

# Macedonia Business Forecast Report Q2 2014

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## Abstracts

### Core Views

Macedonia's economic recovery will gradually shift into a higher gear as stronger industrial activity increases demand for labour and household consumption growth accelerates. For the time being, there is little to suggest that stronger external demand for Macedonian manufactured goods is driving fixed investment into productive capacity, preventing a more robust recovery.

Macedonia's coalition government looks set to fall apart over the nomination of a presidential candidate for elections in April, and the dissolution is likely to trigger an early general election. We have long suggested that an early election looked likely; however, we do not expect it to destabilise the country politically.

With low borrowing costs and a favourable maturity profile, we believe that Macedonia's public debt position is sustainable, with limited risks of instability over the coming years.

### Major Forecast Changes

We have revised up our real GDP growth forecast for 2014 from 2.0% to 2.6%, and have lowered our 2013 growth estimate from 3.0% to 2.4%.

We have modified our current account forecast and now expect a deficit of 1.5% in 2014, from a previous projection for a 3.0% deficit.

### Key Risks To Outlook

Deflationary risks in the eurozone could derail the ongoing economic recovery and significantly curtail demand for Macedonian export goods. In turn, this could slow the

gradual improvement in domestic demand conditions, preventing higher fixed investment into productive capacity and slowing the recovery in household consumption. Should political tensions escalate and an early parliamentary election over the coming months lead to a legislative deadlock, investors could be spooked, and the fixed investment outlook could prove to be worse than we are already projecting this year.

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Early Elections To Have Limited Political Fallout

Macedonia's coalition government looks set to fall apart over the nomination of a presidential candidate for elections in April, and the dissolution is likely to trigger an early general election. We do not believe that an early election, which we have long suggested looked likely in 2014, will in itself destabilise the country politically. That said, friction with the ethnic Albanian community could rise, making future coalition negotiations more complicated.

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Unresolved Name Dispute And Ethnic Tensions Pose Long-Term Risks

Stalled progress on Macedonia's EU accession hopes and lingering ethnic tensions remain major challenges to the country's long-term stability. Moreover, we note that a deteriorating demographic picture could pose severe economic challenges and exacerbate ethnic tensions as Macedonian society grows more heterogeneous over the coming decades. A lot will depend on whether the government will remain committed to economic and political integration with Europe, which has already driven much of the country's reform progress in recent years.

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Macedonia's economic recovery will gradually shift into a higher gear as stronger industrial activity increases demand for labour and household consumption growth accelerates. For the time being, there is little to suggest that stronger external demand

for Macedonian manufactured goods is driving fixed investment into productive capacity, preventing a more robust recovery. Greater political clarity following what could be an early parliamentary election could see business confidence rise and fixed investment increase. We forecast real GDP growth of 2.6% in 2014 and 2.8% in 2015.

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A sharper-than-expected drop in expenditure in late 2013 saw Macedonia's nominal budget deficit narrow significantly, to 4.0% of GDP, and we believe that stronger economic growth this year and next will see the deficit continue to shrink. With low borrowing costs and a favourable maturity profile, we believe that Macedonia's public debt position is sustainable, with limited risks of instability over the coming years.

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The adjustment in Macedonia's current account has been more pronounced than expected, and an increasingly promising export outlook has encouraged us to reduce our current account deficit forecasts for the coming years. Although stronger import growth over the next few years could derail the narrowing of the country's current account deficit, we believe increased remittance flows will mitigate this impact.

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