

## I. World Economic Developments

### 1.1. Developed countries and developing countries

Following the economic crisis in Asia, Russia and Brazil in 1997 and 1998, which threatened to escalate into a global financial crisis, in 1999 the world financial markets and the world economy consolidated. The world economy registered a growth rate of 3.0%<sup>1</sup>, which is by 0.5 percentage points above the rate of growth in 1998, but also around 1.0 percentage point below the average rate of growth in the 1990's. The revival of the world economy in 1999 was supported by the strengthened domestic demand and the preservation of the investments at relatively high levels. The main generator of the growth of the world economy was the American economy. Hence, in 1999, the asymmetric distribution of the economic growth between the developed countries was maintained, without any significant changes in the respective rates of unemployment. At the same time, the considerable increase in the oil prices and the prices of other raw materials at the world markets in the second half of 1999 did not generate any significant inflationary pressures which would in turn jeopardize the achieved price stability.

Table 1

Selected macroeconomic indicators  
- developed countries and developing countries -

	GDP (real growth rate in %)			Inflation (retail prices increase in %)			Unemployment (in %)			Current account of the Balance of Payments (in US Dollar billion)		
	1997	1998	1999	1997	1998	1999	1997	1998	1999	1997	1998	1999
World	4.2	2.5	3.0	-	-	-	-	-	-	-	-	-
Developed countries	3.2	2.2	2.8	2.1	1.5	1.4	6.8	6.7	6.5	81	37	-77
USA	3.9	3.9	3.7	2.3	1.6	2.2	4.9	4.5	4.3	-144	-221	-316
European Union	2.6	2.7	2.0	1.8	1.4	1.3	10.4	9.6	9.1	122	87	59
Germany	1.8	2.3	1.4	1.5	0.6	0.4	9.9	9.4	9.1	-1	-4	0
France	2.3	3.2	2.5	1.3	0.7	0.5	12.5	11.6	11.3	39	41	37
Italy	1.5	1.3	1.2	1.7	1.7	1.5	11.7	11.8	11.7	33	20	19
Greece	3.2	3.7	3.3	5.4	4.5	2.3	10.3	10.1	10.3	-3	-3	-3
Japan	1.4	-2.8	1.0	1.7	0.6	-0.4	3.4	4.1	5.0	94	121	143
Developing countries	5.8	3.2	3.5	9.2	10.3	6.7	-	-	-	-62	-77	-56

Source: IMF World Economic Outlook, October 1999

Under the leadership of the economic growth in the USA, the departure of the Japanese economy from recession and the successful macroeconomic stabilization in the countries of East Asia, the group of developed countries registered a 2.8% rate of economic growth, which is by 0.6 percentage points above the rate of growth in 1998. In addition, the rate of growth of domestic demand, as a result of the favorable movements in the USA and Japan increased by 1.0 percentage point and reached 3.5%. Despite the increased demand, the rate of inflation in the developed countries remained almost unchanged compared to 1998 and equaled 1.4%. The increased rate of economic growth in the developed countries led to a slight reduction in the rate of unemployment, which was reduced to 6.5%.

The group of developed countries is of major importance to the Macedonian economy, having in mind the fact the 60.2% of Macedonian exports in 1999 were sold on these markets. In addition, as a result of the geographical location, within the group of developed countries, the Republic of Macedonia has the most developed economic relations

<sup>1</sup> Estimate, WEO, October 1999

with the countries of the European Union (EU), whose share in the Macedonian export of goods in 1999 equals 44.7%. The rate of economic growth in the EU in 1999 equaled 2.0%, and was by 0.7 percentage points lower compared to 1998, which can partly be explained by the lower domestic demand. The rate of inflation in the EU in 1999 was 1.3%, thus continuing the trend of decline. As well as in the previous years, in 1999, unemployment remains the most serious problem for the countries of the EU. Despite the reduction of the rate of unemployment by 0.5 percentage points relative to 1998, it still remained high and equaled 9.1%.

In the Euro-zone<sup>2</sup>, the rate of economic growth was bit higher and equaled 2.1%. In the first year of its operations, the European Central Bank fulfilled its main goal, i.e. the price stability was maintained, with the rate of inflation falling to 1.0%. The rate of unemployment in the Euro-zone fell by 0.6 percentage points relative to 1998 and at the end of 1999 equaled 10.3%.

Within the countries of the European Union, the Republic of Macedonia has the most developed economic ties with Germany, Greece and Italy, which is visible through the share of these three countries in the total foreign trade of the Republic of Macedonia (30.6% of the total foreign trade). In 1999, Germany, where 21.4% of the Macedonian export of goods are sold, achieved rate of economic growth of 1.4%, which is by 0.9 percentage points below the one registered in 1998. The inflation rate in Germany fell to 0.4%, while the rate of unemployment equaled 9.1%, which compared to 1998 represents a decline of 0.2 percentage points, and 0.3 percentage points, respectively. In Greece, a country that absorbs 7.2% of the total Macedonian exports, the rate of growth of the real gross domestic product (GDP) was 3.3%, and was by 0.4 percentage points below the one registered in 1998. At the same time, there was a substantial reduction in the inflation rate, which was reduced to 2.3%, i.e. by 2.2 percentage points below the inflation rate in 1998. The unemployment in Greece increased by 0.2 percentage points compared to 1998 and reached 10.3%. The rate of growth of the real GDP in Italy, a destination for 5.9% of the exports of goods from the Republic of Macedonia, was 1.2% in 1999, which is the lowest rate of growth registered in the EU and almost unchanged relative to the one registered in 1998. The rate of inflation fell from 1.7% in 1998 to 1.5% in 1999, while the unemployment equaled 11.7%, which is one of the highest rates in the European Union.

Some of the main industrial branches in the Republic of Macedonia, for example the textile and the iron and steel industry, rely heavily on the sale of their products on the US market, which in turn explains the economic importance of the USA for the Republic of Macedonia. The share of the USA in the total export of Macedonian goods in 1999 was 11.4%. In 1999, the rate of growth of real GDP in the USA equaled 3.7%, which represents a continuation of the impressive expansion of the American economy, supported by the high level of domestic demand and the increased productivity. In addition, the rate of inflation reached 2.2% (contrary to 1.6% in 1998), while the rate of unemployment was reduced to 4.3%, which is below the level which was considered to be the natural rate of unemployment in the USA.

Following a six-year period (1993 - 1998) in which the developed countries registered surplus in the current account of their balance of payments, in 1999 they registered deficit in the amount of US Dollar 77 billion. This deficit is due to the substantial increase in the deficit of the USA, which equaled US Dollar 361 billion in 1999, while in the previous year it was US Dollar 221 billion. At the same time, Japan and the Euro-zone registered surpluses on the current accounts of their balance of payments in the amount of US Dollar 143 billion and US Dollar 80 billion, respectively.

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<sup>2</sup> Member countries of the European Monetary Union

The macroeconomic performances of the developing countries continued to improve in 1999. This is due to the implementation of the stabilization programs in these countries, the increase in oil prices and prices of raw materials, which are very important export products for the developing countries. It resulted in a rate of economic growth in these countries of 3.5% in 1999, which is by 0.3 percentage points more compared to 1998. In addition, within the group of developing countries, the most rapid growth of real GDP was registered in the Asian countries, led by China and India. The Asian economies recorded a 5.3% rate of economic growth in 1999, which is 1.6 percentage points higher compared to 1998. The lowest rate of growth of GDP among the developing countries was registered in the countries of the Western Hemisphere (Middle and South America), due to the low rate of growth in Brazil and the consolidation of these economies following the crisis in 1998. The average rate of inflation in the developing countries in 1999 equaled 6.7%, which represents a considerable reduction compared to 1998 when it equaled 10.3%.

## **1.2. Countries in transition**

The importance of the countries in transition for the Republic of Macedonia did not change considerably in 1999 compared to 1998. Namely, the share of these countries in the foreign trade of the Republic of Macedonia fell by 0.5 percentage points to 40.8%. In addition, 36.2% of the total export of Macedonian goods was sold on the markets in these countries, which is by 1.0 percentage point more relative to 1998. The share of the countries in transition in the Macedonian exports is expected to increase further more by utilizing the positive effects of the signing of free-trade agreements with some of these countries. The importance of the countries in transition, excluding the countries of former SFR Yugoslavia, for the Republic of Macedonia fell in 1999, which can be seen through the reduced share of these countries in the Macedonian exports by 2.0 percentage points compared to 1998, thus reducing to 6.3% of total exports in 1999. However, despite the relatively low importance of these countries for the Macedonian economy, their performances in 1999 represent a relevant comparison base for the performances of the Macedonian economy.

The average rate of growth of real GDP in the countries in transition in 1999 was positive and equaled 0.8%, contrary to the decline of 0.2% registered in 1998. This turnover is due to the consolidation in Russia and the neighboring economies, which were most severely affected by the crisis in Russia in 1998. At the same time, the average rate of inflation in these countries increased by whole 18.0 percentage points compared to 1998 and reached 39.0%. However, the deterioration of the price stability is not a common occurrence for all the countries in transition, but is due to the disruption only in couple of countries, primarily Belarus and Russia. The deficit in the current account of the balance of payments in the countries in transition in 1999 was reduced to US Dollar 16 billion or 7.8% of GDP, which is by 2.9 percentage points less relative to the previous year. Compared to 1998, the deficit in the current account in 1999 is lower by US Dollar 9 billion, or by 35.9%. This is primarily due to the surplus registered in Russia.

The countries in transition with a relatively higher importance for the Republic of Macedonia, i.e. the countries of Central and Eastern Europe (excluding Belarus and Russia), registered an average rate of growth of real GDP of 1.7%, or by 0.6 percentage points below the one registered in 1998 and by 1.0 percentage points below the rate of growth recorded in the Republic of Macedonia. Despite the fact that conditions for a more intensive growth of real GDP in 1999 were created, the war in FR Yugoslavia, the slowing down of growth in the European Union and the contraction of exports to Russia, limited the economic growth in the countries in transition.

Table 2

Selected macroeconomic indicators  
- countries in transition -

	GDP (real growth rate in %) <sup>1</sup>			Inflation (in %) <sup>1</sup>			Current account of the Balance of Payments (% of GDP) <sup>2</sup>		
	1997	1998	1999	1997	1998	1999	1997	1998	1999
Countries in transition	2.2	-0.2	0.8	28.0	21.0	39.0	-8.7	-10.7	-7.8
Central and Eastern Europe "EU accession countries"	3.6	2.4	1.7	39.0	15.0	9.0	-6.4	-6.6	-6.5
Poland	6.9	4.8	3.5	15.0	12.0	7.0	-3.1	-4.5	-5.5
Hungary	4.6	5.1	3.0	18.0	14.0	9.0	-2.1	-4.8	-5.4
Czech Republic	0.3	-2.3	0.0	8.0	11.0	3.0	-6.1	-1.9	-1.1
Slovenia	4.6	3.9	3.5	8.0	8.0	5.0	0.2	0.0	-0.7
Estonia	10.6	4.0	0.0	11.0	8.0	4.0	-12.1	-9.2	-6.3
Bulgaria	-7.0	3.5	0.0	1,082.0	22.0	-1.0	4.3	-2.3	-5.7
Romania	-6.9	-7.3	-4.0	155.0	59.0	40.0	-6.2	-7.9	-7.0
Slovak Republic	6.5	4.4	1.8	6.0	7.0	9.0	-10.0	-10.0	-5.2
Lithuania	7.3	5.1	0.5	9.0	5.0	2.0	-10.2	-10.1	-5.2
Latvia	6.5	3.8	2.0	8.0	5.0	2.0	-6.1	-11.1	-8.0
Other countries									
Croatia	6.5	2.3	-0.5	4.0	6.0	4.0	-12.0	-7.1	-6.8
Macedonia <sup>3</sup>	1.5	2.9	2.7	4.4	0.8	-1.1	-7.4	-8.5	-3.9

Source:

1/ IMF World Economic Outlook, October 1999

2/ EBRD Transition Report 1999

3/ Data from institutions of the Republic of Macedonia

Average rate of inflation in the countries in transition of Central and Eastern Europe (excluding Belarus and Russia), was reduced from 15.0% in 1998 to 9.0% in 1999, with an acceleration of the inflation being registered in only two countries (Slovak Republic and Moldova). Despite the reduction in the average inflation rate in these countries, it is still far above the inflation rate in the Republic of Macedonia.

The deficit in the current account of the balance of payments of the countries of Central and Eastern Europe (excluding Belarus and Russia) equaled around 6.5% of GDP on average in 1999, which represents a minimal reduction from 6.6% in the previous year. The deficit in the current account of the balance of payments of the Republic of Macedonia was reduced to 3.9% of GDP, and is below the average for the transition economies.

The deficit in the current account of the balance of payments of the countries in transition reflects their need for foreign financial assets for the financing of the intensified investment activity, which is a pre-condition for the closure of the gap between these countries and the developed countries. In conditions of relatively low levels of domestic saving, considerable source of funds for the transition countries are the foreign direct investments. In 1999, the foreign direct investment in the countries in transition reached USD 24 billion (on average around 1.5% of GDP), which is by US Dollar 2 billion or by 9.1% more compared to the previous year. In addition, there are big discrepancies in the distribution of foreign direct investment among the countries in transition with the investments being greatest in the most advanced countries in transition. In 1999, the foreign direct investment in the Republic of Macedonia equaled US Dollar 26 million, or around 0.7% of GDP.

Regarding the European integration process in 1999, the Republic of Macedonia was not included in the group of countries from Central and Eastern Europe which were in a more advanced stage of EU integration (so called EU accession countries). However, analyzed exclusively from the aspect of the previously determined quantitative convergence criteria, in 1999, the Republic of Macedonia fulfilled these, which was not the case with some of the EU accession countries.

Table 3

- convergence criteria for entrance into EMU and developments  
- in the Republic of Macedonia-

Convergence criteria	Values set by the EU	Republic of Macedonia	
		1998	1999
Price stability	at most 1.5 p.p. above the average of the three countries with lowest inflation (2.7% in 1999)	0.8%	-1.1%
Budget deficit	not exceeding 3% of GDP	1.8%	1.5%
Public debt	not exceeding 60% of GDP	47.7%	51.0%
Average long-term interest rate	at most 2 p.p. above the average for the three countries with lowest interest rates (5.8% in 1999)	no comparable interest rate exists	no comparable interest rate exists
Interest rate on credits extended to enterprises	6.7%	20.47%	19.98%
Exchange rate	at least two years in the ERM, without any larger tensions or devaluations	1 DEM = 31.0 MKD (since July 9, 1997 godina)	

Concluding that the Republic of Macedonia has fulfilled the criteria for entering the European Monetary Union, solely due to the fulfillment of the quantitative convergence criteria, would be premature and untrue. The Republic of Macedonia is faced with a process of structural economic reforms which will ensure convergence of the Macedonian economy with the performances of the EU economies, as well as harmonization of the legal framework with the respective one of the EU.