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Economic trends in FYROM during and after the economic crisis

Ljupco Daveev

Abstract

The situation in FYROM’s economy after the most difficult period during the economic crisis in 2009 is not giving any positive signal for smooth recovery. Instead, some numbers are predicting more complex period with higher budget deficit, lower consumption, bigger unemployment rate and significantly higher trade deficit. The beginning of 2010 is showing that company’s profitability will be significantly low. It is obvious that the government anti-crisis actions do not gave the necessary results and there is an immediate need for completely new steps. There are some steps that immediately should be taken for better business climate in FYROM. They should be oriented toward improvement of the company’s liquidity in FYROM and promoting investment activities with the same conditions for the domestic and international entities.

Keywords: anti-crisis actions, company’s liquidity, government finance, investment conditions.

Introduction

The real situation in FYROM’s economy is indicating that unfavorable economic trends will continue this year. The dynamics of the decrease in the fourth quarter in 2009 was smoother, but more as a result to the lower comparing base, taking in consideration that the effects of the world economic crisis generate decreased production in the fourth quarter of 2008, and in the first three quarters in 2009.

The industrial production in the first ten months during the last year decreased for more than 10% compared to the same period in the previous year. There are some industrial branches with smooth increase in their production. But, these industries where we have increase in the production, in the same period have increase in the finished goods inventory. For example, in the food industry, decrease in the production of only 2, 6% is not very positive signal, because in the same period inventory increased for 20-30%.

The negative trends resulted with decrease in the import of more than 30% and decrease in the export near to 40%, compared to the previous year. This resulted with 1.608 million US dollars outside trade deficit and covered import by the export of just 54.8%.

Encouraging news are the positive signs given from the economies in the other European countries to which out export is oriented. But, we should not expect that the positive movement in their economies immediately will have the same impact on our economy. According to the experts and managers from the real sector which are directly feeling this situation, 2010 will be extremely difficult due to the period needed for recovering of the economy, taking into consideration high illiquidity and indebtedness of the companies.

South East Europe Countries

The crisis in the countries from Central and East Europe mainly entered via the channels of demand for their exporting products, decreasing the capital gains and significantly negative expectations from their companies.

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initiated from the crisis in the developed countries. Opposing to the good economic results in 2008, in 2009 this group of countries had decrease in the economic activity. The domestic demand was under the influence of the negative expectations: slowing the credit growth in the situation when the risk increase and the places for financing decrease, uncertainty about the future economic trends and absence of bigger investment decisions. Depending on the variation of the economies and the stability of their fundamentals, there is difference in the intensity and speed of entrance of the crisis, which will also make difference in the recovery from the crisis in those countries. Except Bulgaria and Croatia, the external debt of the other countries from this region has regular margins, which is one of the positive reasons why they should smoothly pass the crisis. Speaking separately, the biggest decrease in the economic activity is perceptible in Turkey, about 15% in the first quarter in 2009, but in the second the decrease was half in comparison to the first quarter. In this group of countries, Turkish economy has bigger chances for faster recovery, mainly because of the stable banking system (in comparison to other regional countries), small external debt and diversified base for economic growth. On the other hand, the economic slowdown in Romania, which was 6% in the first and about 9% in the second quarter of 2009, does not give any signal for faster recovery, but longer anemic economic revitalization. This is coming mainly from the long period of low domestic demand, but also from the fact that the financial stability was not very bright point of Romanian economy even before the crisis. The inflation slowdown is noticeable in all the countries from South East Europe, mainly because of the lower pressure from the prices of imported products and the demand. But, in some countries like Turkey and Serbia, the inflation is gravitating around 7-8%, which is comparable to the nominal depreciation of their currencies.

FYROM Economic Situation during 2009

Domestic supply

In the second quarter of 2009, the downturn in the domestic economy sharpened. The annual GDP fall of 0.9%, as it was in the first quarter, increased to 1.4%. The crisis deepened amid further decline in the foreign effective demand (from 4% in the first quarter to 4.4% in the second quarter); however, primarily it was a result of the reduced domestic demand, which was lower by 6.2% in the second quarter (as opposed to the rise of 6.1% in the first quarter). Hence, the economic downturn, initially caused by the reduced foreign demand, was caused by the downward adjustment of the domestic demand in the second quarter. With respect to the quarterly dynamics (second quarter of 2009, relative to the first quarter of 2009), the seasonally adjusted data indicated GDP growth, whereby the trend of quarterly decline in the GDP from the preceding two quarters was interrupted.

Unlike the first quarter, when the crisis was dispersed to several activities, in the second quarter the fall in industry was dominant, while deterioration was registered also in the trade and in hotels and restaurants. On the other hand, a significant improvement relative to the first quarter was registered in the construction and in financial intermediation. The GDP fall of 1.4% also in the second quarter, was significantly lower than the one registered in the countries of the region, of which Serbia registered a decline of 4%, Croatia of 6.3%, and Turkey and Montenegro of 7% and 3.5%, respectively. Only Albania continued with the positive economic results also in the second quarter, when it registered an increase in GDP of 5.3%.

The most significant activity in industry, manufacture of basic metals, continued with the half volume of operations also in the second and in the third quarter of 2009, when a decline of 52% and 45%, respectively, was registered. Nevertheless, certain positive movements in this activity were evident during the end of the third quarter. The increase in the output is in line with the increase in the metal prices on the world markets, and having in mind the expectations about maintaining the prices on the current level, gradual increment in the output is expected also in the forthcoming period. On the other hand, in the second quarter of the year, the situation in the textile industry, activity which employs the biggest number of employees, significantly deteriorated, with lower exports, lower output and number of employees. Certain improvement in the textile industry was registered in the third quarter, when the decline in the exports and output was reduced.

The growing restraint of consumers amid economic crisis, in combination with tightened credit conditions, led to a decline in the private consumption in the second quarter. These movements reflected on the activity in the second most important branch of the economy, trade, which registered a decline for the first time in the past two years. In line with the expected further contraction of the private consumption, it is expected the activity in trade also to decline in the beginning of 2010. In contrast to these trends, managers of the trading entities assess the business environment in next year as better relative to 2009.
After the sudden slowdown in the first quarter, the activity in construction in the second quarter of 2009 returned to the path of high rise, so that the increment in this field contributed significantly to the alleviation of the GDP fall. Thus, despite the crisis, the period of expansion in the construction, which has been present for two years, continued. The main factor behind the intensified construction activity in the second quarter were the high government capital investments, which went up by 6.5%, and analyzed by construction business, the highest growth was registered in the hydro construction. Despite the favorable results, managers of construction companies assess the business condition in the second quarter to be worse than in the previous quarter, and they emphasize the insufficient demand as the most serious restrictive factor for the future. One of the reason why they are pointing this is that government capital investments in the third quarter dropped by 7%.

Aggregate demand

A characteristic of the second quarter of 2009 is the faster decline of the domestic economy, but also the change in the direction of the domestic and net-export demand. Unlike the first quarter, when the decline was a result of the lower exports as a consequence of the lower foreign demand, the main factor of decline in the second quarter was the reduced domestic demand, i.e. the lower private and investment consumption. Such structural changes indicate a process of adjustment of the behavior of the domestic entities, and they indicate that regaining of the confidence will be one of the factors for recovery from the crisis. On the other hand, the larger contraction of the domestic demand relative to that of the foreign demand spilled over in the imports, whose intensive decline is the reason behind the positive contribution of the net-export demand. This can be seen from the graph 1 presented below.

Graph 1: Domestic Demand and Net-exports

Source: State Statistical Office
Budget and Public Consumption

In circumstances of higher nominal growth in expenditures (10.7%), relative to the growth in the revenues (0.3%), in the second quarter of the year, the consolidated budget deficit went up to 0.9% of the projected GDP for 2009 (from 0.5% of the projected annual GDP in the first quarter).

Graph 2: Budget revenues and expenditures

[Graph showing revenues, expenditures, and balance over the years 2000 to 2009]

Source: Ministry of Finance

The growth in budget revenues was entirely a result of the paid dividend of one company. On the contrary, the deteriorated economic condition continued to reflect also on the tax revenues, so that the VAT revenues registered a decline of 14.5%, as a consequence of the inhibited economic activity, while the revenues from the profit tax dropped by 70.4%, partially due to the deteriorated profitability of the companies, but partially also due to the tax relieves which came as part of the anti-crisis measures. On the other hand, the increase in budget expenditures is to a large extent a result of the higher current expenditures (11.2%), primarily of the growth in wages (16.3%) and pensions (10.8%), given the high rise both in the transfers to local authorities (22.3%) and other transfers (27%). Increase was registered also in the capital expenditures (6.5%), which stimulated the construction and investment activity in the economy.

Employment and wages

Despite the annual contraction of the economic activity in the first two quarters of 2009, no changes in the trends were evident on the labor market in the following quarter. Thus, in the second quarter, the upward trend in the employment continued in this market segment, with simultaneous drop in the unemployment rate being registered. The lack of reaction on the labor market can be partially explained with several factors. First, the change in the phase of the economic cycle transferred on the labor market with certain delay. In most of the other economies, where the recession touched the bottom, the adjustment of the labor market already happened, whereas our economy expects the deepest drop to happen in the fourth quarter of 2009 and the beginning of 2010. Simultaneously, these economies characterized with more intensive fall in the economic activity relative to the drop in the FYROM economy. Second, with most of the companies, the decrease in the level of facility utilization was followed with temporary termination of the engagement of the employees, as a consequence of the uncertainty about the character and the sustainability of the effects from the crisis. Simultaneously, the uncertainty on the crisis duration discouraged part of the employers to reduce the number of employees in this phase. These factors were still not enough to explain the improvement of the trends on the labor market, manifested through the growth in the employment, which still can be explained mainly by the growth in the employees in the public administration. However, the fall in the domestic economy till the end of the year indicated to potential worsening in the conditions on the labor market in the area of the unemployment in the following period.
Balance of payments

In the first half of 2009 positive developments were registered on the current account. The effect from the drop in the export transfered on the import demand with more intensive dynamics, and it was intensified with the smaller pressures through the demand as well, which resulted in annual narrowing in the trade deficit. Simultaneously, with the stabilization of the expectations of the domestic entities, the pressures on the domestic currency dropped as well, so since April the net inflows from private transfers registered upward trend. Opposite to this, the global financial crisis still restrains the foreign investors and creditors to make more considerable financial investments, so the annual fall in the net inflows continued in the capital and financial account. In July 2009, the trend of more intensive downward adjustment in the domestic demand relative to the foreign continued, thus narrowing the trade gap. Despite the positive trends, the risks about the recovery dynamics of the global economy and the re-stabilization of the global financial flows were still high. This created uncertainty about the possibility for the domestic economy to withdraw additional capital inflows, necessary for funding the gap in the current transactions.

Inflation

The annual average inflation rate in the third quarter is negative of 1.4%, compared to the 0.6% price cut in the second quarter of 2009. Consequently, the cumulative price change shifted to the negative zone, and in the first three quarters of 2009, the average inflation rate equaled -0.4%. The price cut primarily reflects the high-base effects of the energy and food price component, and the decrease pressures of the import prices and the fall in the aggregate demand. The labor unit costs went up in the second quarter of 2009, as well, given the lower productivity and higher paid wages, but as the demand dropped, no larger inflationary pressures are expected through this channel. The annual inflation rate projections indicate further decrease in the next period, due to the broadening of the negative output gap and the expectations for relatively stable prices of the global products.

Government anti-crisis action

The governments of most of the countries came with anti-crisis actions to smoothly overtake the global financial and economic recession. The same was done in FYROM from the state government. First group of these actions was brought in November 2008 with the fiscal stimulus of 330 million Euros for the domestic economy. The actions, according to the government, were mainly pointed to the companies who have problems with liquidity, but also to help the companies that were in a good condition during the recession. The second anti-crisis actions were brought as eight year program for infrastructure projects with total amount of 8 billion Euros. The idea on the short run was helping the building and construction sector which is directly influencing the economic development, and on the long run to improve the competitiveness of the domestic economy. April 2009 there are another, third, anti-crisis actions which cover 70 steps which can be grouped in 3 segments. The first one is rebalancing the budget, which include change of the asset and liability sides in accordance to the macroeconomic projections and situation on the market. The second one is direct help for the companies with credit lines. This should be especially pointed to the small and medium companies which are either working for the domestic market or are exporting to other foreign markets. And, the third segment is consisted of 54 other steps for support of the companies in the specific fields like faster customs procedures, lower transportation costs for companies and transporters etc.

Economic situation in 2010

It is obvious from the beginning of 2010 that company's profitability will be significantly low. All the steps that will be taken from them for the exit from the crisis will be unsuccessful if there aren't specific actions that will give them the opportunity to work normally. Here, the priority is given to the public sector, which should be of support for the private companies, not just for their rigorous control. It is normal to work according to the obligations given from the laws, but not to produce norms in order to oblige companies to pay penalties. This process must come to an end. There are two steps that are against the interest of the companies and are showing why the government should stop with this process. First, the Custom officials do not accept the custom guarantees from the import companies, which are issued from the banks. This means that the companies that already had guarantees from the banks will have to
additionally deliver funds from their cash flow in order to pay the current customs. This will have significant financial impact on the companies which have to wait from the Custom to return back that funds. Second, on every fifteenth of the month, when the return of VAT should happen, in fact nothing is happening. This means lack of funds for the production companies that should be invested in the current production. It is a big question for the production companies when the return of VAT will be, while in the meantime the state liquidity is contemporary improved.

It is obvious that the budget has a lack of funds to finance the basic obligations. The revenues from the penalties from private entities and companies will cover the shortage to some extent, after which there will be no sources for funds to cover the rest of the government spending. After this, we will be all victims of the forced obligations and penalties for the private companies, coming together with the late return of VAT. With the forced obligations and penalties for the private companies the government should collect 50 million Euros in 2010. Even this is not the biggest problem if the government spends the money for some capital investment, building new factories or highways. All that money are planned for paying the interest rate for the domestic bonds, but also for the Eurobond issued from the government. In fact, the government will finance the banks, domestic and international, with the money collected from the private companies and the real sector in FYROM.

**Actions for better business climate in 2010**

There are some steps that immediately should be taken for better business climate in FYROM. Here are some of them as proposals:

1. **Promoting investment activities with the same conditions for the domestic and international entities.**

   With the intention to assemble as more as possible international investments, the Government brought new measures with the changing of the Law for Technological and Industrial Development Zones, with which there is a possibility for the Government to give support for the potential international investors. As one of the news in this law is 100% relief for the personal tax obligations for 10 years for the international companies that will invest in FYROM, which previously was 50% relief for five years. This is surprising for the business community. One of the basic issues from the economic crisis was the importance of the domestic production in the real sector and the influence it has on the domestic supply. This reason is enough for the government to equalize the conditions for investing for the domestic and international investors.

   It is fact that the international investments are key factor for intensified production without increase of the aggregate spending in the country, which on the short-run will decrease the trade deficit. It is also fact that production increase is in direct proportion with the technical and technological modernization and know-how, which faster will come with international direct investments. That is why there should be a big priority for the Government to intensify the international investments in FYROM. But, the increase of the international investments should not decrease the importance of domestic investments. After all, all business subjects are equal in front of the law and should be equally important for the country.

2. **Actions for improvement of the company's liquidity in FYROM**

   As mentioned previously, the liquidity is among the biggest problems for the companies in FYROM. Very big percentage from the companies has problems with the payment of receivables. This is resulting with everyday problems, accounts blocked, inability to compete for better credit lines etc. Some of the proposed actions are

   - Insuring the short-term inquiries from the domestic buyers on the basis of sold products and services

   There is a possibility for the domestic companies to insure the short-term inquiries from the international buyers after the export is done, but the business sector is trying to have the same condition regardless of the origin of the buyer. With this, the Bank for Support and Development (MBSD) will indicate new service and scan the domestic company which is the buyer for the products of services (same as the international company), after which will guarantee or not that the payment will be done after the specific period.
- Realization of the compensation for the debt obligations between the private and the public sector

On the long run this will regulate the obligation between the private and the public sector that are lasting for years. For this, a new law that will regulate this type of obligations is needed. This law will regulate the subjects which will enter in this type of compensation, type of obligations, their level, way and time of realizations etc.

- Coordinative actions of different inspection officials

Initiation of new Coordinative Body for inspection officials, which main activity will be collecting the data for the companies from different officials and making a data base for the companies, which will shorten the time that inspection officials are spending in the companies.
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