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Macedonia Economy briefing:
Back on the Growth Path
- Reflection on Macedonia's Economic Performance in Q2 2018

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Introduction

After noting 0% GDP growth in 2017, and 0.1% growth in Q1 2018, Macedonia's economy is finally back on the path of growth in Q2 2018. According to the data provided by the State Statistical Office, the national economy achieved a growth of 3.1% on year-on-year basis. While still below the projections, and far from the needed growth rate for Macedonia to catch up with the European Union, the news of the positive movements in the economy suggest that the Government of SDSM and DUI has perhaps finally consolidated itself in the realm of economic governance and Macedonia has moved beyond the policies of VMRO-DPMNE, and recovered from the damage inflicted by the political crisis 2015-2017. However, it is still unclear what kind of future lies ahead. Based on the reports about the economic performance in Q2 2018, this paper traces the contours of the emerging Macedonian economic policy model in the Zaev era, and discusses the future prospects on the short and medium term.

Back on the path of growth: how was it done?

If in Q1 2018 Macedonian officials had to defend the thesis that 0.1% growth rate is still bigger than 0, their job is much easier in Q2 2018. One reason for this is that the value of the reference point for the year-on-year comparison, Q2 2017, is extremely low, as it was one of the worst economic quarters in recent years, marked by a negative economic growth of -1.3%. In that sense, a positive growth in Q2 2018 was expected; even though, as a number of economists have reminded the public – the growth in Q2 2018 is still lower than the projections, and even lower is the cumulative growth of Q1 and Q2. Nevertheless, in announcing the numbers, the Government has conveyed the message that the situation is under control, and that the performance in Q2 provides a preview in how they see the economy running in the future.

One general rule about the trends in Macedonia's economy is that, sans periods of utter political instability, they are greatly intertwined with the trends in the EU – in particular, when the EU economy grows, so does the Macedonian one. This is likely the best explanation behind the relative success of Q2 2018 – after a period of instability, Macedonia's economy realigned with the European one. The growth in Q2 is believed to be a result of the improved performance of the industrial production which has been gradually accelerating since the beginning of the year, and the export of goods - economic sectors dominated by foreign – and in the first place European – companies who have invested in production capacities in Macedonia, or who are engaged in trade processing. Additionally, another source of growth has been the significant increase in foreign direct investment, which is again related to the activities of foreign companies in Macedonia, after having restored confidence and lowered the political risk. All of these trends are perceived to be associated with a longer term process of the increase of Macedonia's production base, which according to the mainstream economic thinking in Macedonia is ultimately a positive and promising tendency. Foreign companies, in this sense, are seen as having the potential to help in upgrading Macedonia's production capacities up the value chain, and help integrate them in global supply chains. Nevertheless, for this model of an integrated Macedonian economy to succeed, the major challenge remains the shortage of skilled labor, and in general the issue of labor productivity, as Macedonia remains a cheap labor destination that attracts producers mostly in the labor intensive industries. Moreover, the government needs pro-activity from the domestic companies – something they have been trying to stimulate but have so far not managed to significantly improve.

Yet, enthusiastic about the data on Q2 2018, the official government discourse is that Macedonia is set for a bright future. The Prime Minister Zaev, Vice Prime Minister Angjushev, and the Minister of Finance Tevdovski, have all had their public appearances to present the economic achievements, brimming with confidence and promising that at the end of the year Macedonia will get to the projected annual GDP growth rate of 3%. The Government has been particularly vocal about the reduction of unemployment, which at present is slightly above 21% of the population, a figure that is the lowest in years (even though objectively it is still dramatically high). Interestingly, while in the past, there seemed to be a cacophony on issues of economic policy, now the three main officials in charge of the economy (Zaev, Angjushev and Tevdovski) seem to speak in unison. Of particular significance is the alignment of Angjushev and Tevdovski, who used to have disagreements on issues such as taxation – but have ever since devised a new approach based on their shared ideology of prudence, and one could even say, soft austerity.

The economy is likely to keep on growing in Q3 2018, which will be a wind in the back of the Government of SDSM and DUI. Nevertheless, economic analysts have argued that the data are still inconclusive with regard to question whether Macedonia has moved beyond the crisis. Macedonia is yet to achieve the projections of about 3.2% year-on-year GDP growth for 2018, a target the Government officials say that is still manageable. International financial institutions, such as the World Bank and the International Monetary Fund already had reduced the projected targets for 2018 to 2.3% and 2.8% respectively for 2018, but also lowered the expectations for the years to come. And in order to catch up with the European Union in the course of this century, Macedonia will still need to not only achieve the projected growth rates, but rather double them (it needs a prolonged period of 5-6% of annual growth).

Expectations for the future

One source of doubt about the future performance of Macedonia's economy is the endurance of the low rate of state investment, and the low rate of realization of existing capital investments in both Q1 and Q2 2018. There is a wide consensus that the stagnation and the inability to meet the economic growth projections is first and foremost a consequence of the halting of major construction works, including key infrastructure projects. Even though the Government had announced an ambitious program of state investment for 2018, and has allocated more than 400 million EUR for that purpose, in Q1 and Q2 they completed mere 16.5% of the planned investments (around 65 million EUR). The opposition, as well as a number of experts have repeatedly called out the Government on the significant underperformance in this sector, considered to be the key to unlocking any more significant growth rate. The Governor of the National Bank of Macedonia, Anita Angelovska-Bezhoska, while acknowledging the growth rate of Q2 2018, has remarked that the reason why the economy is still way below the desired performance is in fact the sloppy start of the investment cycle.

The Vice Prime Minister in charge of Economic Affairs, Kocho Angjushev, has been constantly active in defending this approach by the government. His main point has been that state investment has stagnated because of the emphasis on due diligence, prudence and transparency, not only with regards to forthcoming projects, but also to existing projects and contracts inherited from the previous government. Angjushev has argued that the Government had all the possibility to pursue much more investments if they wanted to, but this would have been irresponsible way of handling taxpayers' money, as it would not have yielded any returns. Much of the efforts of the Government, in that sense has been the revision and correction of existing projects – the major one being the Kichevo-Ohrid highway, contracted to Sinohydro. Announcing that many of these contracts have been successfully revised, Angjushev promised that state investment will start to be realized with greater efficiency by the end of the year. He even argued that the amount of investment will surpass the Government spending, as a number of other projects are to be realized by public and private companies. For Angjushev and his supporters, therefore, the news about the growth achieved in Q2 2018 are even more remarkable, given the fact that they are achieved without significant reliance on state investment. They expect that once, as promised, the state investment is realized, the numbers will improve and Macedonia will achieve the projected growth. But underneath all this, lies the general belief that state investment should not be a priority – as both Angjushev and Zaev favor an economic model driven by the market than by the state.

The hopes of the government, of course, also lie in the forthcoming referendum on the Prespa Agreement, by which Macedonia obliges to change its name, in return for the support of Greece in its integration in NATO and the EU. If the referendum succeeds, it is expected that Macedonia's accession to NATO will be concluded in early 2020. The government sees NATO membership as a security guarantee, which also helps in reducing risk, building confidence and instilling sense of security among foreign partners and investors, but also as a development that will soften the reluctance of domestic companies to (re)invest. In this sense, in the pre-referendum campaign, but also in their economic analyses, government officials repeatedly argue that successful referendum, and conversely NATO membership will lead to skyrocketing in foreign direct investment, which on the other hand is seen as the real game changer on the long run. They back these claims by data from Macedonia's neighboring countries – Bulgaria and Albania – that are presented as having experienced surge in investment thanks to NATO (a claim that it is at best oversimplification, and at worst, a falsehood). The association between NATO membership and increased capital inflows has in fact dominated the public discourse, and has become not only political, but also economic canon of the Government and its supporters, regardless of the fact that it has been frequently disputed by experts. The government also expects that a successful referendum would further advance Macedonia's EU bid and result in receiving more EU financial assistance in the form of grants for a variety of projects. Finally, they believe that with a successful referendum, they will be able to finally move beyond the era of instability, which would motivate Macedonian companies to be more ambitious, and will facilitate the conditions for domestic business to flourish.

The vision of Zaev and Angjushev, however, seems to be more of the same free market orthodoxy – in theory, it is not too different compared to any previous leadership Macedonia has had. On the other hand, in further implementing their economic policies and measures they are yet to show that the benefits will not end up only in the hands of those around them (as both come from the private sector and are involved in a myriad of businesses; and so far, many of the government programs in support of the private sector as well as tenders for public procurements have been marred by controversy and suspicion of corruption), but will genuinely benefit the country. Finally, even if all works out, they ultimately face the challenge of not only meeting, but rather moving beyond the most optimistic projections of 3% on the short term and moving towards closing the gap with the more developed parts of Europe on the medium and long term – something that, at present, seems unimaginable.