



DG ECFIN

The Impact of the Financial Crisis on the Former Yugoslav Republic of Macedonia

**European Economic and Social Committee
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Overview

1. The financial crisis and transmission channels
2. Impact on the economy
3. Policy response and Challenges
4. The role of the Civil Society



Further information

Background Material:

- EU Spring forecast (excerpt)
- 2008 Progress Reports (Economic Chapters)

Internet sites:

EU Institutions	http://europa.eu/
EU Commission	http://ec.europa.eu/
DG ECFIN	http://ec.europa.eu/economy_finance/

Disclaimer

1. The financial crisis and transmission channels



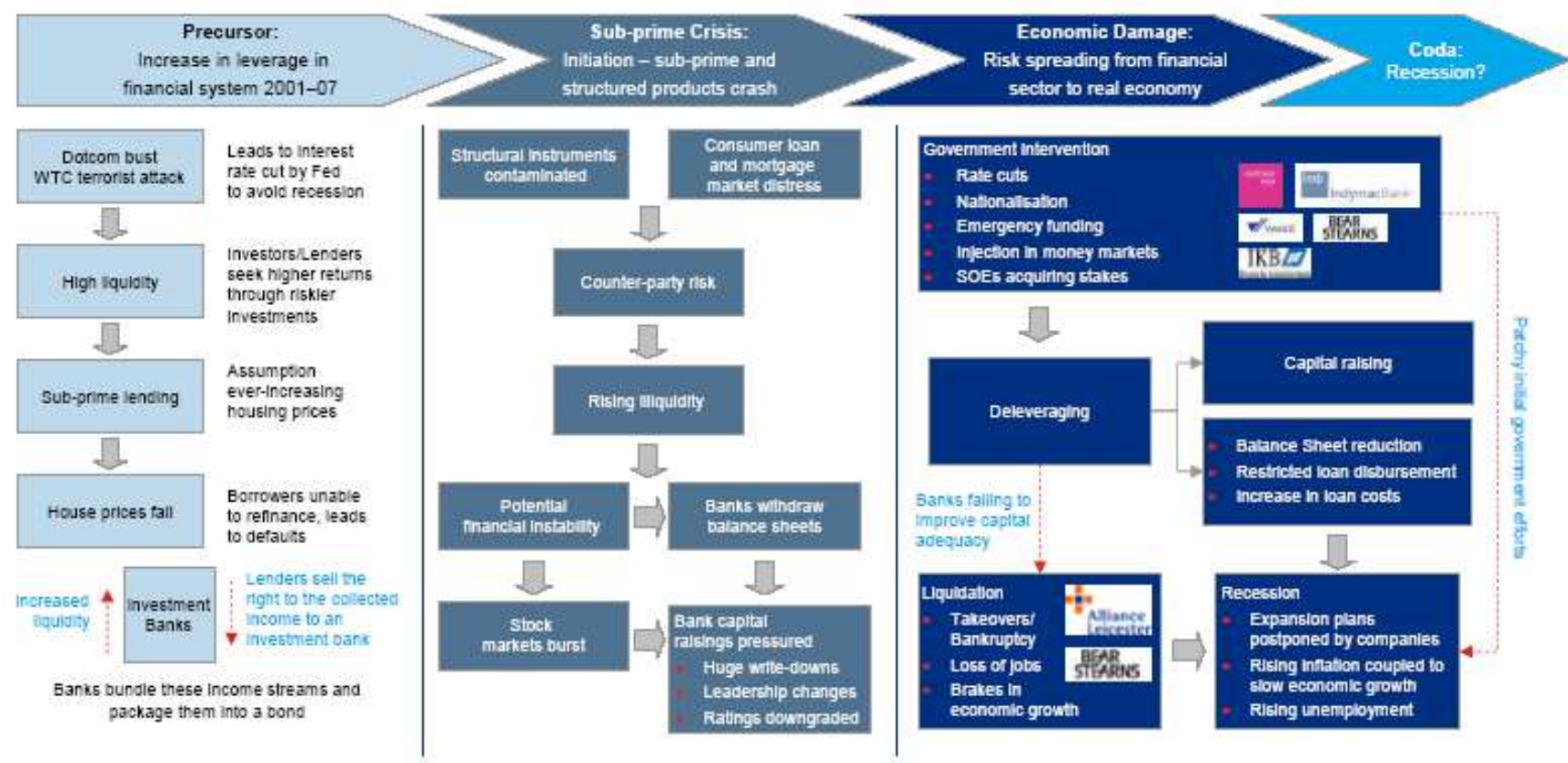


The financial and economic crisis

- Crisis started in 2007 already with problems in US sub-prime mortgage market
- Turned into a major financial crisis in September 2008 (Lehman)
- The following uncertainty (credit squeeze) translated financial market turbulences into real sector problems
- Risk of feedback effects from real to financial sector

Credit Crunch into Confidence Crisis

The sub-prime crisis of Summer 2007 was the catalyst for the broader crisis which followed. It led to a breakdown of confidence in the banking system, and a subsequent lack of liquidity, with bank balance sheets placed under severe stress and deleveraging rapidly while government intervention was uncoordinated.



Source: Citi, Street Research, Factiva.

2 Events to Date





2. The impact of the crisis





2. Impact on the economy: What history tells us

Downturns following a banking crisis (% pts of GDP)

	<i>cumulative output gap</i>				<i>maximum fall in business investment</i>			<i>maximum fall in housing investment</i>		
	<i>year of banking crisis</i>	<i>in downturn following</i>	<i>average of other downturns</i>	<i>ratio</i>	<i>in downturn following the crisis</i>	<i>average of other downturns</i>	<i>Ratio</i>	<i>in downturn following the crisis</i>	<i>average of other downturns</i>	<i>ratio</i>
United States	1988	- 10,5	- 5,0	2,1	- 2,0	- 1,3	1,5	- 2,5	- 1,1	2,3
Japan	1997	- 11,9	- 6,3	1,9	- 5,5	- 4,3	1,3	- 5,4	- 1,0	5,2
Spain	1977	- 28,6	- 16,8	1,7	- 5,0	- 3,2	1,6	- 1,8	- 0,2	7,3
Finland	1991	- 27,1	- 8,1	3,3	- 9,1	-4,8	1,9	- 4,0	- 1,1	3,7
Norway	1991	- 11,0	- 5,2	2,1	- 5,6	- 6,5	0,9	- 3,2	- 1,3	2,4
Ave		- 17,8	- 7,4	2,1	- 5,5	- 3,8	1,6	- 3,5	- 1,0	4,0

Source: OECD 2008

Economic Impact on the former Yugoslav Republic of Macedonia

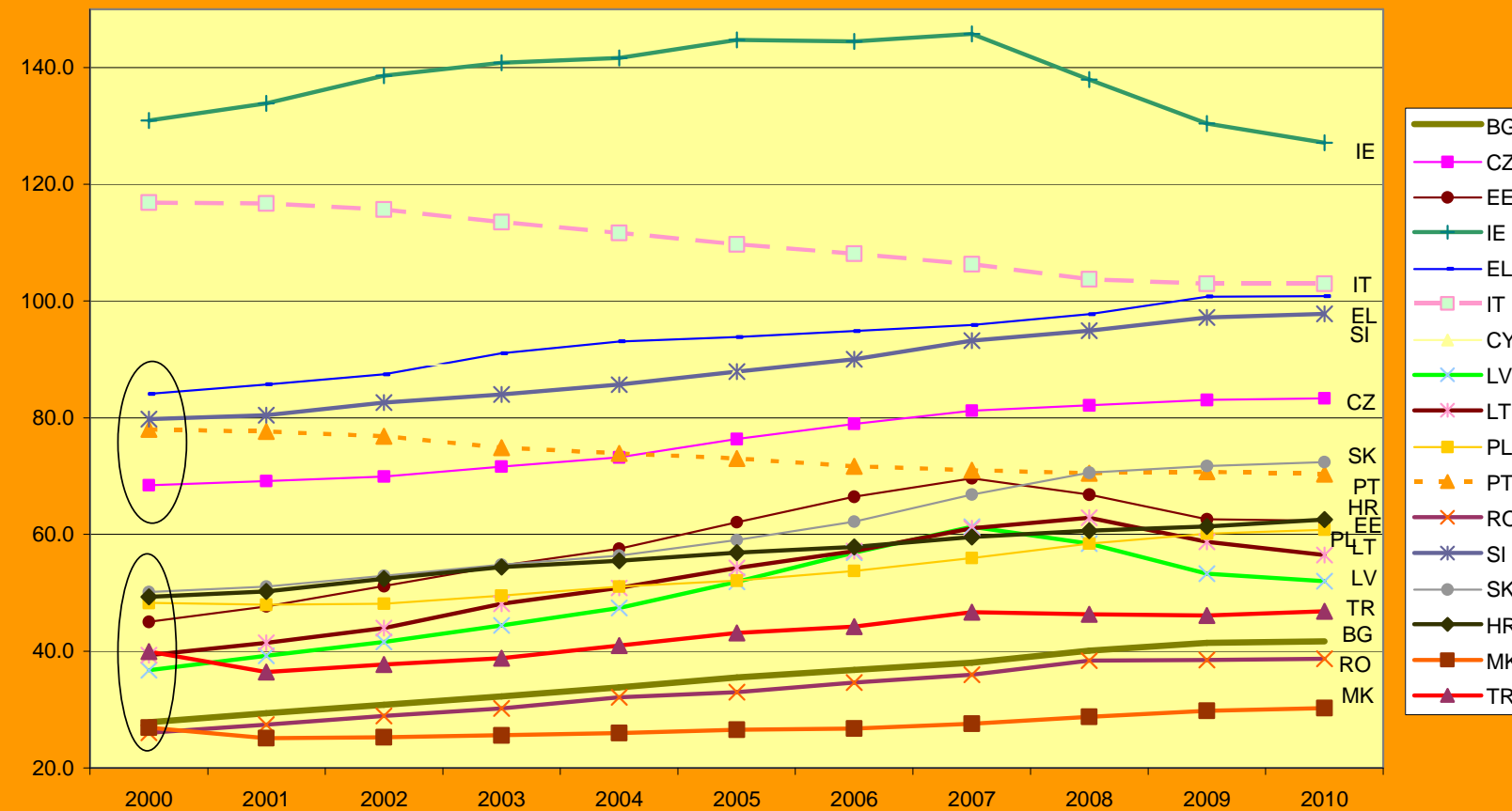
Key features of the economy

- Small open economy (Malta, Baltic countries)
- Export structure highly specialised
- High structural unemployment
- Weak capital base
- Low economic growth



How did the country perform so far ?

Real convergence II
Per-capita GDP, PPS, EU-27 = 100



Source: EU Spring 2009 forecast



Transmission Channels

Countries “import” global crisis through various channels:

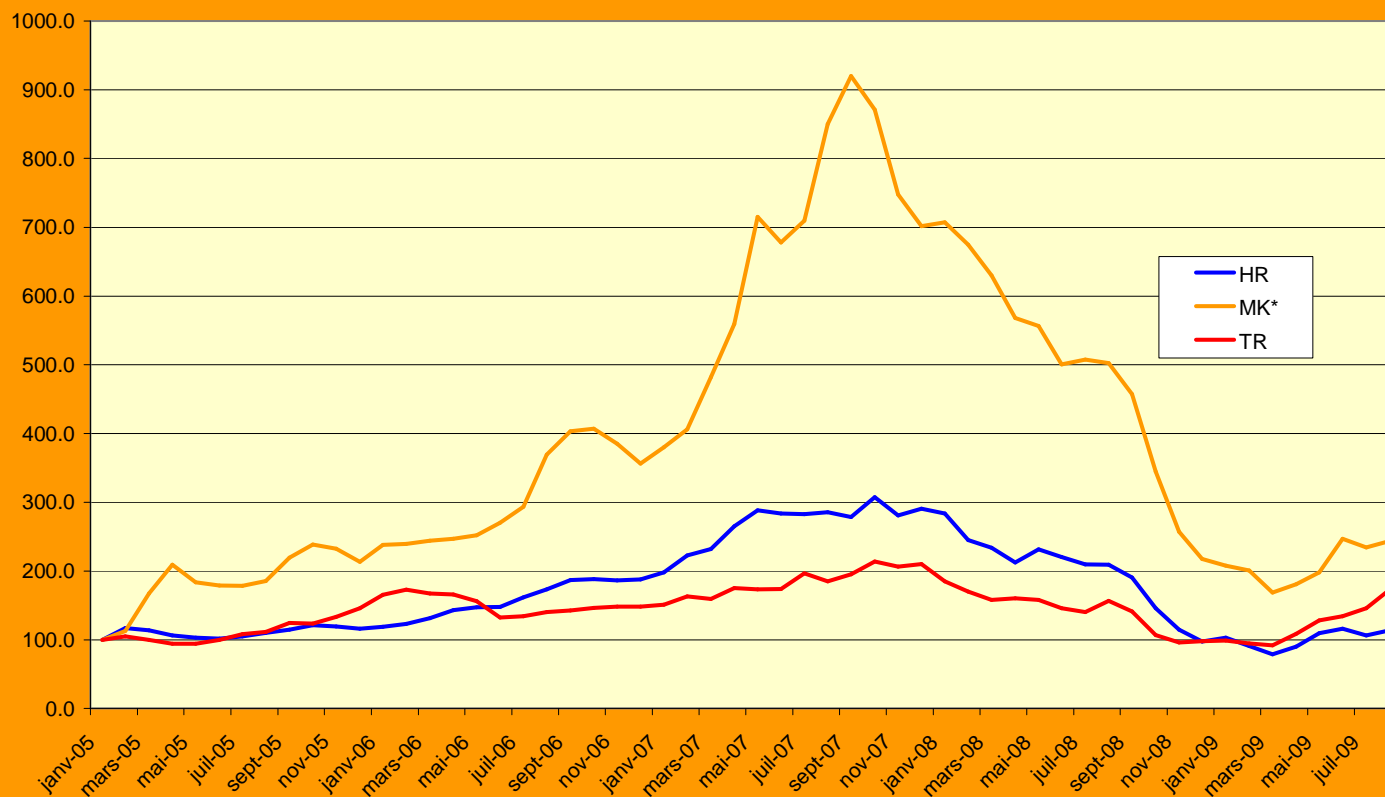
- Wealth effects
- Income effects
- Trade channel



Transmission channel: Wealth

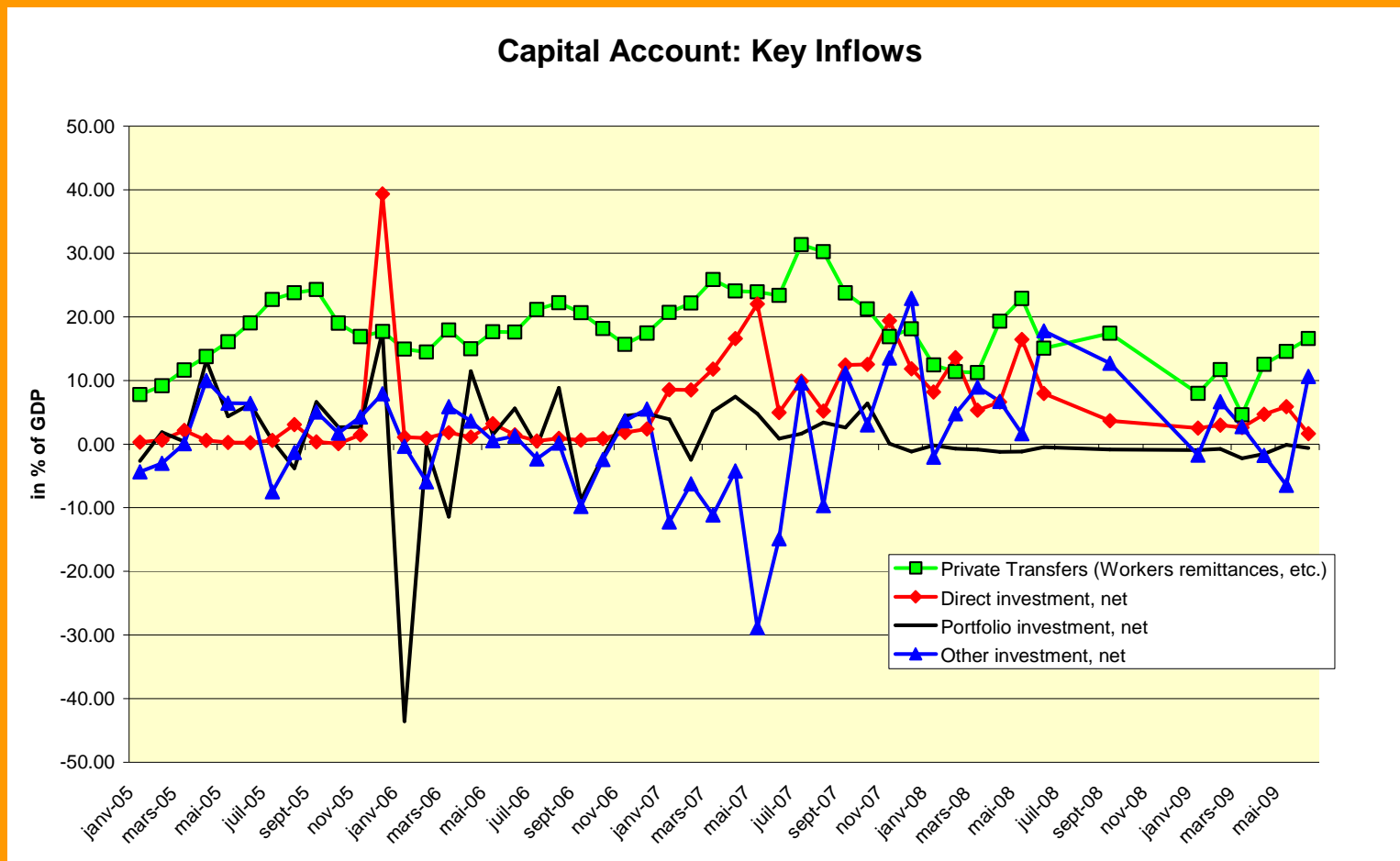
Stock market performance

2005-01-01 = 100



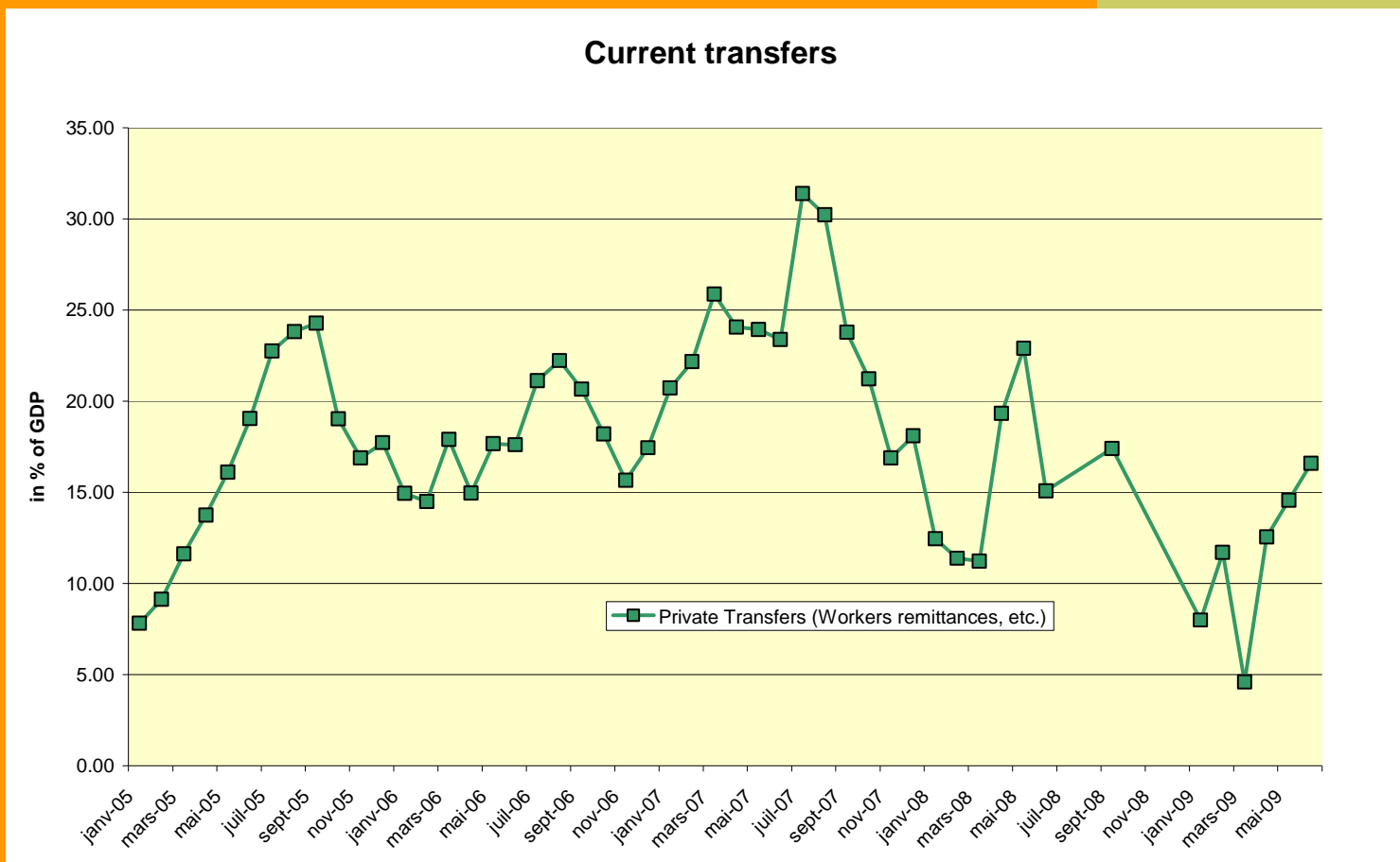


Transmission channel: Capital flows



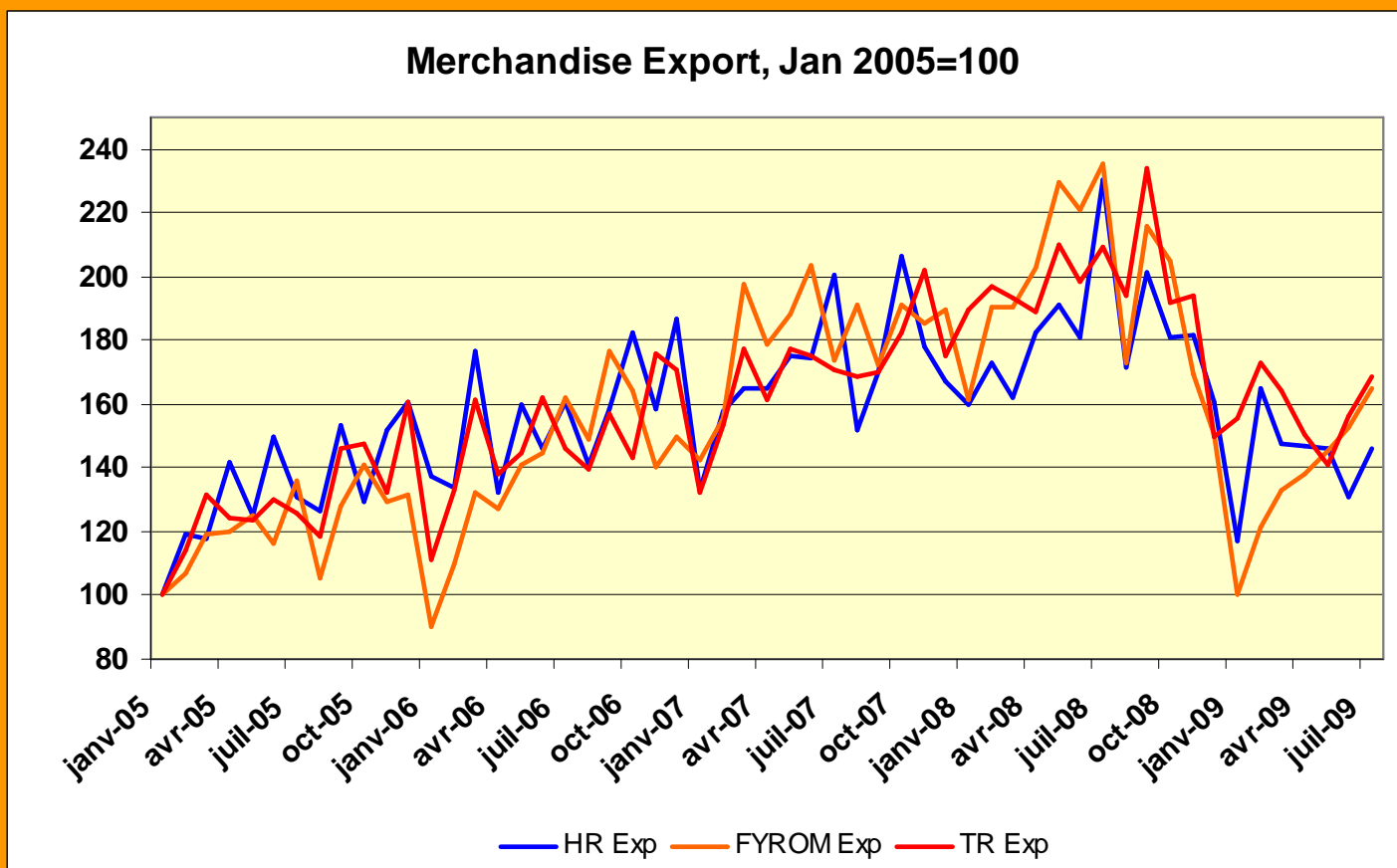


Transmission channel: Income abroad





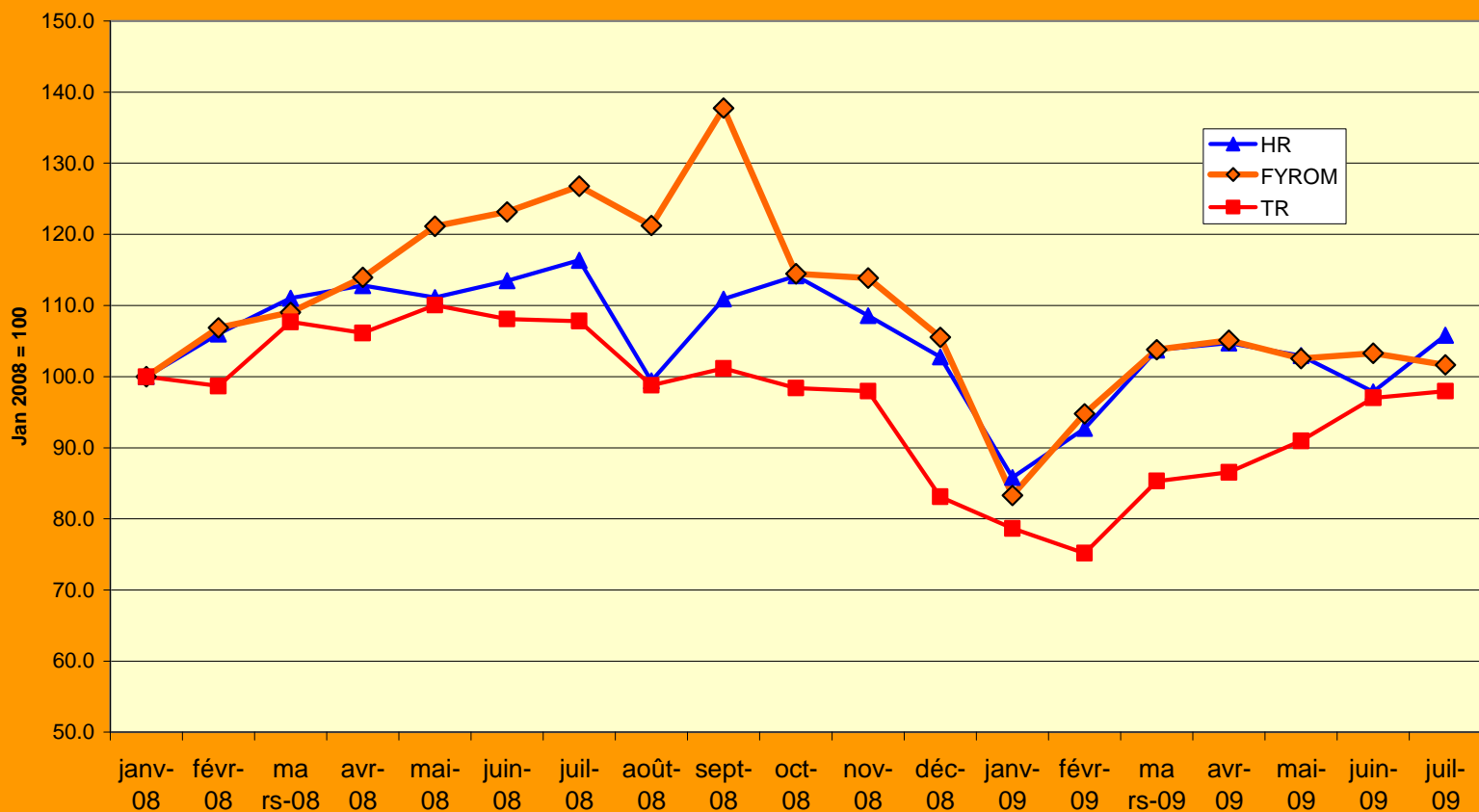
Transmission channel: Trade





Impact on economy

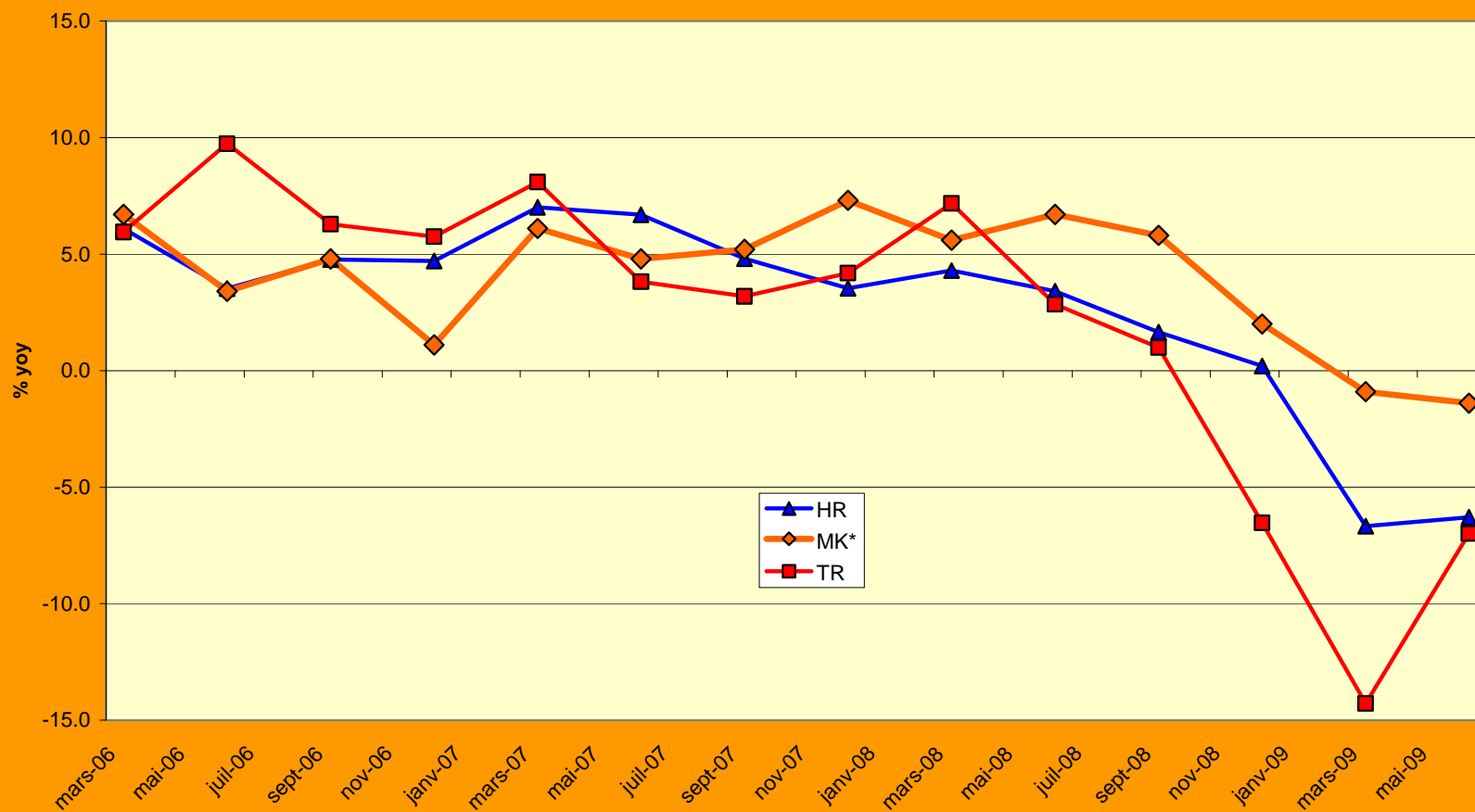
Industrial Production





Impact on economy

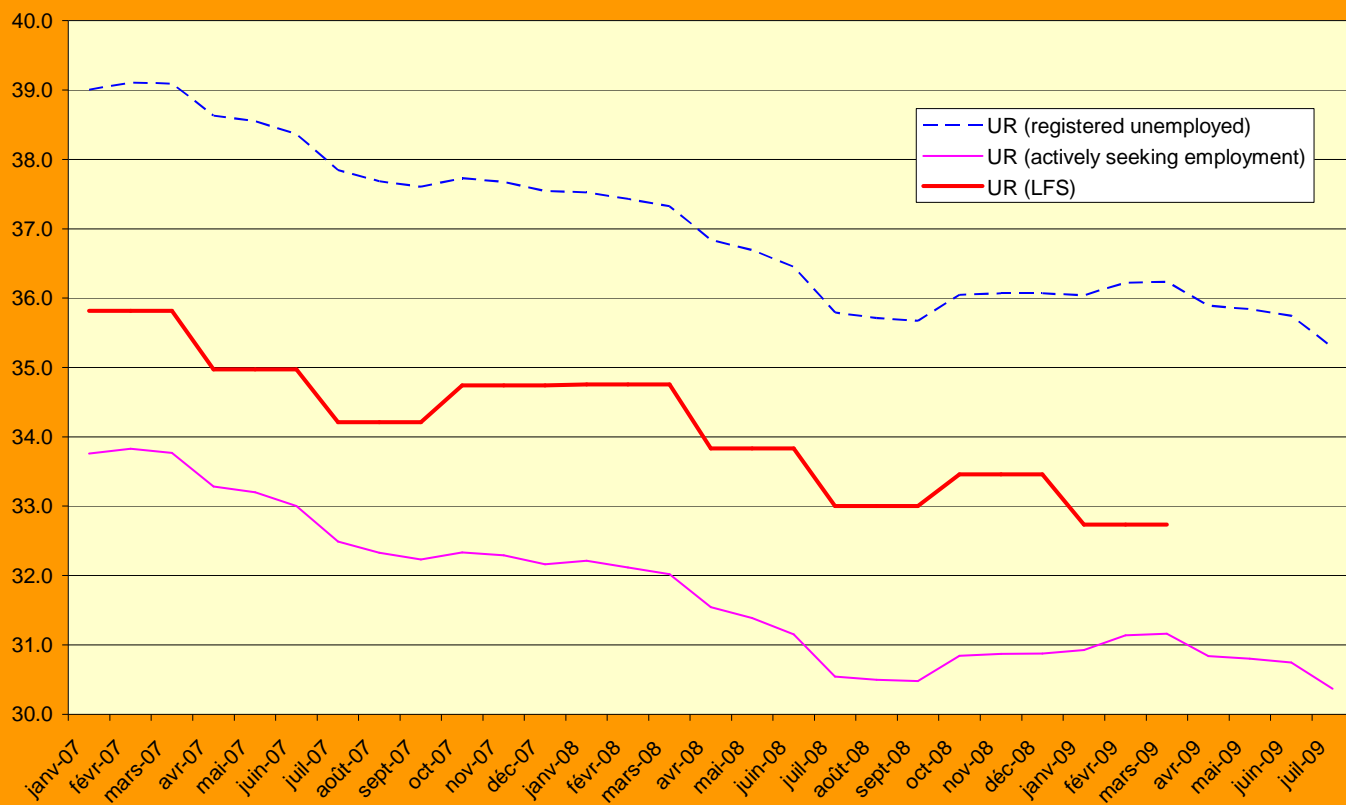
GDP growth





Impact on economy

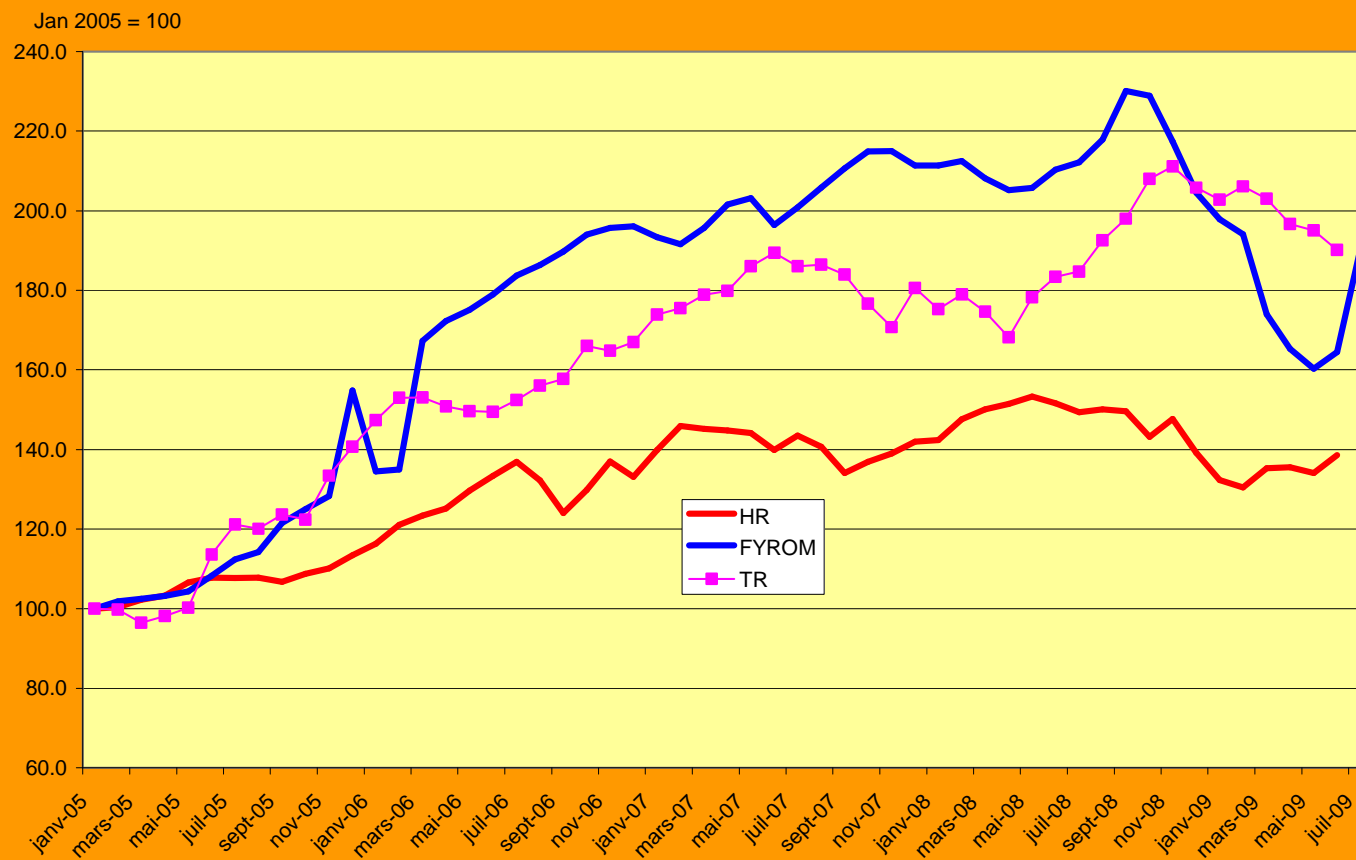
Unemployment





Impact on economy

Foreign exchange reserves





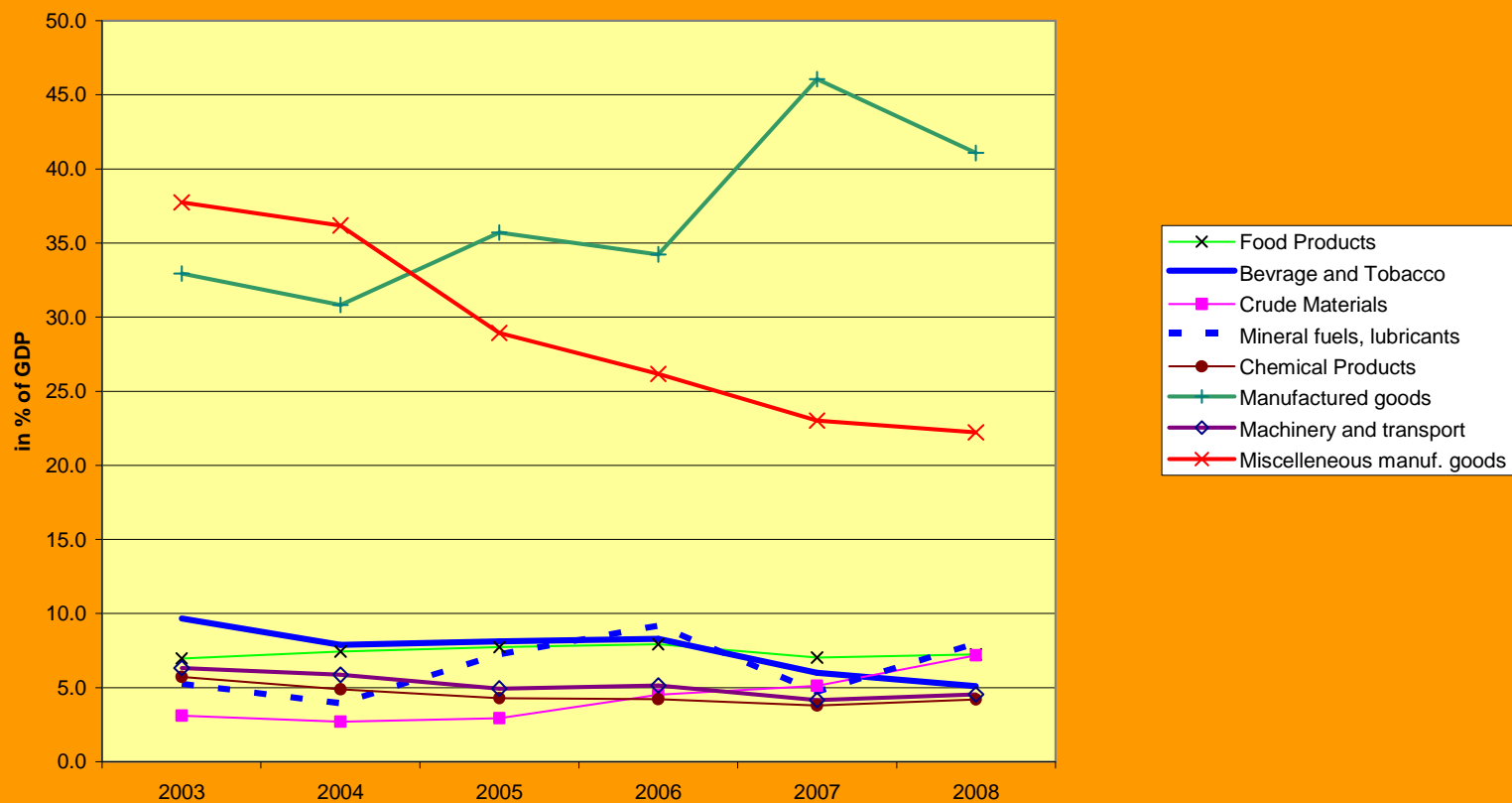
Why not hit harder??

- Statistical illusion?
- Export specialisation?
- Built-in “stability”?
- Government activities?



Export specialisation

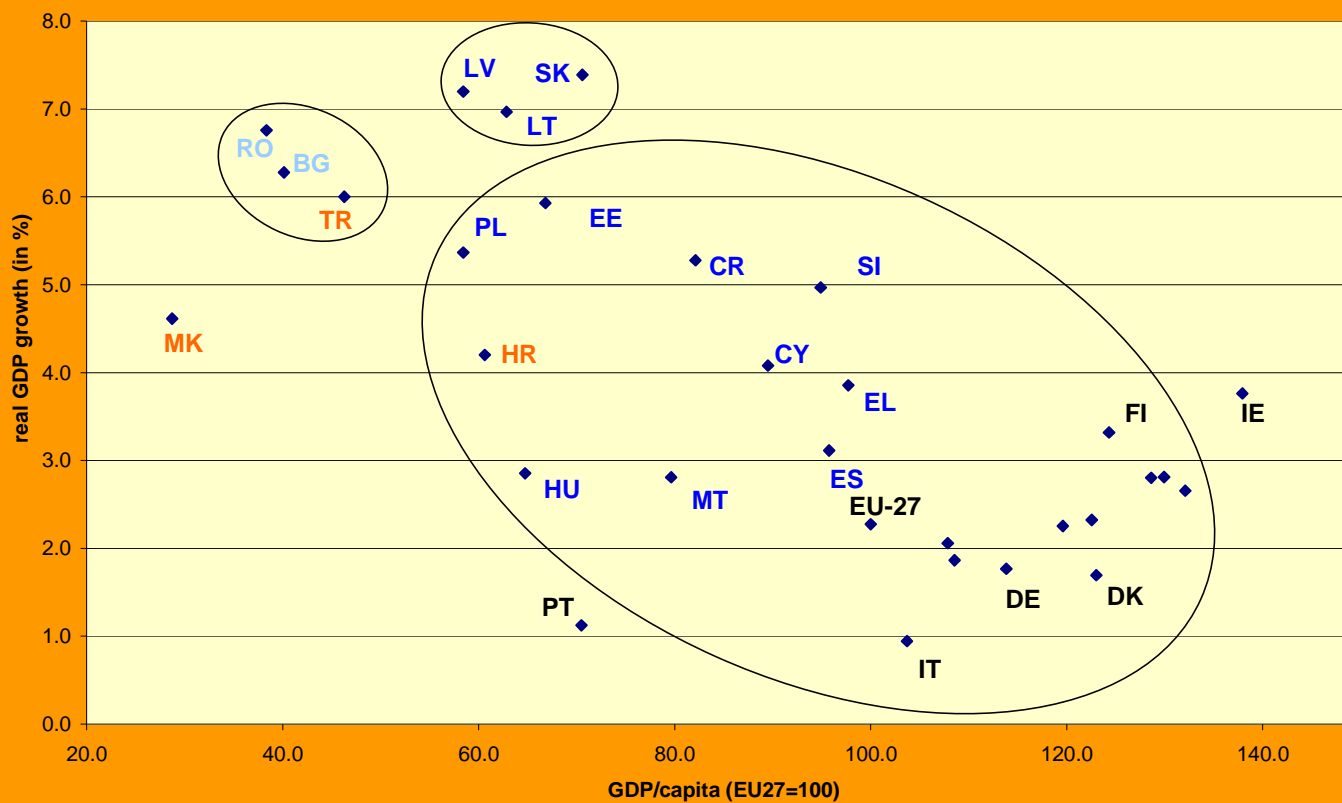
Trade structure
(SITC 1-digit)





Built-in stability ?

Real Convergence (2003-2008)



Source: EU COM services (AMECO database)

Has the policy response kept growth relatively strong?



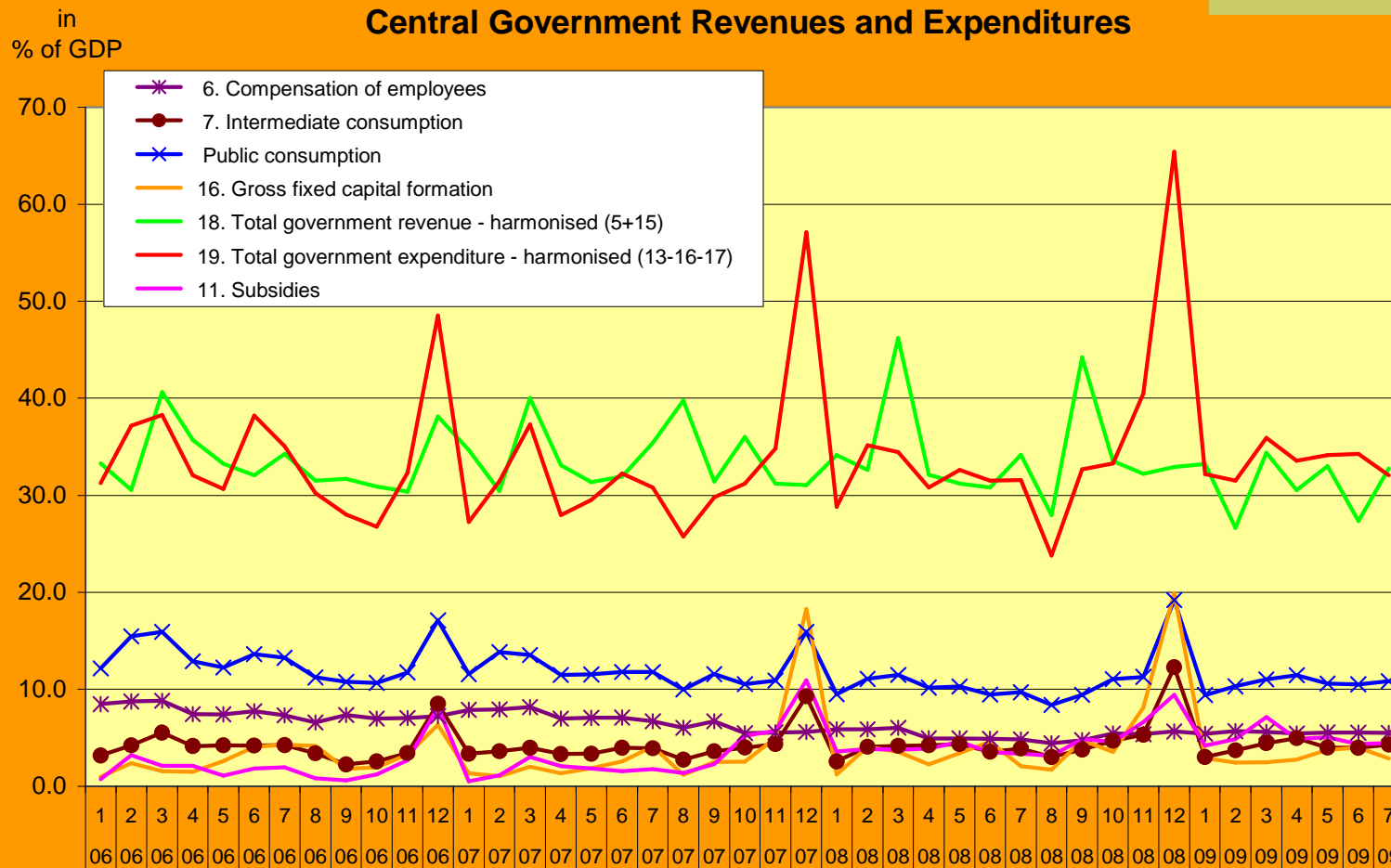


Government Anti-Crisis Measures

- 10 Measures Package (November 2008)
- Updated Investment programme (March 2009)
- Rebalancing budget (April 2009)



Government Spending





Main challenges might still be ahead

- When global recovery will start?
- How it will look like? (V, W, L shape)?
- Consensus increasingly moves towards L shape ...
- Next few years could become quite difficult:
 - low global growth,
 - less capital available,
 - lower remittances,
 - stronger competition from emerging Asia



Key challenges ahead

Below potential growth and high unemployment, resulting from:

- Low investment (physical capital)
 - small home market
 - administrative and regulatory barriers
 - low degree of legal certainty
 - weak regulatory and supervisory agencies
 - outworn infrastructure

- Low education (human capital)

- Weak institutions
 - Government
 - Public administration (highly politicised)
 - Weak communication between main actors (government, trade unions, consumers)



4. Role of civic society

- Social dialogue limited so far
- Experience in some Member States points to the importance of well functioning communication between authorities and civic representations. For example:
 - “Good governance” not possible without dialogue with citizens and various interest groups
 - Positive impact on attractiveness for FDI (social peace, ...)



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Thank you for your attention !