

Key developments and challenges

There were further improvements in the Former Yugoslav Republic (FYR) of Macedonia's business climate over the past year, with greater labour market flexibility and an improved land cadastre. However, cumbersome court procedures and administrative bottlenecks in the bankruptcy process continue to cause difficulties for businesses and investors.

Continued modernisation of the power infrastructure, effective tariff reforms and a further opening up of the market are needed to increase competition in the sector and provide incentives to end-users for more efficient use of electricity.

The impact of the crisis on the financial sector has been relatively modest so far. However, external imbalances have increased due to a drop in exports and capital inflows. Maintaining fiscal discipline over the medium term and avoiding accumulation of external debt are therefore essential for overall macroeconomic stability.

Country data

Population (in millions)	2.1
Area ('000 sq km)	26.0
GDP (in billion US\$, 2008)	9.6
Average transition score (scale: 1 to 4.33)	3.26

Progress in structural reform

Liberalisation and privatisation

FYR Macedonia became a formal EU candidate country in December 2005 but, as of early October 2009 no date had been set for starting accession talks. However, the European Commission has recommended to the Council of the European Union that the country (with Montenegro and Serbia) be given visa-free access to the Schengen area.

Business environment and competition

The business environment improved further over the past year. Significant progress was made in establishing the real estate cadastre, which by mid-2009 covered more than 90 per cent of the country. Property registration was eased by reducing the average time to register a title deed by eight days. Amendments to the labour law introduced in January 2009 led to a reduction in minimum social contributions and made hiring of workers more flexible. The authorities also harmonised the bases for social security contributions and personal income tax and made these dependent on gross rather than net wages. These improvements are reflected in the World Bank's *Doing Business 2010* survey, which ranks FYR Macedonia 32nd out of 183 countries (up from 69th) and also places it among the top 10 reformers globally with regard to business environment reforms implemented over the past year.

Further improvements to the judicial system and the functioning of courts are required to bring the country to EU standards as well as to increase the country's attractiveness as an investment destination. The 2008/09 Business Environment and Enterprise Performance Survey (BEEPS IV) found that dealing with courts is a severe constraint on businesses. Despite ongoing reforms to speed up court procedures, legal procedures are still slow, hampering contract enforcement. For example, while the average duration of bankruptcy procedures has fallen slightly, it still takes around two years on average to close a business.

Infrastructure

The unbundling of the energy sector has been completed, but the generation segment is still dominated by the state-owned ELEM. The government increased electricity tariffs for households by 13 per cent in November 2008, in line with its policy of gradually increasing electricity prices to market levels. A further opening up of the market in line with the provisions of the Energy Community Treaty is needed to encourage competition and provide incentives for more efficient use of electricity to end-users.

In the road sector, the government, supported by the EBRD, is implementing a programme to upgrade more than 400 km of regional and local roads. The aim is to improve key regional transport links and provide connections to international road corridors. The planned modernisation of the airport system on the basis of a 20-year concession won by the Turkish company, TAV, has been postponed to 2010 due to pressure resulting from the global economic crisis.

Financial sector

The impact of the crisis on the financial sector has been relatively modest to date, mainly because banks rely primarily on domestic deposits to fund lending and deposit withdrawals have been limited. Strengthened banking supervision and adequate regulation have helped maintain the stability of the sector. However, lending has become more restricted and growth in bank lending to the private sector slowed significantly to 11.2 per cent year on year by the end of July 2009, compared with 34 per cent at the end of 2008. At the same time, the annual growth of deposits came to a virtual standstill in July 2009, compared with a 12.4 per cent growth at the end of 2008. Overall, banks remain well capitalised, including through continued support by overseas parent banks, and the capital adequacy ratio remained stable at 16.5 per cent after the first quarter of 2009, double the minimum that is required by law. At the same time, the number of non-performing loans increased to 8.4 per cent at the end of June from 6.8 per cent at the end of 2008. The public credit bureau increased its coverage and at the end of 2008 the first privately owned credit bureau was established. In July 2009 the voluntary pension insurance system ("third pillar") became operational, completing a seven-year pension reform intended to harmonise FYR Macedonia's social insurance legislation with that of the European Union.

Macroeconomic performance

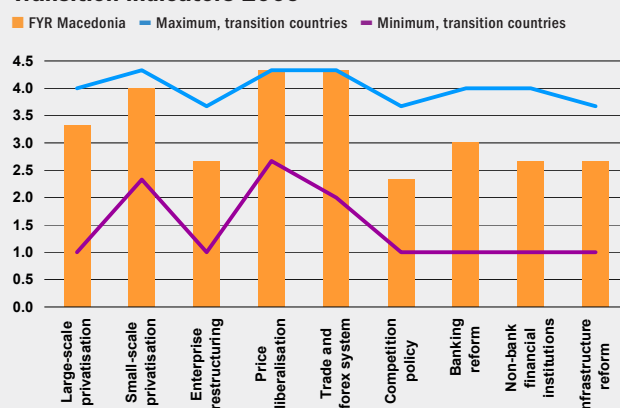
After several strong years, GDP growth declined from 5.9 per cent in 2007 to 4.9 per cent in 2008. The global financial crisis started affecting the economy in the fourth quarter of 2008, led by a decline in the output of the metal and textile sectors. The situation deteriorated in the first half of 2009 as industrial production contracted by 11 per cent compared with a year earlier, while foreign trade dropped sharply and foreign direct investment (FDI) roughly halved. The growth of GDP was -1.4 per cent in the second quarter of 2009 (compared with -0.9 per cent in the first quarter and 2 per cent growth in the fourth quarter of 2008) and unemployment remains high at about one-third of the workforce. At the same time, external imbalances increased, forcing the central bank to increase the reference interest rate from 7 to 9 per cent in March 2009 and repeatedly intervene on the foreign exchange market. As a result, foreign exchange reserves fell to 3.4 months of imports in May 2009, but have stabilised somewhat since then at a level of above 4 months of imports, supported by the issuing of a eurobond as well as inflows based on special drawing right allocations. Gross external debt remained at around 50 per cent of GDP, partly reflecting increased public borrowing. Inflation remained subdued at around 0.1 per cent in the first half of the year.

In response to the crisis, in November 2008 the authorities adopted an economic stimulus plan, which includes a number of fiscal measures such as rebates and write-offs of unpaid social security contributions, a further lowering of taxes on profits and agricultural incomes and a reduction of some import tariffs. As a result, fiscal policy has become more expansionary and after being in surplus during most of 2008, intensive spending in the last months of the year resulted in a budget deficit of 0.9 per cent of GDP for 2008. In March 2009 the government presented a €8 billion investment programme for the next seven years, focusing on large infrastructure projects in energy, transport, environment protection, education and culture. In June 2009 in order to preserve the projected 2009 budget deficit at -2.8 per cent of GDP and following lower-than-projected revenue performance in the first months of 2009, the parliament adopted a revised budget which included a cut in public expenditures of 9 per cent, mainly through a hiring freeze and a suspension of public wage increases.

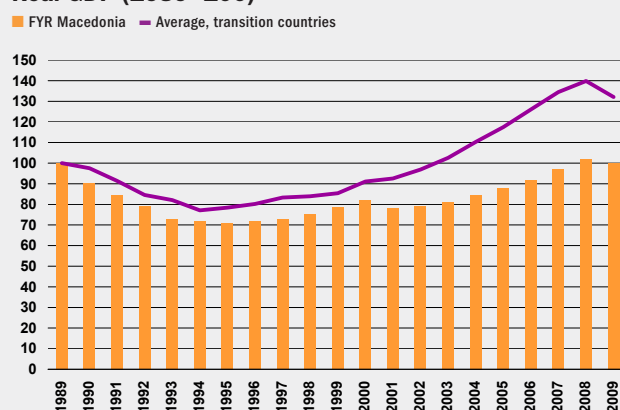
Outlook and risks

The economy is likely to fall into recession this year as a result of a sharp drop in industrial output and exports. A more expansionary policy stance, reflecting the government's anti-crisis measures and the need to modernise the country's infrastructure, will result in a shift from modest fiscal deficits or surpluses of earlier years to higher deficits in the near future. The combination of lower exports, falling capital inflows (including FDI) and an expansionary fiscal policy have increased external risks, especially given the drop in reserves and relatively modest reserve coverage. These pressures, with weaker remittances, could necessitate a sharp contraction in imports, triggering a deeper and more prolonged recession. However, the recent rise in reserve coverage, as well as the government's commitment to fiscal discipline should help to mitigate these risks. Continued progress in the EU accession process is an important condition for the realisation of FYR Macedonia's medium-term growth potential.

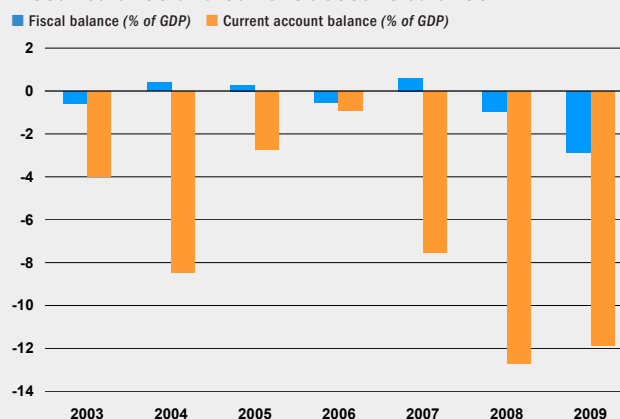
Transition indicators 2009



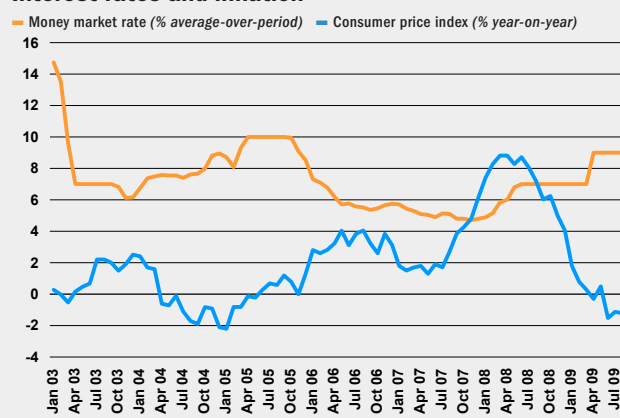
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation	Business environment and competition	Infrastructure	Financial sector	Social reform
Current account convertibility - full	Competition office - yes	Telecoms regulatory assessment compliance - high	Capital adequacy ratio - 8 per cent	Share of population living in poverty - 3.2 per cent (2003)
Controls on inward direct investment - yes ¹	Quality of insolvency law - high	Independence of the electricity regulator - partial	Deposit insurance system - yes	Government expenditure on health - 4.8 per cent (2008)
Interest rate liberalisation - full	Secured transactions law - modern/some defects	Separation of railway infrastructure from operations - yes	Private pension funds - yes	Government expenditure on education - 5.1 per cent (2008)
Exchange rate regime - de facto fixed to euro		Independence of the road directorate - partial		Household expenditure on power and water - 6.6 per cent
Wage regulation - no				
Tradeability of land - limited de jure				

Structural and institutional change indicators

	2003	2004	2005	2006	2007	2008	2009
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	13.6	13.8	14.3	20.0	20.2	20.6	na
Private sector share in GDP (in per cent)	60.0	65.0	65.0	65.0	65.0	70.0	70.0
Private sector share in employment (in per cent)	50.0	55.0	55.0	60.0	60.0	60.0	na
Budgetary subsidies and current transfers (in per cent of GDP)	1.1	1.1	1.3	2.3	3.3	4.6	na
Share of industry in total employment (in per cent)	23.8	25.8	25.8	25.0	24.9	24.8	na
Change in labour productivity in industry (in per cent)	14.0	-5.7	2.7	1.9	0.9	2.5	na
Investment/GDP (in per cent)	20.0	21.4	20.7	21.9	24.2	na	na
<i>EBRD index of small-scale privatisation</i>	4.0	4.0	4.0	4.0	4.0	4.0	4.0
<i>EBRD index of large-scale privatisation</i>	3.0	3.3	3.3	3.3	3.3	3.3	3.3
<i>EBRD index of enterprise reform</i>	2.3	2.3	2.3	2.7	2.7	2.7	2.7
Markets and trade							
Share of administered prices in CPI (in per cent)	13.4	1.5	1.2	1.2	1.2	0.7	na
Number of goods with administered prices in EBRD-15 basket	1.0	0.0	0.0	0.0	0.0	0.0	na
Share of trade with non-transition countries (in per cent) ²	58.8	55.9	54.1	51.6	53.4	51.3	na
Share of trade in GDP (in per cent)	77.2	83.6	88.5	95.4	105.1	110.2	na
Tariff revenues (in per cent of imports)	5.1	4.2	3.4	4.3	2.8	2.3	na
<i>EBRD index of price liberalisation</i>	4.0	4.3	4.3	4.3	4.3	4.3	4.3
<i>EBRD index of forex and trade liberalisation</i>	4.3	4.3	4.3	4.3	4.3	4.3	4.3
<i>EBRD index of competition policy</i>	2.0	2.0	2.0	2.0	2.3	2.3	2.3
Financial sector							
Number of banks (foreign-owned)	21 (8)	21 (8)	20 (8)	19 (8)	18 (11)	18 (14)	na
Asset share of state-owned banks (in per cent)	1.8	1.9	1.6	1.6	1.4	1.2	na
Asset share of foreign-owned banks (in per cent)	47.0	47.3	51.3	53.2	85.9	93.1	na
Non-performing loans (in per cent of total loans)	34.9	27.5	22.2	15.1	10.9	10.1	na
Domestic credit to private sector (in per cent of GDP)	18.8	22.1	25.1	30.2	36.8	43.9	na
Domestic credit to households (in per cent of GDP)	3.7	5.6	7.5	9.6	13.5	15.5	na
- Of which mortgage lending (in per cent of GDP)	na	na	na	na	2.6	3.3	na
Stock market capitalisation (in per cent of GDP)	7.7	7.7	11.0	16.5	31.8	9.0	na
Stock trading volume (in per cent of market capitalisation)	8.1	8.6	18.3	22.4	26.5	8.9	na
Eurobond issuance (in per cent of GDP)	0.0	0.0	3.0	0.0	0.0	0.0	na
<i>EBRD index of banking sector reform</i>	2.7	2.7	2.7	2.7	2.7	3.0	3.0
<i>EBRD index of reform of non-bank financial institutions</i>	1.7	2.0	2.0	2.3	2.3	2.3	2.7
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	25.9 (38.3)	26.4 (48.5)	26.2 (62.0)	24.1 (69.5)	22.7 (95.4)	22.4 (122.6)	na
Internet users (per 100 inhabitants)	19.1	21.0	23.0	25.0	27.3	42.9	na
Railway labour productivity (1989=100)	67.2	76.2	112.9	132.0	161.0	162.4	na
Residential electricity tariffs (USc kWh)	4.7	5.1	4.4	5.1	5.7	6.1	na
Average collection rate, electricity (in per cent)	77	82	88	85	86	87	na
GDP per unit of energy use (PPP in US dollars per kgoe)	4.9	5.2	5.5	na	na	na	na
<i>EBRD index of infrastructure reform</i>	2.0	2.3	2.3	2.3	2.3	2.3	2.7
- Electric power	2.3	2.3	2.7	3.0	3.0	3.0	3.0
- Railways	2.0	2.0	2.0	2.0	2.0	2.0	2.0
- Roads	2.3	2.3	2.3	2.3	2.3	2.3	2.3
- Telecommunications	2.7	3.0	3.0	3.0	3.3	3.3	3.7
- Water and wastewater	2.0	2.0	2.0	2.3	2.3	2.3	2.3

¹ There are controls on arms production, trade in narcotics, historical and cultural heritage.

² For some years data were unavailable for some important trading partners, such as Bosnia and Herzegovina, Croatia, Serbia and Montenegro. As a result, the share of trade with non-transition countries for these years has been over-estimated.

Macroeconomic indicators

	2003	2004	2005	2006	2007	2008 Estimate	2009 Projection
Output and expenditure	<i>(Percentage change in real terms)</i>						
GDP	2.8	4.1	4.1	4.0	5.9	4.9	-1.6
Industrial gross output	6.6	-2.1	7.0	3.6	3.7	5.5	na
Agricultural gross output	4.8	6.2	0.2	4.6	-2.0	3.5	na
Employment¹	<i>(Percentage change)</i>						
Labour force (end-year)	4.4	-3.3	4.4	2.6	1.7	1.4	na
Employment (end-year)	-2.8	-4.1	4.3	4.6	3.5	3.2	na
	<i>(In per cent of labour force)</i>						
Unemployment (end-year)	36.7	37.2	37.3	36.0	34.9	33.8	na
Prices and wages	<i>(Percentage change)</i>						
Consumer prices (annual average)	1.2	-0.4	0.5	3.2	2.3	8.3	-0.4
Consumer prices (end-year)	2.6	-1.9	1.2	2.9	6.1	4.1	-1.0
Producer prices (annual average)	-0.3	0.9	3.2	4.5	2.5	10.3	na
Producer prices (end-year)	-0.2	1.3	4.0	3.2	4.2	-1.8	na
Gross average monthly earnings in economy (annual average)	4.9	4.1	2.7	8.0	4.8	8.7	na
Government sector	<i>(In per cent of GDP)</i>						
General government balance	-0.6	0.4	0.3	-0.5	0.6	-1.0	-2.8
General government expenditure	34.5	33.2	34.9	34.0	33.1	35.2	na
General government debt	39.0	36.6	39.5	32.9	24.7	21.3	na
Monetary sector	<i>(Percentage change)</i>						
Broad money (M2, end-year)	18.1	17.1	15.5	24.8	28.1	7.1	na
Domestic credit (end-year)	7.0	27.5	3.7	27.4	67.1	39.4	na
	<i>(In per cent of GDP)</i>						
Broad money (M2, end-year)	30.7	34.1	36.5	41.9	47.1	44.9	na
Interest and exchange rates	<i>(In per cent per annum, end-year)</i>						
Basic rate of the National Bank	7.0	6.5	6.5	6.5	6.5	6.5	na
Interbank interest rate	6.2	10.0	8.5	5.7	4.8	6.5	na
Deposit rate	6.7	6.5	5.6	4.4	5.3	5.7	na
Lending rate	14.5	12.0	12.1	10.7	9.9	9.7	na
	<i>(Denars per US dollar)</i>						
Exchange rate (end-year)	49.1	45.1	51.7	46.5	41.7	43.7	na
Exchange rate (annual average)	54.3	49.4	49.3	48.8	44.7	41.9	na
External sector	<i>(In millions of US dollars)</i>						
Current account	-184.1	-452.8	-157.9	-56.4	-596.8	-1,209.6	-1,155.0
Trade balance	-851.0	-1,139.0	-1,063.0	-1,285.0	-1,629.8	-2,551.8	-2,000.0
– Merchandise exports	1,362.7	1,674.9	2,040.6	2,396.3	3,349.5	3,970.9	2,300.0
– Merchandise imports	2,213.7	2,813.8	3,103.6	3,681.2	4,979.2	6,522.7	4,300.0
Foreign direct investment, net	117.5	321.9	94.2	424.0	700.2	612.0	300.0
Gross reserves, excluding gold (end-year)	897.7	905.0	1,228.5	1,750.6	2,082.3	1,920.3	na
External debt stock	1,840.5	2,816.9	2,970.6	3,284.4	4,160.8	4,678.3	na
	<i>(In months of imports of goods and services)</i>						
Gross reserves, excluding gold (end-year)	4.1	3.3	4.0	4.9	4.5	3.2	na
	<i>(In per cent of exports of goods and services)</i>						
Debt service	19.7	12.4	10.2	18.8	15.5	na	na
Memorandum items	<i>(Denominations as indicated)</i>						
Population (end-year, million)	2.0	2.0	2.0	2.0	2.0	2.1	na
GDP (in billions of denars)	251.5	265.3	286.6	310.9	354.3	398.6	407.0
GDP per capita (in US dollars)	2,285.6	2,645.2	2,854.0	3,119.4	3,868.1	4,633.1	na
Share of industry in GDP (in per cent)	20.8	19.5	19.6	20.2	21.9	22.3	na
Share of agriculture in GDP (in per cent)	11.4	11.3	10.8	10.8	9.4	9.4	na
Current account/GDP (in per cent)	-4.0	-8.4	-2.7	-0.9	-7.5	-12.7	-11.9
External debt - reserves (in US\$ million)	942.8	1,911.9	1,742.1	1,533.8	2,078.6	2,758.0	na
External debt/GDP (in per cent)	39.7	52.4	51.1	51.5	52.5	49.1	na
External debt/exports of goods and services (in per cent)	105.6	132.4	116.2	109.6	105.4	102.4	na