



On the economic effects from the political crisis and the potential growth scenarios in 2017 and 2018

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Finance Think assesses that the latest data on the Macedonian economic trends show the further **negative consequences** of the political crisis on the economy. The first indicator is the slowdown in the gross domestic product (GDP) growth from 3.9% in 2015 to **2.4% in 2016**. Secondly, gross investment recorded a significant decline. Thirdly, credit growth became negative in the last four quarters. Finally, the industrial production volume for 2016 decreased by 1.5% compared to last year. Currently, the only driver of the economy continues to be the construction industry, mainly induced by the construction activities in the country, with recorded annual growth of **18.5%** in 2016.

This FT Comment elaborates in detail these economic trends, and then develops three potential scenarios on which the Macedonian economy can move in the forthcoming period.

- According to the [State Statistical Office \(SSO\) data about the Gross Domestic Product](#), the slowdown of the GDP growth is a result from several components on the production side: mining industry (1% decline), manufacturing industry (2% decline) and the real estate industry (1% decline), compared to 2015. These three branches account for 34% of the overall GDP, indicating that their trends can have a significant impact on the trend of the entire economy.
- **The industrial production** decreased by 1.5% compared to 2015. The decline of the industrial production was largely due to the decline of several manufacturing sectors. Namely, the production of refined petroleum products and the production of basic metals declined by 23% compared to 2015. Additionally, the manufacturing of non-metal mineral products and furniture decreased by 17%, each, while the production of paper and the production of wearing apparel exhibited a drop of 14% compared to 2015. The decline in these industries and in several others is worrying given that the manufacturing industry employs 19% of the overall employed population in Macedonia. This decrease is due to the insufficient and
- [Gross investment](#) **dropped by 4.3% in 2016**. This decrease is predominantly a reflection of the uncertainty in the private sector – the domestic and foreign, in terms of investment, which is a direct consequence from the prolonged political crisis in the country.

reduced foreign and domestic demand, as well as the uncertainty of the economic environment.

- [Fitch Ratings Agency](#) lowered the credit rating of Macedonia from **BB+ to BB**. The main reasons for this decline include **the political crisis, no-elected government and the expected widening of the fiscal deficit**. This is confirmed by [Standard&Poor's last report about the credit rating](#), where the **prolonged political crisis and political uncertainty** prevented the improvement of the BB-/B rating for 2017. These ratings thwart the improvement of the country's outlook at the international financial markets and cause **an increased risk premium, which would result in increased interest rates on future government borrowing on international financial markets, thus subsequently bringing increased pressure on the fiscal deficit, interest rates of domestic bonds and the foreign public debt**.
- The decline in gross investment is also confirmed with the **decreased growth of loans** to the private sector. For the first time in five years, lending to companies decreased. From 7.1% credit growth in 2015, lending declined by 4% in 2016. This indicates that the tendency of the private sector to use loans to finance their investment ventures is reduced, which is a direct reflection of the prolonged political crisis that creates great uncertainty in the private sector.
- **As a main driver of the economy, specifically the maintainer of the economic growth during the crisis in Macedonia, is construction**. According to the SSO's data, growth in construction soared to 18.5% in 2016, which is six times higher the entire GDP growth for the same period. The growth in construction is mainly stimulated by the government's investment activities. The construction in Macedonia slowly approaches the second position in GDP share, exceeding the mining and manufacturing industries. The share of this industry in GDP was 13% in 2016 and levelled with the share of mining and manufacturing industries.
- The SSO's reports show negative assessments about the business tendencies in [construction](#), [manufacturing](#) and [retail](#). In the three industries it is expected that the

number of employees will decrease in the next three months, which is probably caused by the uncertainty triggered from the political crisis.

Undoubtedly, the political crisis has a multifaceted influence over the Macedonian crisis. In this context, Finance Think predicts **3 possible scenarios about the trends of the Macedonian economy** for the upcoming period:

- **Scenario 1:** Finding a compromise on forming a new government between the political parties will continue to be difficult. If forming a government by any party or parties, occurs, the uncertainty will continue due to the instability of such a government. This will cause, to some extent, continuous presence of uncertainty and insecurity in the private sector, and furthering the companies' restraint in planning their current and future investment and development activities. However, the negative effects on the economy can slightly relax due to the possibility of leading a more active fiscal policy (compared to the technical-government situation) and the initiation of certain structural reforms. Additionally, some investment plans of foreign investors can move in a positive direction. In such a circumstance, **Finance Think's GDP growth projection for 2017 is 3.1%**. The growth for 2018 is projected at 3.6%.
- **Scenario 2:** Forming a government might be delayed until the fall of 2017, or even after holding new elections. The potential solution for the political crisis in the third quarter of 2017 represents furthering and strengthening of the uncertainty in the business and institutional environment. The tendency of the private sector to withhold investment activities and spending will strengthen, the lending will further slowdown, and the planning of new jobs will be delayed. The current, already started trend in decreasing the investment activity, followed by industrial production and lending decline, will continue to deteriorate, making the turn to positive trends much more inflexible and lengthier. In such a state, the effects on the growth will be significantly much more negative and **the GDP growth projection may range downward to 2.3%**. The potential positive influences from the political solution

in the fall of 2017 may be noticed during the first half of 2018 at the earliest. Late in the second half of 2018 the gross investments will be able to stabilize without decreasing risks, as well as the lending to the private sector will be able to increase. The industrial production could show improvement, firstly by eliminating the negative growth rates. Additionally, the GDP growth rate in 2018 will be stabilized, but growth will hardly exit the range of 2.5-3.0%.

- **Scenario 3:** Under a reinforced pressure by the international community, the political parties find a robust solution for the political crisis at the end of March 2017 through forming a stable government. In this case, the possibility for stabilizing the Macedonian economy and clearing up the uncertainty in the business environment in the middle of 2017 is

prevalent. The positive effects will be noticed as early as in the third quarter of 2017. In this period, the decline in gross investments and lending to the private sector are expected to stop and there will be a noticeable trend steadiness, there is a possibility of slight positive movement, or spurt of growth. Additionally, the industrial production would stabilize its decline in many of its industrial branches, and would further a more stable path of growth till the end of 2017. With this in mind, the GDP growth in 2017 **will be slightly over Finance Think's current projection and will range from 3.1% to 3.5% for 2017**, while the projection for 2018 will be possible to move up around 4%.