Interview

Stephanie Eble, IMF Regional Resident Representative for the Western Balkans

The IMF says we will have an even deeper recession of 5.5% this year

The recession as a result of the severe consequences of the pandemic on the economy is completely inevitable this year, both globally and in the country, but the latest forecasts of the International Monetary Fund (IMF) instill even greater pessimism. Despite the initially expected drop in gross domestic product (GDP) of 4%, the IMF Regional Resident Representative for the Western Balkans, Stephanie Eble, in her first interview with Kapital revealed that the IMF forecasts that the decline in economic activity will reach 5.5%. This is two percentage points more negative forecast than those of the Government or the National Bank. However, the IMF points out that this forecast is extremely uncertain, i.e. it depends on several factors related to public health and economic consequences that are unprecedented and basically difficult to predict. In addition to the latest forecasts of the Fund for the economic situation, Stephanie Eble in this interview talks about the response of the authorities to the crisis so far, the closure of Eurostandard Bank and the stability of the financial sector more broadly, and suggests what should be the next steps for the country to deal with the economic impact of the health crisis.

1. **Based on the latest data available, how do you see the current macroeconomic situation and outlook for North Macedonia?**

Like in all other countries in the world, the pandemic has taken a heavy toll on the economy of North Macedonia, with the biggest impact felt between March and June. The lockdown, which was necessary to address the health emergency, coupled with a sharp drop in foreign demand and remittances, triggered a sizeable contraction in economic activity in the spring. It is important to note, though, that the timely policy measures taken by the Government and the National Bank of the Republic of North Macedonia (NBRNM) have counteracted the negative impact on the economy.

More recently, high-frequency indicators such as industrial production and retail sales are showing signs of improvement, although it is clear that the situation remains difficult.

2. **How realistic is it for the Macedonian GDP to fall even more than the current forecast of 4% in 2020, given the fears of a new wave of infection in the fall?**

We forecast that North Macedonia’s economy will contract by close to 5½ percent in 2020. This is unprecedented, but less than projected for the European Union, for example. We expect this contraction to be followed by a strong rebound in 2021. However, the uncertainty around the forecast is unusually large as it relies on public health and economic factors that are unprecedented and inherently difficult to predict.

Overall, we see risks to the forecast as broadly balanced. On the one hand, successful implementation of the main WHO recommendations to avoid the spread of COVID-19, but also progress with vaccines and treatment could allow for a stronger rebound, globally and in North Macedonia. On the other hand, a large wave of new infections as you suggest, or slower-than-anticipated progress on vaccines and treatment, could lead to worse growth outcomes

3. **What is the regional context of the crisis, how do the countries from the whole region "swim" in these waves of crisis and where do you see North Macedonia compared to the other neighboring countries?**

The entire region has been heavily hit by the crisis, albeit to a lesser extent than advanced economies in Europe. In our latest World Economic Outlook update, published in June, we projected real GDP in the European Union to drop by more than 9 percent in 2020, compared to 5½ percent in the Western Balkans.

Within the Western Balkan region, North Macedonia's GDP growth of 0.2 percent year-on-year in the first quarter of 2020 was below the regional median of 0.8 percent. The GDP contraction in the second quarter was sharp in North Macedonia, but in line with expectations, but we expect the economy to start rebounding in the third and fourth quarter. While we do not yet have second-quarter data for most other Western Balkan countries, the GDP contraction for the year as a whole is expected to be broadly in line with the Western Balkan region.

4. **How do you assess the policy response by the Government and the NBRNM toward the Covid-19 pandemic?**

Both the Government and the NBRNM have played an essential role in mitigating the economic and social impact of the pandemic.

The Government acted swiftly to implement temporary measures to support firms, protect jobs, and assist those most in need. The private sector wage subsidy has likely contributed to containing unemployment, which remained at about 16 percent of the labor force in the second quarter. Measures such as tax deferrals, loans at favorable terms, and sector-specific support have helped keep firms afloat. The social assistance schemes and cash vouchers have protected the most vulnerable. We encourage all governments to track crisis-related spending and make it subject to ex-post controls to ensure that resources have been spent well.

Thanks to the adequate level of foreign exchange reserves and subdued inflationary pressures, the NBRNM had policy space, which it used effectively to support the economy. More specifically, it has cut its policy rate and reduced the amount of central bank bills, which has helped limit the rise in borrowing costs and injected liquidity into the economy. As a consequence, credit growth remains solid, at above 8 percent annually in July. The monetary policy actions have been supplemented with measures to support the financial sector, including a temporary revision of certain credit risk regulations that has permitted banks to restructure loans and thereby provide temporary relief to borrowers that have been affected by the pandemic.

5. **What is your view on the Central Bank's decision to withdraw Eurostandard Bank's license? What should be the next steps?**

The NBRNM is an independent institution and is mandated by law to contribute to the maintenance of financial stability and to protect depositors' interest. As suggested by international best practices, the NBRNM's duties and powers include revoking a bank's license when it fails to comply with the conditions to keep the license —including not acting upon corrective measures issued by the NBRNM within a prespecified timeframe. In the case of Eurostandard Bank, the license revocation decision came after the NBRNM had ascertained that the bank's capital fell to a very low level that did not permit it to continue its operations—a decision taken to protect the interest of depositors and financial stability.

The immediate priority should now be to ensure the timely payout of insured depositors and maximize the asset (of this bank) recoveries via a transparent bankruptcy process.

6. **How do you assess the stability of the overall financial system after the closure of this bank?**

The latest set of banking sector data show that the system is well capitalized and profitable. The total capital adequacy ratio at end-June 2020 stood at 17 percent, more than double the minimum regulatory requirement under the globally adopted standards of Basel III. Non-performing loans have also continued to decline and are at relatively low level of 4.5 percent of total loans. Yet, amid the economic downturn due to the pandemic, the supervisor needs to remain vigilant about any system-wide deterioration in loan quality.

The closure of Eurostandard Bank also indicates clearly that, when needed, the NBRNM is ready (capable of) to taking/e timely corrective supervisory actions to ensure the overall stability of the financial system, which is reassuring. Still, reforms to further strengthen the financial sector safety net should continue. Such reforms could usefully include enhancements of the existing bank resolution framework, including by broadening the scope of the NBRNM's resolution toolkit. A further strengthening of the deposit insurance system should be a priority.

7. **What should be the fiscal policy priorities for the new government to ensure a sound and equitable economic recovery?**

Addressing the health crisis is clearly a top priority and will be essential for safeguarding the economy and public finances.

Another important anchor for economic policy in the next months will be to revive growth and job creation. This will also be critical to reverse the increase in poverty. Given the limited fiscal space, measures to support firms and households should be well-targeted, temporary and transparently implemented to maximize their impact and ensure that public funds are well spent. In practice, the Government could usefully build on the stimulus measures that have already been put in place, such as the wage subsidy, subsidized loans, and expanded use of existing social safety nets. Higher investment spending can help boost growth in the near term, while also strengthening the economy's long-run growth potential by increasing physical and human capital.

Once the recovery is on a firm footing, the Government should aim to rebuild fiscal buffers to preserve debt sustainability. The efforts could primarily focus on raising revenues, by strengthening the revenue administration to bring in the informal economy, rationalizing tax exemptions, and implementing the personal income tax reform. On the expenditure side, we recommend fully implementing the pension reform and rationalizing agricultural and other subsides, which would provide space for higher capital spending over time, supported by improvements in the management of public investment.