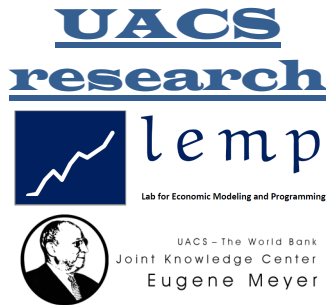




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Quarterly Outlook

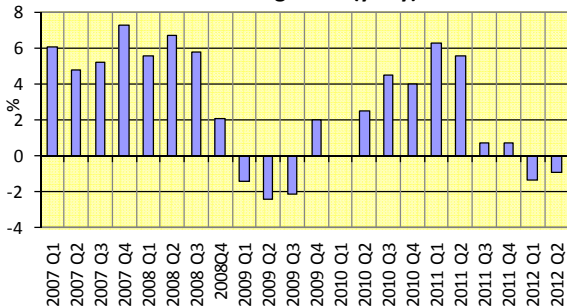
Volume 3, Issue 2, Q2-2012

1. The real economy¹

In Q2-2012, Macedonian economy went into recession. There has been a consecutive negative growth of -0.9% in the respective quarter. The slowdown reflects the further deceleration of the external demand, provided the European debt crisis has not reached its resolution, but also the hesitation of the domestic consumption. The growth rate is worse than UACS Quarterly Outlook projection of 0% for the respective quarter, highlighting the materialisation of the pronounced downside risks that prevailed a quarter earlier.

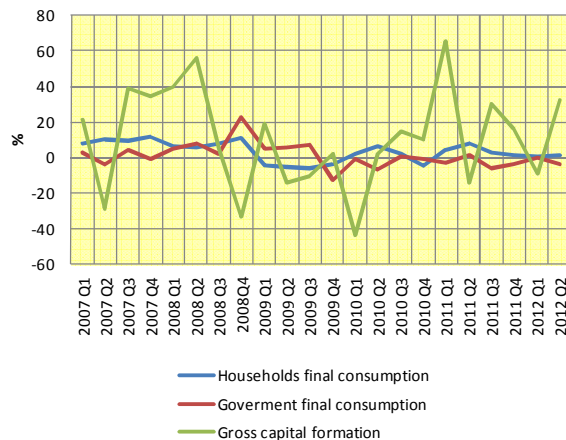
Economic activity and consumer confidence hesitation further determined low household consumption growth of 1% in Q2-2012. Government stimulus faded out as fiscal space for sectoral support tightened (chart 2). However, investment increased by 32%, again highlighting its pronounced volatility. However, this investment growth in Q2-2102 is likely driven by the start-up of come foreign investment announced earlier so that the figure may be drawing some more stable patterns in investment than before.

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



Source: State Statistical Office (SSO)

Chart 2. Growth of GDP and its components



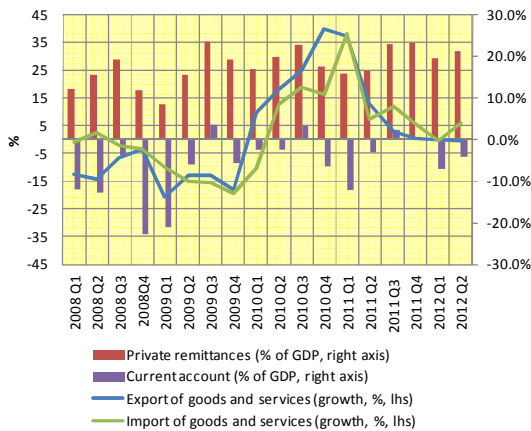
Source: State Statistical Office (SSO)

¹ **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.

Following the tightening of the economy, the current account deficit narrowed down to 4.2% in Q2-2012 from 7% a quarter ago. Notably though, the

materialisation of some foreign investment dragged import up while export fell, hence determining large trade deficit (22.3% of GDP). However, private remittances strengthened (21.3% of GDP) than compared to the previous quarter hence contributing to closing the trade deficit. 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 (127.7% of GDP in Q1-2012).

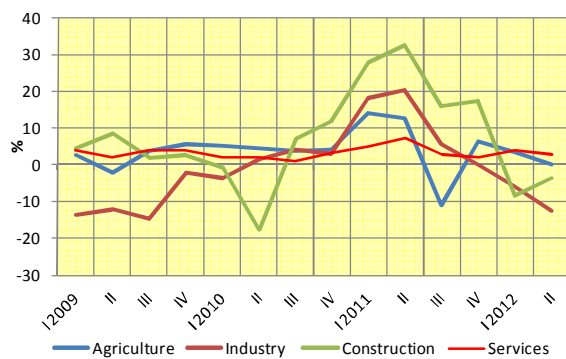
Chart 3. Foreign trade



Source: SSO and National Bank of Macedonia (NBM)

Given the overall and further deceleration in Q2-2012, all sectors decelerated. Industry decline more than doubled in Q2-2012 (-12.5%) than compared to the previous quarter, while the deceleration of the other sectors has been rather moderate.

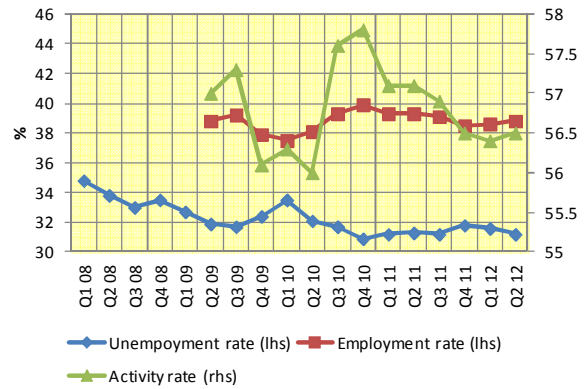
Chart 4. Production sectors growth rates



Source: State Statistical Office (SSO)

Despite growth hold-back, unemployment decreased by negligible 0.1 p.p. while job creation declined by 0.5 p.p. compared to a year ago. Half of the sectors mark an increase in Q2-2012, suggesting that the job losses are not so widespread. Young workers remain the most vulnerable group in terms of their job prospects, as their unemployment rate further increases at 54.9% in Q2-2012 from 54.6% a year ago. Also, unemployment increases with the decrease of level of education.

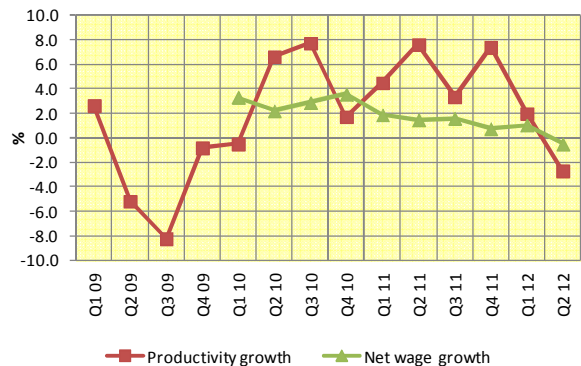
Chart 5. Labour market



Source: State Statistical Office (SSO)

The slowdown of the economic activity reflects the negative net-wage and productivity growth. Nominal net wage in Q2-2012 decreased by 0.5% at the annual level. In the same quarter, productivity decreased by 2.5% - a drop after eight consecutive quarters of increase.

Chart 6. Wages and productivity

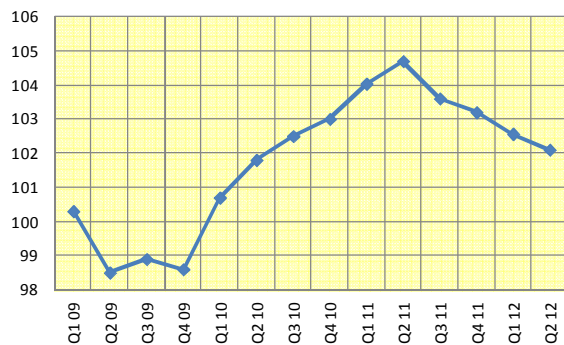


Source: State Statistical Office (SSO)

2. Inflation

The low demand mirrors into subdued price effect and Q2-2012 marks further deceleration of the price increase at 2.1%. However, the downward dynamics of the rate of inflation also reflects the effect of stabilization of the prices of food and other primary products. The latter, however, remains unpredictable and prices may soar again due to droughts in some parts of the world. In addition, some inflation persistence is further maintained likely due to the upholding of oil prices again, along with the developments in Syria.

Chart 7. Consumer price index

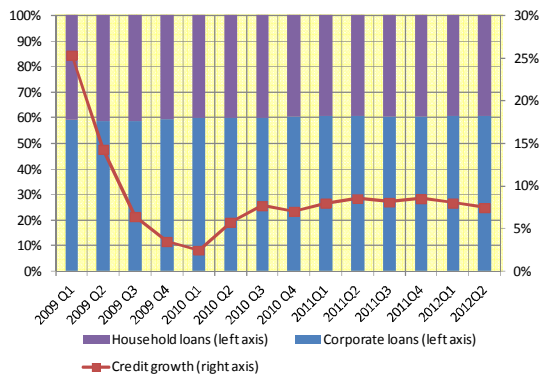


Source: State Statistical Office (SSO)

3. Financial intermediation and interest rates

Financial intermediation growth has been further maintained in Q2-2012, now eight quarter in row at 7.5% annual credit growth. The same distribution of growth is sustained through corporate loans (7.6%) and consumer loans (6.8%) (chart 8).

Chart 8. Credit



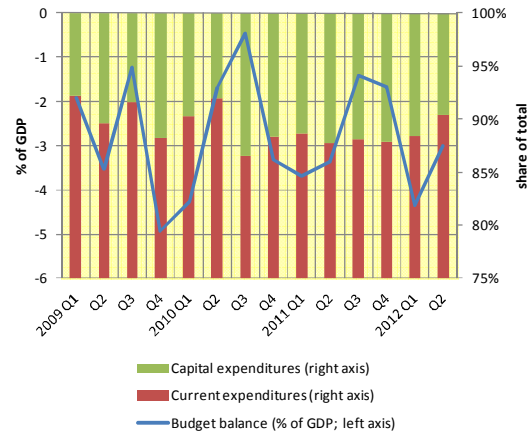
Source: National Bank of Macedonia (NBM)

Monetary policy retained its relaxed stance in conditions of stable money market and foreign-exchange market conditions. The reference interest rate decreased at 3.8% at the end of Q2-2012 from 4% a quarter ago. Both Denar- and forex-loan interest rate slightly declined at 8.5% and 7.0%, respectively.

4. Fiscal behavior

Fiscal policy largely remains prudent, with slightly narrowing budget deficit to 3% in Q2-2012 from 4.4% a quarter ago. However, while the current government expenditures marked a decline of 0.6% at the annual basis, capital expenditures decreased by magnificent 23.9%, possibly exerting a significant risk of further retarding the low activity (chart 9).

Chart 9. Government finance



Source: Ministry of finance (MoF)

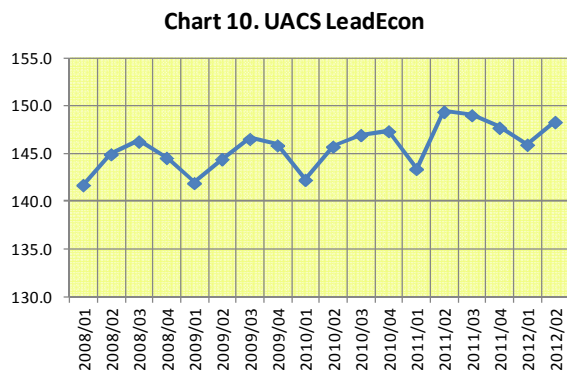
5. Near-term economic outlook

In the past four-to-five months, the global recovery has shown signs of further weakness. Financial market and sovereign stress in the euro area periphery have ratcheted up, close to end-2011 levels. Growth in a number of major emerging market economies has been lower than the forecast. These developments will only result in a minor setback to the global outlook, with global growth at 3.5% in 2012 and 3.9% in 2013. Clearly, downside risks continue to loom large, importantly reflecting risks of delayed or insufficient policy action. In emerging market economies, policymakers should be ready to cope with trade declines and the high volatility of capital flows.

Commodity prices have eased over the first half of 2012, but risks of back up remain elevated. The oil price came back again at the pre-2011 level. Geopolitical risks to oil prices, mainly stemming from Iran and Syria, remain at the stage. Hence, these risks are expected to remain elevated for some time, and oil prices will ease only marginally further in 2012. For commodities, however, the new droughts in Russia and Brazil may elevate prices again. Hence, in the near term, the risks to prices are to the upside.

The global slowdown, 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 considerable 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 by the end of 2012. On the other hand, the accommodative stance of the policies might help in dragging the economy out of a deeper recession.

The leading index of the Macedonian economy, UACS LeadEcon predicted the current deceleration and predicts further stagnation. In Q2-2012, the index declines by 1.1 index points at the annual level (chart 10).



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

Despite some inflow of foreign investment realized in Q2-2012, the risks for the next quarters are significantly on the downside. Foreign-investors' confidence in emerging markets remains further threatened by the no-resolution of the sovereign debt market. Domestic investment will likely 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 elevation of prices of commodities may put additional burden on households' decisions to spend. The net-wage and consumer-loan growth will be further moderating only reinforcing this trend.

Net external trade's contribution to growth will noticeably continue the pull-back in the near term, in the context of the slow external demand resume. The moderating trend of industrial production will likely continue by the end of the year.

Inflation may elevate again. Droughts in some part of the world may cast significant risks for prices of certain commodities, hence restraining 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 moderation 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, despite with very limited power.

Overall, the dim prospects for major part of 2012 drag forecast down to 0.5% for the entire year with downside risks, while the projection for Q2-2012 is around zero percent growth.

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