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ANALYSIS OF THE EFFECTS OF THE ECONOMIC CRISIS IN GREECE ON THE MACEDONIAN ECONOMY

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Abstract¹⁸

The deep economic crisis which currently is "shaking" our neighbour Greece emerged as a new variable in the predictions and planning of the economic activity along with all the main economic variables in the Macedonian economy. In this study we are attempting to determine the potential effects of the Greek economic crises on our economy, having in mind that our neighbour - Greece - is one of the bigger investors and trading partners of our country. The dominant part - the core of the analysis - will focus on determining the effects of the economic crisis in Greece on: foreign effective demand of Macedonia (two scenarios), threatened export sectors and possible options for reducing the effect on those sectors (case study), the effects on the flows of foreign direct investment, the effect of spreading the crisis outside the Greek economy (Euro zone), and other direct and indirect effects connected with the initially mentioned.

Key words: Greek economic crises, foreign effective demand, export, FDI, Macedonian economy

Introduction

The extended economic crisis in our neighbour Greece arouses great doubt, various expectations and debates about the effects that the Greek economic crisis could have on the Macedonian economy. The economic crisis in Greece initiates various statements and opinions from a variety of sources (ministers, analysts, representatives of international organizations - IMF, etc.), which lead public opinion in different directions, but a study that would dedicate special attention to this problem is not prepared yet. This was one of the reasons for preparing this study based on empirical data that would analyze the effects of the Greek crisis, and will break the doubts about this essential issue. The deep economic crisis which currently is "shaking" our neighbour Greece emerged as a new variable in the predictions and planning of the economic activity along with all the main economic variables in the Macedonian economy. In this study we are attempting

18) The extensive version of this study with comprehensive explanations and analysis is available on: www.cea.org.mk

to determine the potential effects of the Greek economic crises on our economy, having in mind that our neighbour Greece is one of the bigger investors and trading partners of our country. The dominant part - the core of the analysis - will focus on determining the effects of the economic crisis in Greece on: foreign effective demand of Macedonia (two scenarios), threatened export sectors and possible options for reducing the effect on those sectors (case study), the effects on the flows of foreign direct investment, the effect of spreading the crisis outside the Greek economy (Euro zone), and other direct and indirect effects connected with the initially mentioned.

The study is not pretending to go into the analyzing and determining of the size of the crisis, measures for fighting the crisis and economic situation in Greece, - the focus in our study is oriented on the scenario that could affect the Macedonian economy in this turbulent period. Thus, the study should give a realistic overview of the situation (caused by the Greek crisis) that the Macedonian economy could face in the future period, and then present a solid basis for further analysis, debates and considerations that will illuminate one or more aspects of this relevant issue.

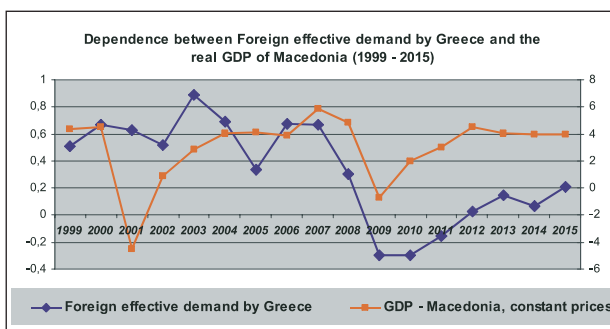
Effects on foreign effective demand

The reduction in economic activity of the most important trade partners of Macedonia negatively affected foreign effective demand, which in 2009 noted a historically deep decline of 3.7%. Collapse of the foreign effective demand was mostly expressed in the first half of the year (4.5%), when we notice the strongest effects of global crisis and the main uncertainty regarding recovery of the global economy. Macedonia as a small and open economy can not achieve good growth rates and operate successfully when isolated from its environment (trading partners and foreign investors). Therefore, the various shocks in the environment are essential for our economy because a small and open economy like Macedonia can easily spiral downwards.

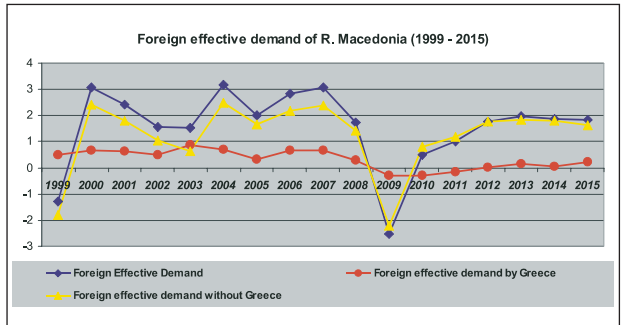
There is a significant dependency and relationship between the rates of GDP growth and foreign effective demand (before the economic crisis, during the crisis and during the recovery period). Therefore the recovery of our major trading partners in mid-2010 will lead to positive GDP and export growth rates. However, economic developments at the moment show that it is still early to take these assumptions without reserve. There is a close link between the movement of the Greek effective demand and the movements of GDP rates in our economy, but it should be noted that Greek effective demand is recovering slower than the growth of the Macedonian economy. This leads to the conclusion that the expected growth in other major trading partners of Macedonia will positively influence the growth rates in the Macedonian economy, despite the prolonged economic crisis in Greece.

The chart below shows that the effective demand by Greece is far below the total foreign effective demand of Macedonia. In the period 2010 - 2011 we can notice a clear difference between

the total foreign effective demand and foreign effective demand without Greece. This leads us to conclude that the reduced effective demand of Greece will affect the reduction of the total foreign effective demand. But it should also be added that the effects of reduced effective demand by Greece have a small and less significant effect on total foreign effective demand. The effects on the total effective demand would be more significant if IMF estimates for Greek growth rates (which we used to determine the total foreign effective demand of Macedonia) take into account the current effects of the economic crisis on the Greek economy.



In order to calculate the strong effect from the economic crisis in Greece, we designed two scenarios (2010 - 2014), which present the effects of the global crisis on the Greek economy and the effects on the Macedonian foreign effective demand. The basis for the design of scenarios are IMF estimates for GDP growth in Greece (World Economic Outlook Database April 2010), calculated without taking into account the Greek economic crisis and the income elasticity of Macedonian exports with a value of 1,5.

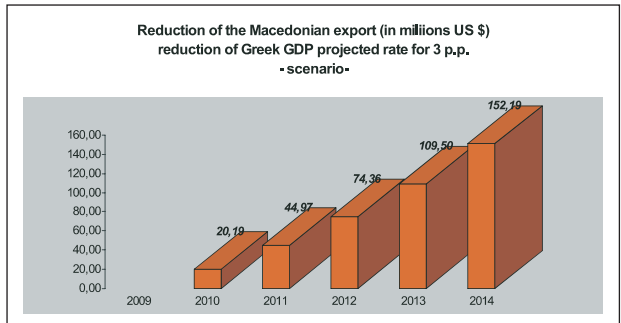


The first scenario predicts reducing the projected GDP rate of Greece by 3 percentage points (each year in the period 2010-2014) at an income elasticity ratio of 1.5.¹⁹

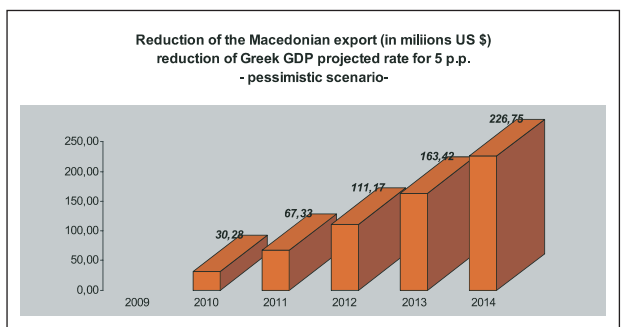
- The analysis shows that the early effects of this scenario are not so significant, but over time if the Greek economy does not start to recover, the effect will be cumulated, leading to a decline of Macedonian export by: 20.19 million U.S. \$ in 2010.; 44.97 million. U.S. \$ in 2011; 74.36 million U.S. \$ in 2012; 109.50 million U.S. \$ in 2013; 152.19 million U.S. \$ in 2014 (which is a significant loss).

The second scenario is quite pessimistic and assumes reduction in the GDP projected rate of Greece by 5 percentage points (each year in the period 2010-2014) at the ratio of income elasticity of Macedonian exports - 1.5.

- The analysis shows that the early effects of this scenario on Macedonian export are modest, but over time if the Greek economy does not start to recover, the effect will be cumulated, leading to a decline of Macedonian export by: 30.28 million U.S. \$ in 2010; 67.33 million U.S. \$ in 2011; 111.17 million U.S. \$ in 2012; 163.42 million U.S. \$ in 2013; 226.75 million U.S. \$ in 2014 (an amount which should be seriously considered).

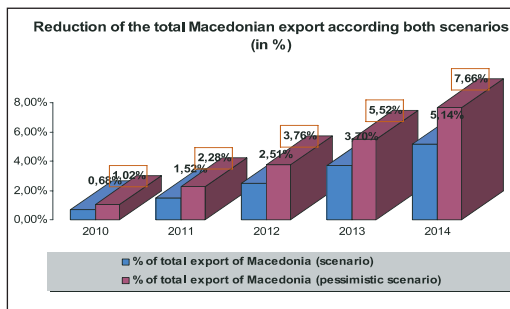
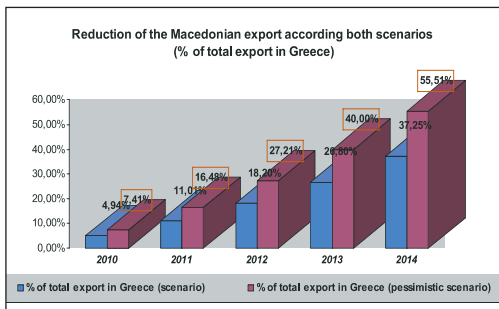


The analysis shows that the reduction of the Macedonian export in Greece according to both scenarios is significant and therefore policy makers should undertake appropriate measures to support the Macedonian companies whose production is marketed in Greece. According to the first scenario we should expect a decline of exports to Greece of 4.94% in 2010; 18.20% in 2012 and a fall in exports for 37.25% in 2014. According to the pessimistic scenario, figures about the decline of Macedonian exports overall are even more negative: a decline of 7.41% in 2010, a decline of almost one third in 2013 and a halving of the exports in 2014 (55.51%).



19) Income elasticity ratio of Macedonian export

The duration of the economic crisis in Greece is proportional to the size of the effects on the total exports of Macedonia. Under the first scenario (projected decline of Greek GDP for 3 percentage points - which is more realistic), the effects on the decline of the total Macedonian exports are small and less significant (a



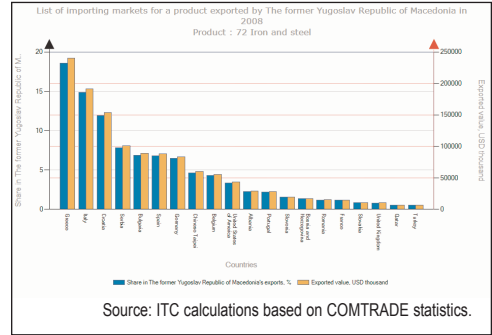
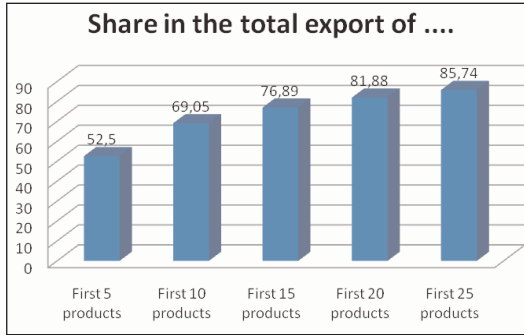
decrease of 0.68% in 2010; 1.52% in 2011; and 2.51% in 2012), but a significant decline of 4% in 2014 and 5% in 2014 - which policy makers in Macedonia should consider and include in their projections. According to the pessimistic scenario (a projected decline in Greek GDP of 5 percentage points), effects on the decline of the total Macedonian exports are: decline of 1.02% in 2010; 2.28% in 2011; 3.76% in 2012, and especially significant is the decline of 5.52% in 2014 and 7.66% in 2014 (which should not cause panic, but should be seriously considered during the creation of the economic policy in the future period.)

The modest effects of the Greek economic crisis on the Macedonian export are results of the estimations (IMF) used in the creation of scenarios which are predicting only decline in the GDP of Greece (negative shock), while the IMF projections of GDP for other economies (which are part of Macedonian effective demand), are moving in the direction of relatively fast recovery and solid GDP growth. Such projections (IMF), assume that growth in other economies will entreat greater import demand, and thus the negative effects of the Greek crisis on the Macedonian export will be absorbed. According to our estimations, the value of lost exports (- first scenario in millions \$ - 20.19 in 2010; 44.97 in 2011; 74.36 in 2012; 109.50 in 2013 and 152.19 in 2014; - pessimistic scenario in million \$ - 30.28 in 2010; 67.33 in 2011; 111.17 in 2012; 163.42 in 2013 and 226.75 in 2014) are not negligible and should be taken into consideration, but should not cause panic or too much concern (taking into account: the level of foreign reserves - 1606.6 million euros Q.1 in 2010., and coverage of imports with foreign reserves - 4.9 months in 2009.) as a factor which could cause any serious/worrisome pressures on the foreign exchange market and foreign exchange rate. On the other hand the exports' decline would have adequate influence over the domestic - export-oriented production, hence negatively influence other economic variables, such as employment and GDP growth. Thus economic policy makers inevitably need to include this variable (Greek economic crisis) in their scenarios and measures of economic policy planned for future periods (particularly in creating appropriate measures for support of Macedonian companies whose production is marketed in Greece (especially the production of steel, iron and textile products)

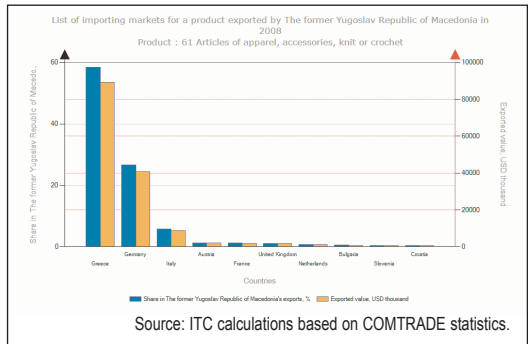
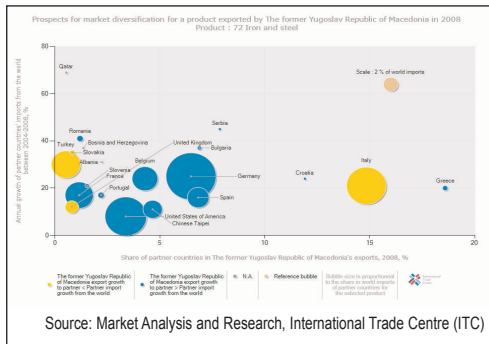
Effects on the major trends in the trade between Macedonia and Greece

Greece is the third largest trading partner of Macedonia and the structure of exported products is quite concentrated. The first five products comprise 50 percent of the total Macedonian exports to the Greek market. Considering that the largest market for Macedonia's two strategic export products, iron and steel, as well as textiles, is the Greek market, it is of great importance that institutions and companies jointly seek a way out of the unfavourable situation.

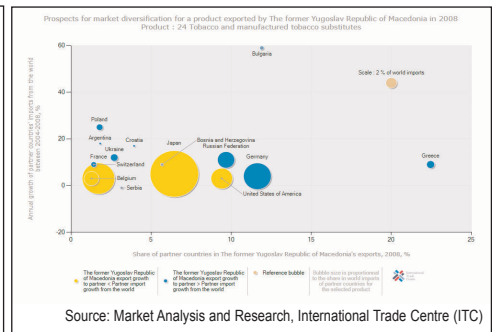
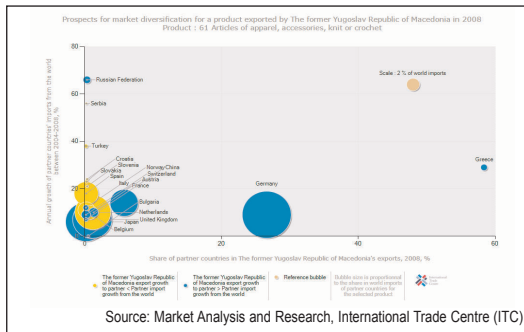
Most critical is the situation with "loan" operations in the textile industry. More attention must also be devoted to exports of products from metal and steel and electrical appliances. Greece is the most important market for these products, and to lessen the consequences of the Greek crisis requires organized support for expansion to new potential markets. This will provide much needed diversification of Macedonian exports.



The largest market for Macedonian iron and steel is Greece, participating with 18.59 percent in total exports of these products. To overcome the consequences of the Greek financial crisis and decrease the demand for iron and steel it is necessary to expand to new markets or to increase the share in the existing fast developing markets. Those with the most potential are: Turkey, Italy, Germany, Slovakia and the countries from the Balkans: Serbia, Bulgaria, Bosnia and Herzegovina, Albania and Croatia.

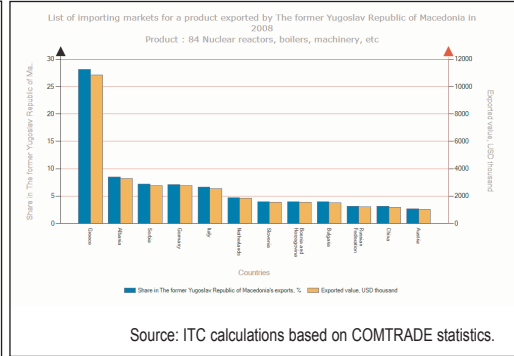
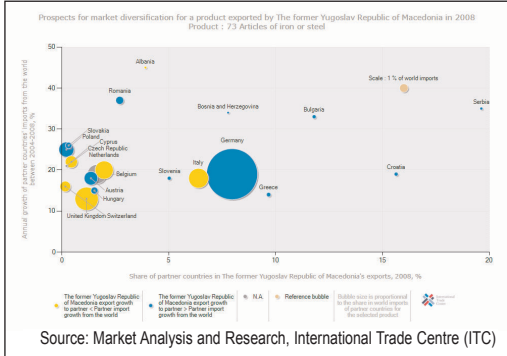


More than half of Macedonian textile products are sold in the Greek market, participating with 58,73 percent in the total export of these kinds of products. Because Macedonian textile manufacturers do not have their own product, expanding to new markets is the biggest challenge for overcoming the consequences from the Greek financial crisis. Macedonia is exporting only cheap labor which has a very small added value. This situation should be used as an additional reason for developing Macedonian final textile products.

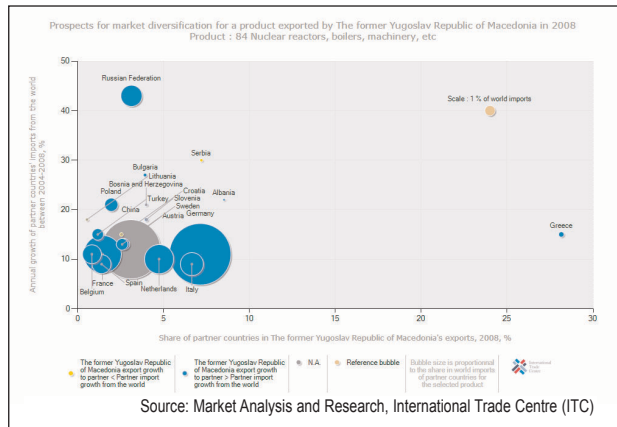


Tobacco is the third most imported Macedonian product to the Greek market. Almost all quantities are exported as a raw tobacco and only a very small part as cigarettes. Almost all export of tobacco is realized by strong global companies such as Imperial Tobacco and Socotab, which in this situation will help in finding new markets for the Macedonian tobacco.

In 2008 Macedonia was placed as a fourth major exporter of articles of iron and steel in the Greek market, with 9,7 percentage share in the total Greeks import. Also, on the national markets of the Balkan countries, Macedonia's export of these products has very positive results. Macedonian companies from this segment are very competitive and with small, well organized support significantly can be increased the export in the Balkan countries and neutralized negative effects of the Greek financial crisis.

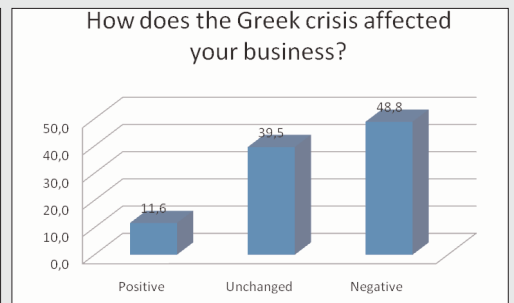
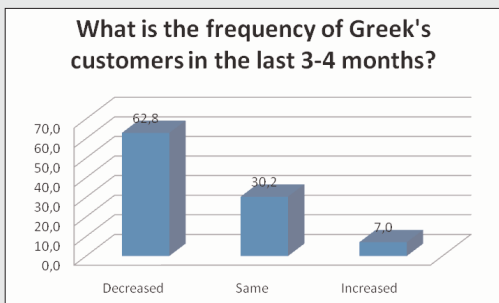


Greece is the biggest importer of electrical appliance (dryer, water heaters, heaters etc) from all countries with share of 28,15 percentage in Macedonian export of this products. Mitigating the effects from the reduction of exports in Greece of these products can be done by increasing the exports in the Balkan countries. This should be easy, because almost in all Balkan countries, Macedonia has seen increased export market share, or more growth in terms of increase in total imports in the same markets.

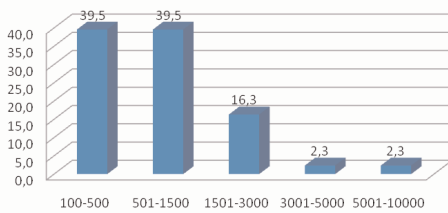


CASE STUDY

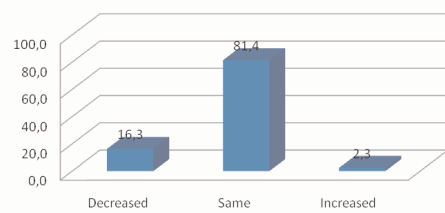
The study was made in Bitola as the biggest Macedonian town in the area of the Greek border. There are negative effects in the cross-border trade in the towns which are located close to the Greek border - Bitola, Gevgelija, Strumica etc. The decreasing buying power of the Greek citizens is decreasing the sales of



How much money Greek customer is spending on one purchase?



What is the impact on the prices level?

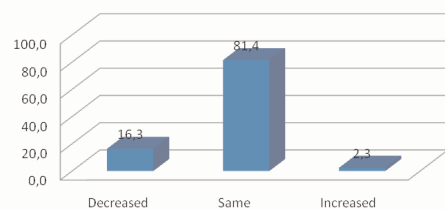


products and services. Restaurants and coffee places from the cross-border places are not having any negative effects, and the only positive effects are seen at gas-stations - because of the lower prices of the gas in Macedonia they had increased sales to the Greek buyers.

A survey in Bitola shows that negative effects from the Greek financial crisis will be experienced by local economies from the cross-border area. Decreasing demand from the Greek customer will

decrease the sales, which will contribute to a decreasing of profits, as a result of which the employment will be decreased which will additionally decrease the demand for products and services. Instead of waiting to see what will happen, there should be efforts made to use this situation as an opportunity. Municipal departments for local economic development, chambers and associations should act for improving the situation. At the least there can be some coordinated promotions, activities, and POPUSTI organized to keep the number of Greek customers, and at the same time to attract new customers from Greece. For more concrete measures there must be made further analyses and assessments of the situation.

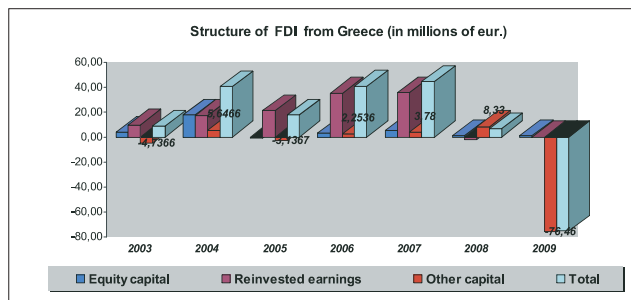
What is the impact on the prices level?



Effects on flows of FDI - Greece /Macedonia

The scenario for FDI flows that we should expect in 2010 and in the upcoming years (which began in 2008 and the trend continues):

- Insignificant inflow of equity capital from Greece, given that a large majority of Greek companies are in poor condition;
- Drastic reduction of reinvested profit (of which the average from 2004-2007 is around 30 million Euro), and consequently an increase in the payment of dividends which will be absorbed by the Greek investors;
- Greek investors will complement the need for additional funds by reducing net inflows on the basis of inter-company borrowing, through higher payments on loans used by parent companies and increased claims based on loans for parent companies;



- Any significant withdrawal of major Greek investments in Macedonia should not be expected, because most of the large investments in Macedonian companies are in a monopolistic or oligopolistic position and these companies realize high and consistent profits;

According to our estimations, the outflow of FDI (foreign currency) in the amount of 75.51 million euros in 2009 are not negligible and should be taken into consideration, but are far from significant (compared with the total annual inflow of FDI) as factors that could cause some serious pressures on the foreign exchange market and exchange rate. Speculation may have even more influence in this direction about the effects of the crisis since speculation can strongly influence the expectations of individuals in our economy. Besides the impact on foreign exchange rate, the effects of lower FDI and in particular reducing the share of reinvested profits may have modest effects on modernization, competitiveness and standard of the companies where the Greek capital is dominant. On one hand, many economies in the world are recovering from the economic crisis, which leads to the assumption that in the future through intense economic activity we could expect FDI inflows from a number of other economies that have pulled out of the economic crisis. On the other, the global economy is recovering slowly, and foreign investors are suspicious that that may delay FDI and contribute to the accumulation of the effects caused by the Greek scenario.

Macedonia covers a small part of Greek investments in the banking sector (in the first place are Romania, Turkey and Bulgaria), but if we observe profitability (ROE) of Greek investments in the banking sector in the region, Macedonia is between second and third place (behind Turkey and Bulgaria). Considering that Greek investments in the Macedonian banking sector are among the most profitable compared to the Greek investments in the banking sector in countries in the region, we should not expect a withdrawing or any other way of endangering the stability and efficiency of these banks. The banking sector in Macedonia is well capitalized, the National Bank closely monitors the situation (capital structure and credit exposure), especially in the banks with a dominant Greek capital, thus we should not expect some seriously negative effects on normal operation in this sector. The only factor that may harm not only the banks with dominant Greek capital, but the entire banking sector in Macedonia are negative expectations and lack of confidence, which can endanger even the performance of the most efficient and most stable banks.

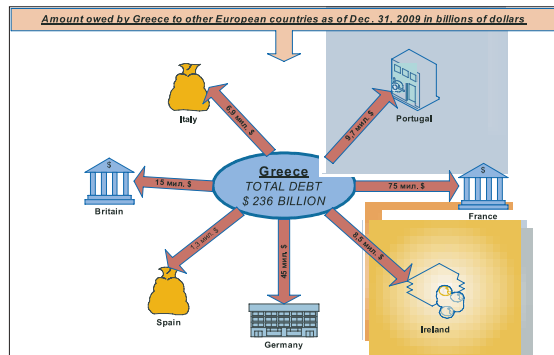
Effects on other economies in the Euro zone

(Major trading partners and investors in the Republic of Macedonia)

When we look at the links "credit - debit" (financial connections) of the economies in the euro area, it is not difficult to notice and conclude that major creditors and policy makers in the European Union were without much choice or "between the hammer and the anvil". Financial integration of the economies in the euro area made the countries vulnerable and susceptible to economic crises that can affect one or more countries which are parts of the euro zone. Rapid transmission of negative shocks from the economic crisis in Greece on the other economies (especially on financial markets) and the lack of defence mechanisms were strong arguments to in the short term adopt a plan and coordinate action in order to help the Greek economy to come out of the economic crisis. Despite a plan to rescue the euro / euro area and the taking other safety measures, there is still a serious risk of spill over the economic crisis in Greece to other economies in the euro area -> a risk that should not be neglected and should be taken into consideration during the creation of economic policies and strategies, especially in small, open and export-sensitive economies such as Macedonia.

If such a scenario occurred - the Macedonian economy whose GDP growth is highly determined / dependent on foreign effective demand will be faced with a decline in exports, FDI, and private transfers, which would further lead to pressure on the foreign exchange market, the decline in production, increasing unemployment (which is currently the highest in Europe) and a significant deterioration of the economic situation in our economy. The effects of such a scenario would have the same direction as the effects of the

economic crisis in Greece (effective demand and foreign trade flows, FDI effects and indirect effects on many economic variables such as GDP, unemployment, exchange rate, prices, etc.), but their effects would be far larger and destructive.



Based on "In and Out of Each Other's European Wallets" od NELSON D. SCHWARTZ, 30 April 2010, The New York Times (Week in Review), <http://www.nytimes.com/2010/05/02/weekinreview/02schwartz.html>

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