Anita Angelovska Bezhoska: Address – Balkan Business Week

Address by Ms Anita Angelovska Bezhoska, Governor of the National Bank of the Republic of North Macedonia, at the Balkan Business Week, Skopje, 7 June 2021.

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Dear all,

Ladies and gentlemen,

The world economy has been faced with one of the most severe threats ever – a pandemic capable of bringing societies to their knees by threatening their livelihoods and wellbeing. Western Balkan countries, as small and open economies, were not shielded from this global shock, but were caught on a strong footing, amidst solid economic fundamentals and absence of significant disequilibria mirrored in solid growth pattern and moderate inflation. Despite this favourable initial condition, the magnitude of the GDP adjustment was immense, with an average contraction of 6.4% in 2020, which is three times stronger compared to the global financial crisis.

Although it is a common global shock that in a synchronized manner affects all economies, the scrutiny of data reveals notable differences in economic losses, which to a great extent can be attributed to the different sectoral composition of the economies, their pre-crisis vulnerabilities and availability of policy space for reaction to the crisis. The dispersion of growth outcomes ranges from -1% (Serbia) to -15% (Montenegro)[1]. The recession was particularly severe in countries that rely more heavily on services, especially those largely dependent on social interaction, as well as countries with industries closely tied to the European production chains.

Yet, according to IMF estimates, the shock intensity would have been three times higher without unprecedented monetary and fiscal policy support, both in terms of speed and scale, preventing a more devastating outcome and long-term scarring to the economies. Given the lessons learned from the global financial crisis, that is recognizing the risk of self-fulfilling cycles, central banks this time responded quickly, providing ultra-accommodative support such as policy rate cuts from already historically low levels, regulatory flexibility to prevent credit crunch and some of them even experimented with non-conventional tools. In this crisis episode, monetary policy was not perceived as "the only game in town" and since the very beginning, it was coupled with unprecedented fiscal stimulus. Average fiscal stimulus in the region amounted around 6% of GDP, which was twice as low as the global fiscal stimulus, but still on a comparable level with middle-income economies. Consequently, the pre-pandemic fiscal consolidation was ceased and the fiscal deficit hit a record high of 7.7% of GDP. Overall, during this crisis episode, policy response in the region was swifter, bolder and better balanced.

Looking forward to the policy front, one of the lessons learned from the global financial crisis is that the policy support should not be rollbacked prematurely. Thus, the main challenge is how to provide further support for the recovery stage, but without further creation of vulnerabilities on the other fronts. On the fiscal front, emergency stimulus measures have already pushed high public debt to unprecedented levels - 67% on average, exceeding Maastricht criteria, and in some countries reaching up to 100% of GDP. In this context, credible medium-term fiscal consolidation is necessary to rebuild buffers and maintain credibility of public finances which is very important as investors are expected to start more vigorously differentiating countries based on their vulnerabilities. On the monetary front, apart from the conventional side effects of "too loose for too long" stance, as credit conditions remain highly accommodative, the risk of the so called "zombification" emerges. It is argued that this process reduces the overall productivity in the economy by trapping the available resources and hindering the emergence of new, more productive companies. In a nutshell, the general economic conducive policies need to be smoothly substituted with more specific sectoral polices that will facilitate optimal reallocation of resources and thus underpin post-crisis transformation of economies.

Notwithstanding all these policy measures, the Western Balkan economy is projected to rebound by 5.1 percent in 2021, which implies that pre-crisis GDP level will not be reached this year; it will be lower by around 5% in comparison with pre-pandemic forecasts, and the overall loss will not be recouped even over the medium term. This brings us to the fundamental question - to what extent has the crisis affected the potential growth in the region, and what needs to be done to lift it to speed up the convergence which remains low in the region – just 37% of the EU average. Clearly, macroeconomic policies - fiscal and monetary, can play a growth supportive role, especially in the short-run, but they cannot be a substitute for structural policies needed to address structural bottlenecks across all long-term determinants of growth - labor, capital and total factor productivity.

Now let me quickly reflect on the state of play of these long-term determinants of growth.

Concerning labor, the region has been facing constant shrinking of working-age population - 0.5% on average, per year in the last nine years, mostly due to unfavorable demographics and emigration. If we take into account estimates that 1/3 of the emigration is high-skilled labor, then obviously, this is not only an issue of quantity, but quality as well. In this context, Global Competitiveness Report points to a large human capital gap of the region with an index rank of 62.2, compared to 16.7 for EU15. The health crisis emphasized even more the long-standing and burning issues that need to be tackled such as increasing participation rates (that currently hover around 54%), rising life expectancy, skill mismatches, and in particular digital skills and "jobs skills of tomorrow", although given the structural nature of the problem it will continue to weigh on the medium-term growth dynamics.

Concerning capital stock, data reveals that the capital stock in the region constitutes only one third (35%) of the capital stock in the countries of the European Union. This calls for raising investment ratio and closing investment gaps. These gaps are particularly wide in infrastructure, looking at the average rank of 70.5 for the region compared to 16.7 for EU15[2]. However, there is also a great scope for improvements in ICT infrastructure, as a cornerstone of the new economy, in order to accelerate digital transformation of the economies.

As for productivity, it remains low, about 1/3 of the EU average. In the last five years before pandemics, the average GDP growth of the region was 3%, with TFP contribution of merely 0.3 p.p. To increase productivity, the region must tackle structural and institutional obstacles that inhibit efficient allocation of resources. The evidence suggests that institutional reforms in emerging economies are associated with about 1 p. p. a year higher total factor productivity growth compared to "normal" years[3].

So far, FDIs in the tradable sectors are one of the traditional venues that increase productivity that implies not only tapping additional external sources for growth financing, amidst low domestic savings, but also transfer of know-how and technologies. However, pandemics led to significant deceleration of FDIs and trade flows, flagging up many vulnerabilities of international trade and production that caused dilemmas about future globalization trends that are of key importance for small WB economies.

To conclude, the main challenges ahead are twofold. First, a "wise" exit from the macroeconomic policy stimulus in order to strike a right balance between the need to support economies and prevent accumulation of imbalances. Second, shifting the focus back to structural and transformational policies to address deep seated pre–crisis structural bottlenecks, as well as new structural hurdles that will be left as a legacy of the pandemics, which might not be even well known at the current juncture. This is the only way forward towards transformation of the traditional economies into more smarter, inclusive and greener economies.

Finally, when written in Chinese, the word 'crisis' is composed of two characters. One represents danger and the other represents opportunity. I hope that, we have left the danger behind us, and now we will use the opportunities to elevate the wellbeing of our economies.

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[1] IMF WEO, April 2021.

[2] Global Competitiveness Report, 2019.

[3] https://www.worldbank.org/en/publication/global-economic-prospects