1.9
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-	-	-	-	-	-	-
General government balance (c)				-	-3.8	-4.2	-3.5	-2.6	-3.2	-3.0
Cyclically-adjusted budget balance (d)				-	-	-	-	-	-	-
Structural budget balance (d)				-	-	-	-	-	-	-
General government gross debt (c)				-	34.0	38.0	38.0	39.0	41.0	40.8

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