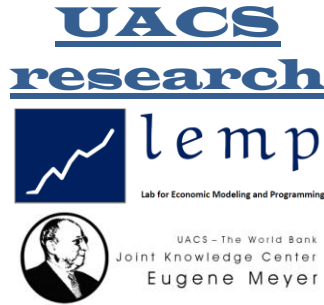




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# Quarterly Outlook

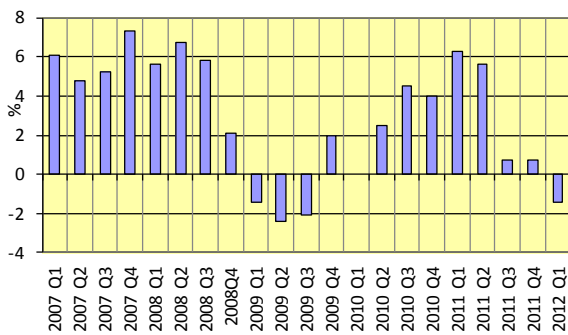
Volume 2, Issue 4, Q4-2011

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

After the slowdown in Q4-2011, Macedonian economy likely continued heading into recession as Q1-2012 growth went negative at -1.4%. The slowdown reflects the further deceleration of the external demand, amid the dip of the European debt crisis, but also the drop of both domestic consumption and investment. The growth rate is in line with UACS Quarterly Outlook projection of -1% for the respective quarter, highlighting the pronounced downside risks that prevailed a quarter earlier.

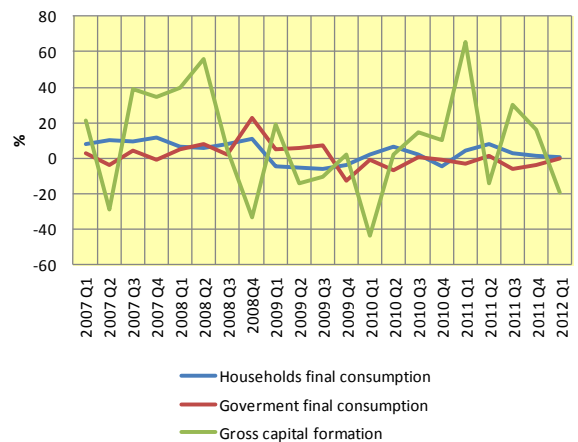
Economic activity and consumer confidence withhold dragged deceleration of the household consumption growth of 0.7% in Q1-2012. Government stimulus was moderately maintained as government consumption was maintained – 0% in Q1-2012 (chart 2). However, investment again fell by nearly 20%. The volatile growth of capital formation highlighted earlier, somehow broadcasted the recession follow up and presently generates substantial loss in confidence among both households and firms. As expected, this likely postpones consumption and investment expenditure.

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



Source: State Statistical Office (SSO)

Chart 2. Growth of GDP and its components

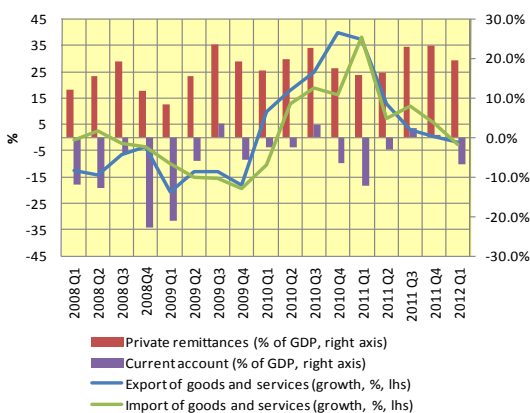


Source: State Statistical Office (SSO)

<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.

Amid such developments in the real sector, Q1-2012 marks a deepening of the current account deficit to nearly 7% of GDP, along a drop in private remittances (19.6% from 23.2% of GDP). In the same line, the trade deficit further deepened by new 3 percentage points at the quarterly level and stood at 23.1% of GDP, despite import (-2.8%) declining more than export (-1.6%). 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 (127.1% of GDP in Q1-2012).

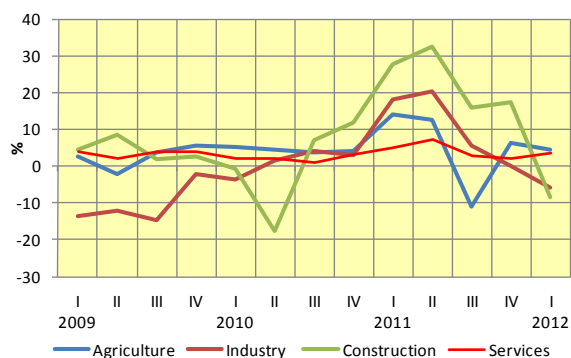
Chart 3. Foreign trade



Source: SSO and National Bank of Macedonia (NBM)

Given overall deceleration in Q1-2012, agriculture growth slowed down (4.6%), while industry and construction went deep negative (-5.7% and -8.4%, respectively). Services growth only doubled to 3.6% than a quarter earlier and likely pulled the economy out of a more serious dip.

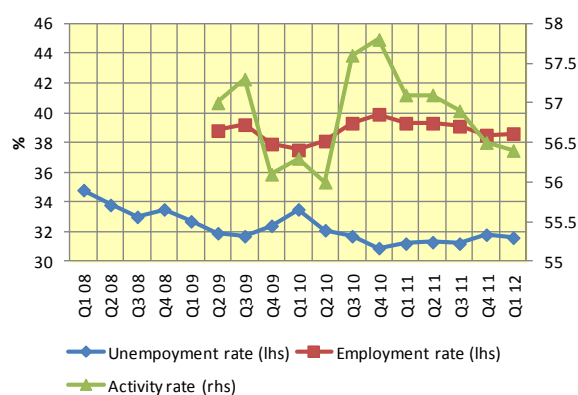
Chart 4. Production sectors growth rates



Source: State Statistical Office (SSO)

Following growth hold-back, jobs creation declined by 0.7 p.p. and unemployment soared by 0.4 p.p. compared to a year earlier. All the major sectors of the economy, except manufacturing, register unemployment increase in Q1-2012. Notably, construction registers a decline of about 12% at the annual level, which has not been a characteristic in the previous quarters. Young workers experienced a relatively large unemployment increase in Q1-2012 by 3.4 p.p., most likely being a result of the fade-out of the earlier-strengthened participation in the tertiary education.

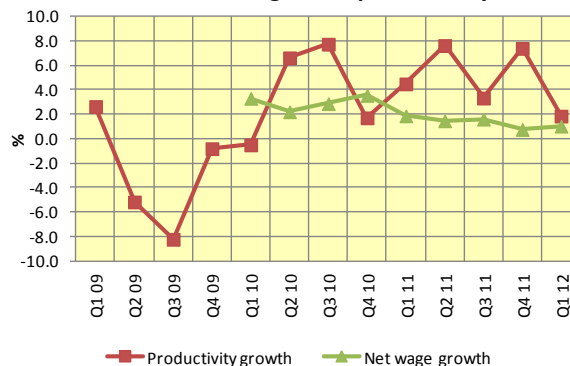
Chart 5. Labour market



Source: State Statistical Office (SSO)

The slowdown of the economic activity mirrors the non-accelerating wage growth, while productivity growth declined. Nominal net wage in Q1-2012 increased by only 1% at the annual level. In the same quarter, productivity increased by 1.9% - a deceleration of 5.5 p.p. than a quarter ago - mainly reflecting the deteriorating employment.

Chart 6. Wages and productivity

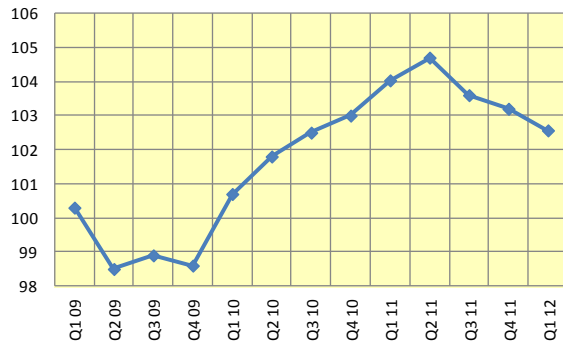


Source: State Statistical Office (SSO)

## 2. Inflation

The effect of the price hike in 2011 continues to fade out and Q1-2012 marks further deceleration of the price increase at 2.6%. 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 dip of the economic activity. Though, inflation persistence is somehow maintained likely due to the upholding of oil prices again, along with the developments in Syria.

Chart 7. Consumer price index

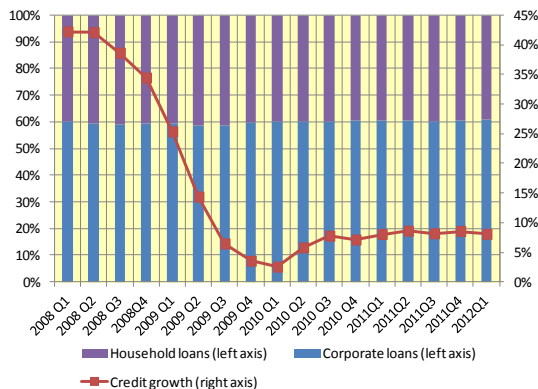


Source: State Statistical Office (SSO)

## 3. Financial intermediation and interest rates

Financial intermediation growth has been further maintained in Q1-2012, with an annual credit growth of 8%. The same distribution of growth is upheld through corporate loans (8.2%) and consumer loans (7.4%) (chart 8).

Chart 8. Credit



Source: National Bank of Macedonia (NBM)

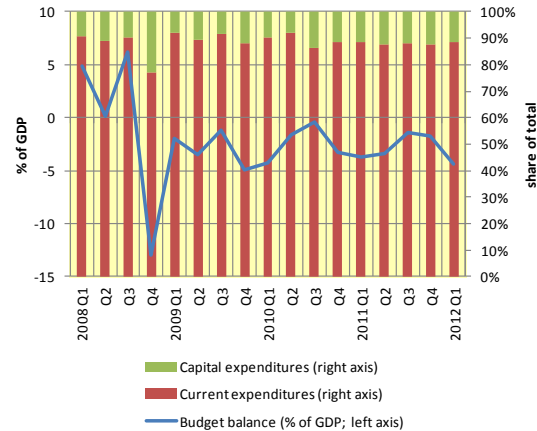
Monetary policy retained its relaxed stance in conditions of stable money market and foreign-

exchange market conditions. The reference interest rate of 4% has been further maintained through Q1-2012. Both Denar- and forex-loan interest rate slightly declined at 8.7% and 7.2%, respectively.

## 4. Fiscal behavior

Fiscal policy largely remains prudent, although the budget deficit soared at 4.4% of GDP in Q1-2012 and represents higher level than the quarters before. However, while the current government expenditures marked a growth of 3.1% at the annual basis, capital expenditures increased by 5.5%, notwithstanding the lose-speed economic activity (chart 9).

Chart 9. Government finance



Source: Ministry of finance (MoF)

## 5. Near-term economic outlook

After suffering a major setback during 2011, global prospects are gradually strengthening again, but downside risks remain considerably elevated, especially in Europe. Weak recovery will likely resume in the major advanced economies and activity is expected to remain relatively solid in most emerging and developing economies. However, the recent improvements are very fragile. Fragility is on the stage in Europe in particular, where the European debt crisis seemed endless until the pro-austerity plan parties won elections in Greece. However, such prospects are also based on the assumption that policymakers will prevent a Greek-style downward spiral from taking hold of another economy on the euro area periphery. Projections for global growth have been maintained. IMF projects real GDP growth worldwide at 3.5% for 2012. Growth in emerging

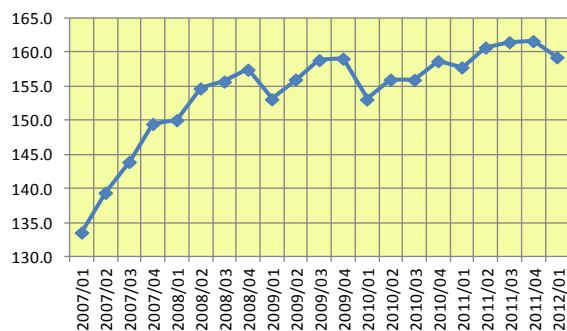
Europe is projected to somehow decelerate, 1.9% in 2012, but to remain quite robust.

**Commodity prices have eased over 2011 and risks of back up remain on the downside. However, the oil price came back again at the pre-2011 level.** Geopolitical risks to oil prices, mainly stemming from Iran and Syria, have risen again, despite the normalization of the supply from Libya. Hence, these risks are expected to remain elevated for some time, and oil prices will ease only marginally further in 2012. For commodities, improving supply conditions and moderating global demand are expected to cause further price maintenance or decline. In the near term, the risks to prices are to the downside for most of these commodities.

**Despite some prospects for resuming global recovery, the still fragile conditions in the euro area and the inherent lags in the transmission of the external developments on the domestic economy, cast a shadow on the near-term economic outlook of Macedonia.** The hold-back of the external demand that started in 2011 will further retard the near-term growth of the economy, at least in the next two quarters. On the other hand, the accommodative stance of the policies might help in dragging out the economy of a deeper recession.

**The leading index of the Macedonian economy, UACS LeadEcon predicted the current deceleration and predicts further stagnation.** In Q1-2012, the index declines by 2.4 index points compared to the previous quarter, but notes some increase of 1.5 index points compared to the same quarter of 2011 (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 the next quarters are significantly on the downside.** Foreign-investors' confidence in emerging markets is threatened further by the developments related to the sovereign debt market, which might then postpone or withdraw the planned investments. Domestic investment will further subside due to the constrained space for proliferating government consumption, along the withholding 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 set back of prices may though ease households' decisions to spend and resume consumer confidence rebound. The net-wage and consumer-loan growth will be further moderating.

**Net external trade's contribution to growth will noticeably pull back in the near term, in the context of the slow external demand resume.** The declining trend of industrial production will likely continue in the next two quarters.

**Inflation is likely to remain further subdued.** 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.** The quarters ahead will be mainly pulled back by the slow recovery of the external demand, the potential resolution of the debt crisis and the 'wait and see' attitude of investors. This may withhold domestic consumer and investor confidence. Both domestic and external risks remain on the stage. Policy responses at present remain appropriate, both from the monetary and fiscal side.

**Overall, the dim prospects for major part of 2012 drag forecast down to 1.5% for the entire year with significant downside risks, while the projection for Q2-2012 is around zero percent growth.**

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