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# Quarterly Outlook

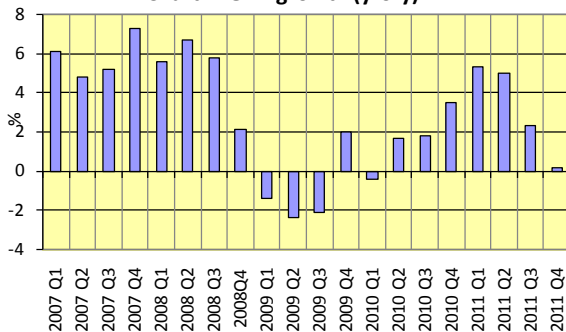
Volume 2, Issue 4, Q4-2011

## 1. The real economy<sup>1</sup>

Macedonian economy exhibited considerable slowdown in Q4-2011 to 0.2% from 2.3% a quarter ago, which resulted with an overall 3% growth for 2011. The slowdown reflects both the higher calculation basis from the previous year, but also the current deceleration of the external demand, associated with the developments on the European debt market. The growth rate is slightly below the UACS Quarterly Outlook projection of 3.5%, as a result of the relatively weaker demand, all by households, government and non-residents. Still, the projection is in line with the expectation of pronounced downside risks.

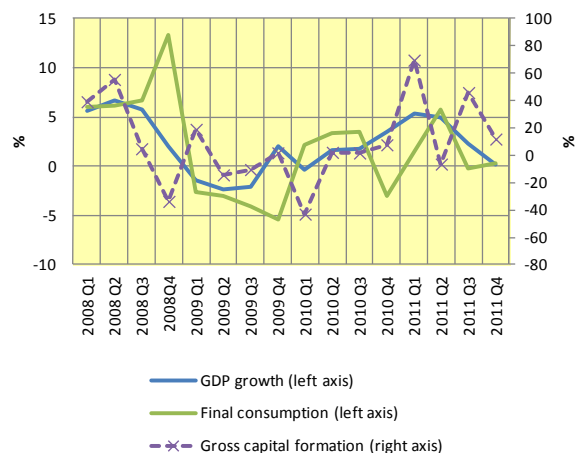
Economic activity deceleration and the withhold of consumer confidence resulted in a modest household consumption growth of 1.6% in Q4-2011. Government stimulus, despite the maintained execution of capital expenditures, continued to fade out (-4.8%) (chart 2). However, government investment activity likely dragged up the entire investment by 12%. The still volatile growth of capital formation yet highlights the still-present risk of double-dip of the economy and further generates substantial loss in confidence among both households and firms. The latter may in turn postpone any likely consumption and investment expenditure.

Chart 1. GDP growth (y-o-y)



Source: State Statistical Office (SSO)

Chart 2. Growth of GDP and its components

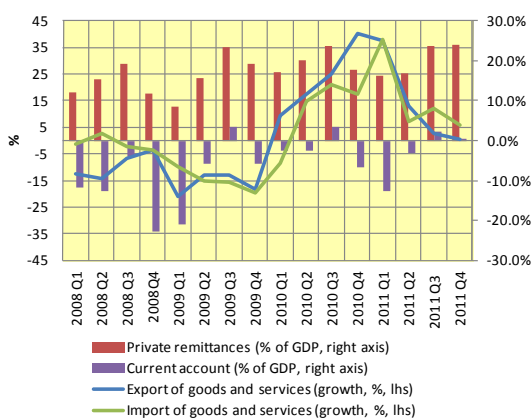


Source: State Statistical Office (SSO)

<sup>1</sup> **DISCLAIMER:** As educational and research institution, UACS does not formulate its own opinions on the economic policy. Hence, although by far balanced, any opinions expressed herein are solely those of the editorial team and not of UACS.

**Q4-2011 marks a small current account surplus of 0.6% of GDP mainly due to the maintenance of private remittances (23.9% of GDP).** However, the trade deficit deepened by 3 percentage points at the quarterly level and stood at 20.6% of GDP, largely as a result of faster growing import (5.7%) than export (0.5%). The persistent uncertainty in the euro zone presently further creates the largest risk for the future engine of Macedonian export, given the large openness of the Macedonian economy (128.2% of GDP in Q4-2011).

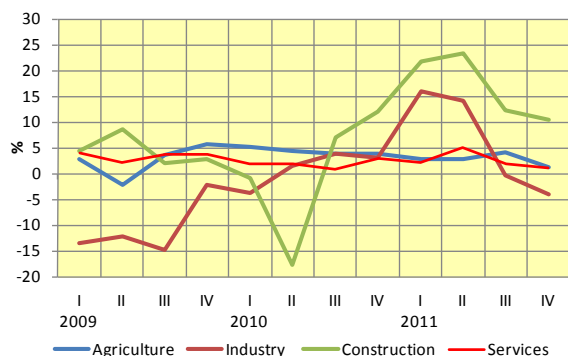
**Chart 3. Foreign trade**



Source: SSO and National Bank of Macedonia (NBM)

**Given the overall slowdown in Q4-2011, agriculture growth decelerated (1.1%), while industry went deeper negative (-4.1%).** Construction, mainly enforced through the government construction that started earlier, maintained its growth at 10.4% and likely pulled the economy out of a more serious dip.

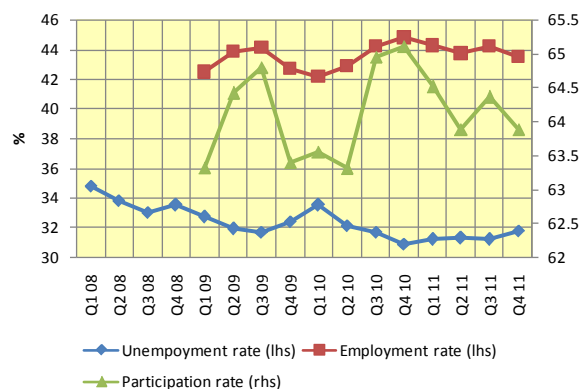
**Chart 4. Production sectors growth rates**



Source: State Statistical Office (SSO)

**Following growth deceleration, jobs growth went negative in Q4-2011, likely due to inherent lags, and unemployment rate increased by 0.6 percentage points mirrored by a similar employment rate decrease.** Private sector employed 74.3% of the total employed people. Employment in state and local government remained intact. All the major sectors of the economy registered unemployment increase in Q4-2011. Young workers experienced a relatively large employment decline in the Q4-2012 of 15% q-o-q, most likely being a result of the increased participation in tertiary education.

**Chart 5. Labour market**



Source: State Statistical Office (SSO)

**The slowdown of the economic activity mirrors the slowdown of the wage growth, while productivity slightly grew.** Nominal net wage in Q4-2011 increased by only 0.8% at the annual level, being the lowest wage growth since the onset of the crisis. In the same quarter, productivity growth increased by 4.9%, mainly reflecting the deteriorating employment.

**Chart 6. Wages and productivity**

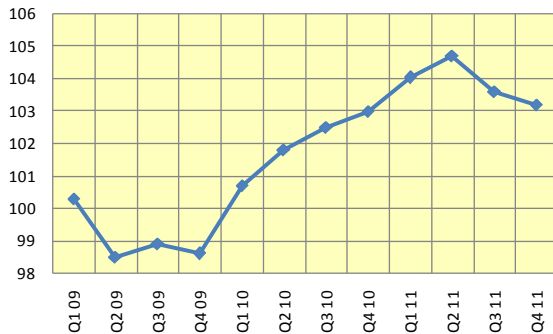


Source: State Statistical Office (SSO)

## 2. Inflation

The effect of the price hike earlier this year continues to fade out and Q4-2011 marks deceleration of the price increase at 3.2%. Expectedly, the downward dynamics of the rate of inflation connects to the combined effect of stabilization of the prices of food and other primary products and the slowdown of economic activity. Though, inflation persistence is somehow maintained likely due to the rise of oil prices again along with the developments in Syria and Iran.

Chart 7. Consumer price index

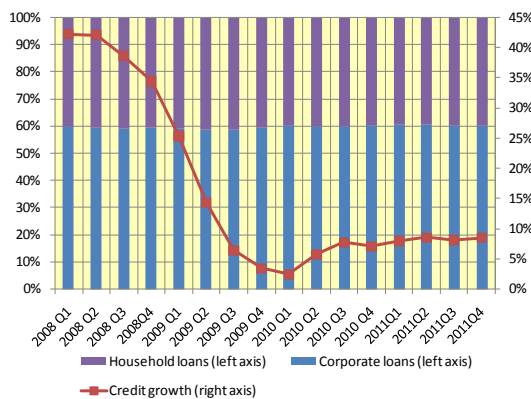


Source: State Statistical Office (SSO)

## 3. Financial intermediation and interest rates

Financial intermediation growth has been further maintained in Q4-2011, with an annual credit growth of 8.5%. The same distribution of growth is upheld through corporate loans (8.6%) and consumer loans (8.1%) (chart 8).

Chart 8. Credit



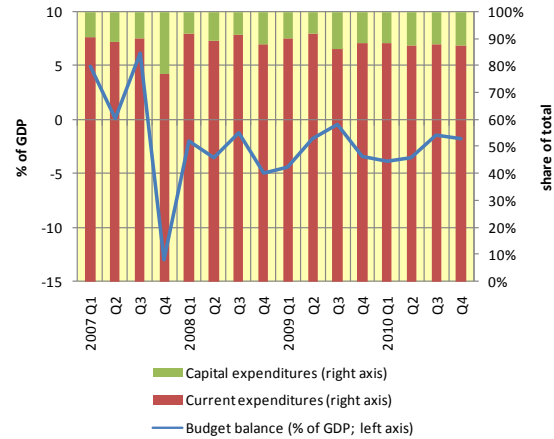
Source: National Bank of Macedonia (NBM)

Monetary policy retained its relaxed stance in conditions of stable money market and foreign-exchange market conditions. The reference interest rate of 4% has been further maintained through Q4-2011. However, both Denar- and forex-loan interest rate stood at 8.8% and 7.4%, respectively.

## 4. Fiscal behavior

Fiscal policy remained prudent, with a budget deficit of 1.7% of GDP in Q4-2011 and 2.6% for 2011. The annual deficit has been largely in line with the initial projection of 2.5%. At the quarterly level, while the current government expenditures marked a decline of 2.6% at the annual basis, capital expenditures increased by 2.3%, notwithstanding the lose-speed economic activity (chart 9).

Chart 9. Government finance



Source: Ministry of finance (MoF)

## 5. Near-term economic outlook

By the end of 2011, the global recovery vanished and became jeopardized by the intensifying strains in the euro area and fragilities elsewhere. Financial conditions deteriorated, growth prospects dimmed, and downside risks escalated. Despite the fuelling of the Greek economy with fresh money, financial strains in euro area sovereign debt markets remained elevated without the potential to drag Greece out of bankrupt. The euro area economy is now expected to go into a mild recession in 2012 as a result of the rise in sovereign yields, the effects of bank deleveraging on the real economy, and the impact of additional fiscal consolidation. Projections for global growth have been revised further downward. IMF projects real GDP growth worldwide at 3.25% for 2012.

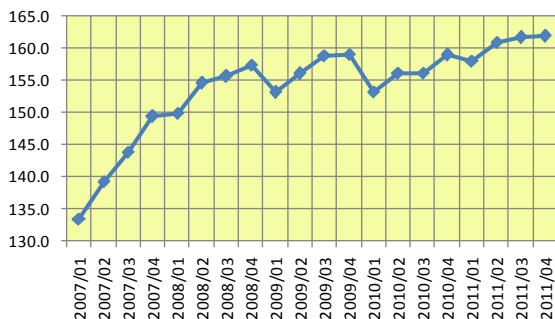
Growth in emerging Europe is projected to further decelerate - only 1.1% in 2012, amid the worsening external environment and declining domestic demand.

**Commodity prices have eased, but the risks for the oil price are on the upside.** Geopolitical risks to oil prices have risen again. These risks are expected to remain elevated for some time, and oil prices will ease only marginally in 2012 despite less favorable prospects for global activity. For commodities, improving supply conditions and slowing global demand are expected to cause further price declines. In the near term, the risks to prices are to the downside for most of these commodities.

**The brake of the global recovery, the pessimism spread over global financial markets and the pertaining fiscal problems on euro area's edge, darken the economic outlook of Macedonia.** The hold-back of the external demand that started earlier in 2011 will further retard the near-term growth of the economy. On the other hand, the potential fade out of the government construction activity might deflate the pace of growth stemming from this source earlier in 2011.

**The leading index of the Macedonian economy, UACS LeadEcon predicted the current deceleration and predicts further stagnation.** In Q4-2011, the index increased by only 0.1 index points compared to the previous quarter (chart 10).

Chart 10. UACS LeadEcon



Source: Trademark of UACS (based on data from SSO, Macedonian Stock Exchange, The employment agency and NBM)

**Despite the announcement of potential capital inflow in the economy, the risks for 2012 are significantly on the downside.** Foreign-investors' confidence in emerging markets is threatened again by the developments related to the sovereign debt

market, which might then postpone or withdraw the planned investments. Domestic investment will likely subside due to the constrained space for government construction activities, along the deceleration of the external demand, the soak-up of (global) liquidity and the deceleration of credit which will cast gloom on investment activity at home (see Chart 8).

**As predicted before, consumption will be growing sluggishly if not enter the waning zone.** The potential maintenance of persisting inflation constrains households' decisions to spend and delays consumer confidence rebound. The net-wage and consumer-loan growth will be moderating amid the deceleration of the entire economic activity.

**Net external trade's contribution to growth will noticeably pull back in the near term, in the context of the global downturn.** As envisaged in the earlier UACS Quarterly Outlook, the growing trend of industrial production has been now halted and the situation will likely endure in the first half of 2012 at least.

**Inflation is likely to remain subdued in the course of 2012.** However, the likely threatening geopolitical context will not set back oil price developments and this will remain a persistent risk for the purchasing power of Macedonian citizens.

**Overall, downside risks for the growth continue to be at the hike and partially already materialized in a drop of export demand and the overall economic activity at the end of the previous year.** The economic year ahead will be determined by the further foreign demand deceleration, further unfolding of the euro zone sovereign debt crisis and the decelerating magnitude of government construction activity. External risks are forcefully on the stage, mainly reflected into blurred euro area outlook given problems with its peripheral economies. Moreover, foreign investors may be pulled back from the market, given the timid outlook for the entire Europe, while inflation might increase given the oil price persistence. Policy responses at present remain appropriate, given the general inflation subsides and budget remains prudent. However, greater-than-expected contraction might require budget tightening along budget redistribution for the most vulnerable social groups.

**Overall, the dim prospects for 2012 prevent devising forecast of above 2% for the entire year with significant downside risks.**

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