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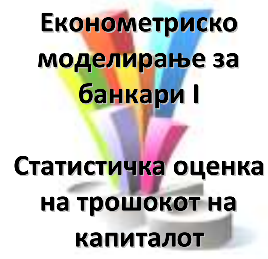


НОЌ НА ИСТРАЖУВАЧИ
27 СЕПТЕМВРИ 2013

University American College Skopje

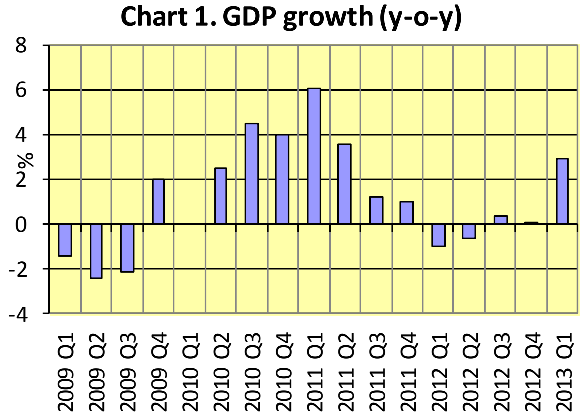
Quarterly Outlook

Volume 4, Issue 1, Q1-2013

1. The real economy[1]

After a year of stagnation, the economy started recovering in Q1-2013. The growth of GDP in the respective quarter amounted to 2.9%. The re-launch of a promising growth performance may suggest that the materialization of the downside risks may be over and more robust recovery is on the horizon. The growth rates are above the UACS Quarterly Outlook projection of 1% for Q1-2013 mainly due to the forced (government) construction activity.

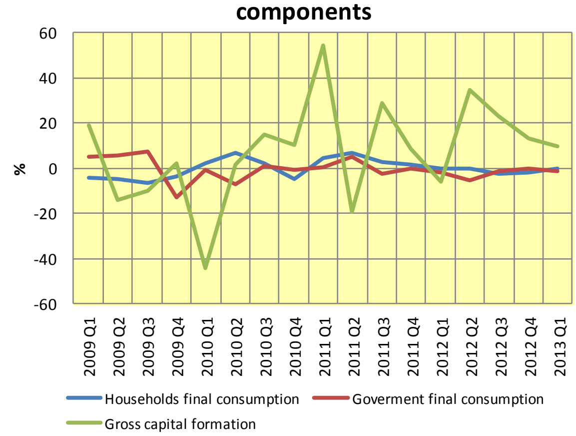
Chart 1. GDP growth (y-o-y)



Source: State Statistical Office (SSO)

Though promising, the growth in Q1-2013 is predominantly a result of the increased gross capital formation boom of 9.4% compared to the same quarter a year ago, mainly in the construction sector. Investment behaviour is likely in line with our earlier projection that investment may be taking on a more stable component due to the ongoing FDIs setting down in the economy. On the other hand, household consumption further moderated as consumers have not yet abandoned their hesitation to spend (chart 2). Government consumption has been declining by 1.5%, despite the profligate stance of the fiscal policy in the respective quarter.

Chart 2. Growth of GDP and its components



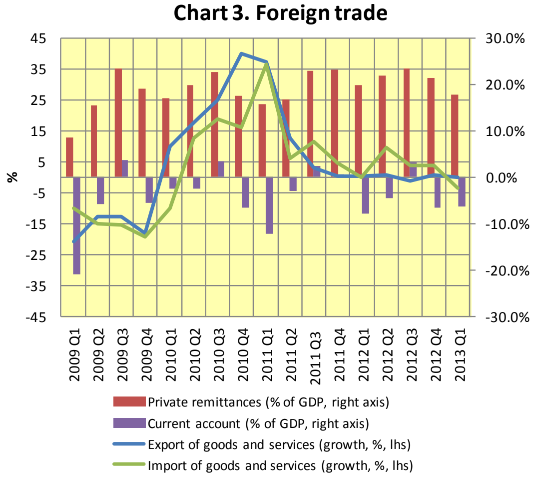
Source: State Statistical Office (SSO)

The promising pace of growth may be though endangered by the external indicators, as import (-3.7%) has been declining faster than export (-0.3%)

[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.

in Q1-2013. Private remittances slightly declined though remained high (17.9% of GDP), which then again contributed to closing the large trade deficit and determined a current account deficit of 6.4%. Despite somehow large, the latter is still in line with the perceptions of sustainable deficit. Given Macedonia's large trade openness toward the European market, the subdued foreign demand continues to be the most pertinent determinant of the moderating export.

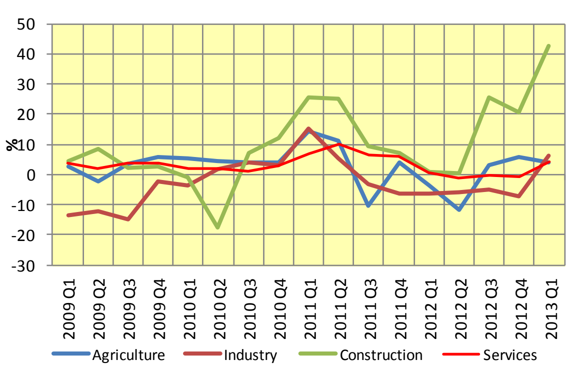
Chart 3. Foreign trade



Source: SSO and National Bank of Macedonia (NBM)

Though growth showed signs of recovery and upsurge, it has been mainly driven by the construction boom of 42.5% compared to the same quarter of the previous year. Construction has been both privately- (the establishment of foreign factories) and publicly-led (continuous investment in the Skopje 2014 project, but also the commencement of some infrastructure projects). However, all industry, agriculture and services recovered in Q1-2013.

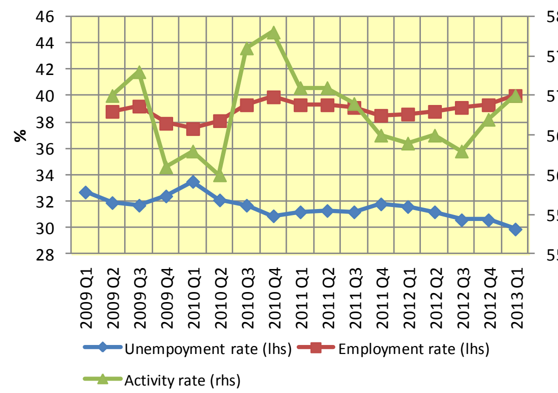
Chart 4. Production sectors growth rates



Source: State Statistical Office (SSO)

Unemployment reduced to 29.9% in Q1-2013, being for the first time below the psychological line of 30% for more than 15 years. Though, the decline is selective and some sectors, predominantly industry, still faced layoffs in Q1-2013. Young workers remain the most vulnerable group in terms of their job prospects, and their unemployment rate was maintained at 53.5% in Q1-2013.

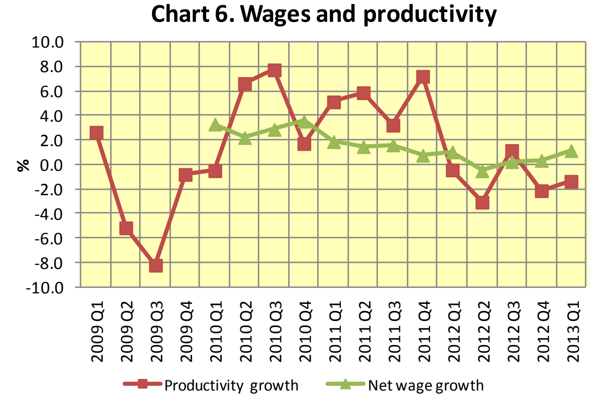
Chart 5. Labour market



Source: State Statistical Office (SSO)

Productivity declined in Q1-2013 due to the faster growth of employment than that of production. Nominal net wage growth in the same quarter accelerated at 1.1% at the annual level. While the later may be in line with our earlier suggestion that wage growth may be associated with the recovery underway, the negative productivity growth still undermines its robustness.

Chart 6. Wages and productivity

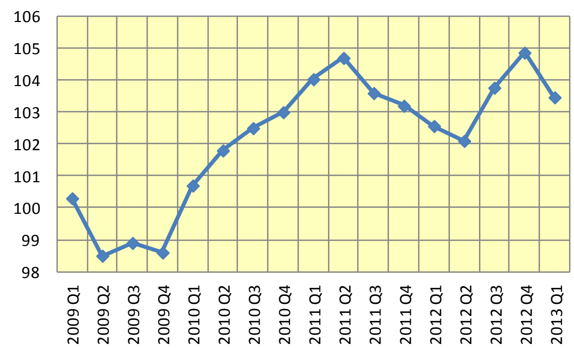


Source: State Statistical Office (SSO)

2. Inflation

Despite still hesitant demand presses prices downward, inflation remained elevated in Q1-2013 at 3.5% annually. This persistent price hike is due to the level effect of rising prices which happened over the summer in 2012.

Chart 7. Consumer price index

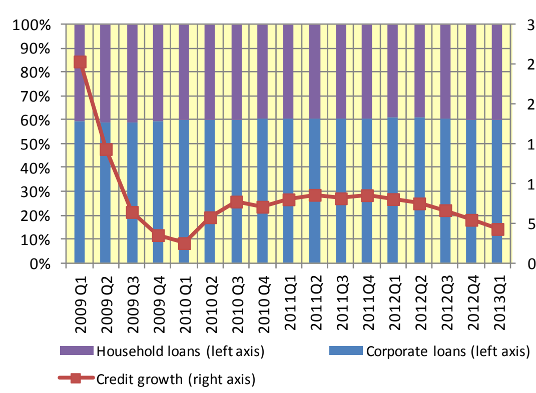


Source: State Statistical Office (SSO)

3. Financial intermediation and interest rates

Despite growth uphold, financial intermediation further decelerated in Q1-2013 at 4.3% annually. The deceleration of credit is dragging recovery behind, especially given it became much pronounced with the corporate loans (2.5%) than compared to consumer loans (6.8%) (chart 8).

Chart 8. Credit



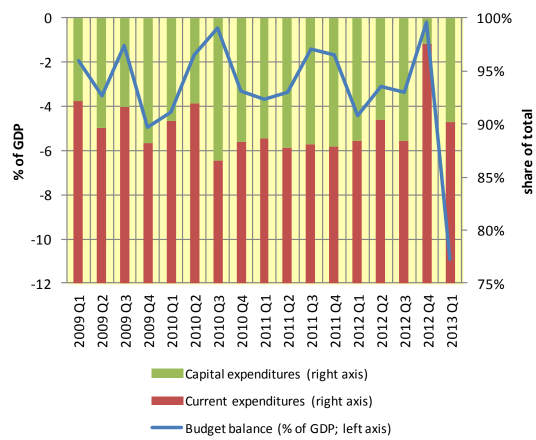
Source: National Bank of Macedonia (NBM)

Monetary policy retained its relaxed stance in conditions of stable money market and foreign-exchange market conditions. The reference interest rate has declined further at 3.4% at the end of Q1-2013**.** Both Denar- and forex-loan interest rate slightly declined at 8.2% and 6.7%, respectively, following the stance of the monetary policy, but still reflecting the pertaining micro-risks in the economy.

4. Fiscal behavior

Fiscal policy got profligate stance in Q1-2013. The budget deficit soared at 10.9% of GDP, mainly reflecting the spending before the local elections. This is reflected in the growth of the current government expenditures (16.2%), compared to the decline (-4%) of the capital government expenditures (chart 9).

Chart 9. Government finance



Source: Ministry of finance (MoF)

5. Near-term economic outlook

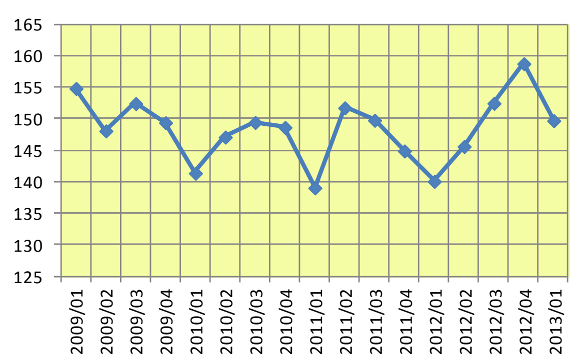
Global economic prospects have improved again but the road to recovery in the advanced economies will remain bumpy. The International Monetary Fund forecasts the world output growth to reach 3.25% in 2013 and 4% in 2014. In the developed world, activity is expected to gradually accelerate, starting in the second half of 2013. Private demand appears increasingly robust in the United States but still very sluggish in the euro area. In the euro area, the main short-term dangers now revolve around adjustment fatigue, weak balance sheets, broken credit channels in the periphery, and insufficient progress toward stronger economic and monetary union at the euro area level. In emerging market and developing economies, activity has already picked up steam, after the slow down over 2012. The activity in developing Europe should again gain speed as demand from advanced Europe slowly picks up.

There are no excess demand pressures, so inflation rates will remain generally under control, although unemployment rates are typically low in many countries, current account balances are falling, credit is buoyant, and asset prices are high. Global inflation is projected to stay around 3% through the rest of 2013 and over 2014. Food and fuel supply developments will help contain upward pressure on prices of major commodities despite the expected reacceleration in global activity.

The global easing prospects and the construction activity at home hold up the recovery of the Macedonian economy in the near term. However, the prospects may be held back by the slow recovery of the external demand due to the sluggish upturn of the euro area economy. Overall, the positive developments in the first half of 2013 may be illuminating a faster recovery in the second half of the year. Policies will remain accommodative as pressures on the foreign exchange market are absent, while debt pressures are still considered sustainable.

The leading index of the Macedonian economy, UACS LeadEcon predicted the current recovery and now predicts further recovery in the second half of 2013. In Q1-2013, the index increased by 5.2 index points at the annual level, while the quarterly decline of 9.1 index points is mainly due to the seasonal effects (chart 10).

Chart 10. UACS LeadEcon



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

The undergoing of some foreign investment and the overall construction activity in the first quarter of 2013 will be pulling the economic activity further up. Though, the main pertaining risks remain the uncertain foreign-demand recovery and the potential further deceleration of the credit activity amid the pertaining micro risks and the soaked-up liquidity among companies.

Consumers will continue to hesitate somehow, but the easing of the labor market pressures and consumer loan activity may relieve the strains on consumption. The level effect of the elevation of prices of commodities is still on the stage and this may be putting additional burden on households' decisions to spend.

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 upsurge of industrial production has robust elements and will likely continue over the remaining part of the year.

Inflation will likely subside. The effects of droughts and floods in parts of the world that dragged prices up seem to gradually fade out. However, the return of prices to the pre-shock level may be unwarranted.

Overall, prospects may now be further optimistic than a quarter ago, but some downside risks for the growth continue to be around. The quarters ahead will be pulled up but the potential intensification of the raise up of factories by the foreign investors, the continued intensified construction activity, but potentially further retarded by the moderation of the external demand. Consumers' confidence will be restored only gradually. Monetary policy responses at present remain appropriate, while the profligate fiscal stance will need to get back on prudent track immediately.

Overall, the slow but steady upsurge of economic activity in the first quarter of 2013 allows for elevating the overall growth forecast at 2% for 2013, while Q2-2013 is expected to be around 3%.

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