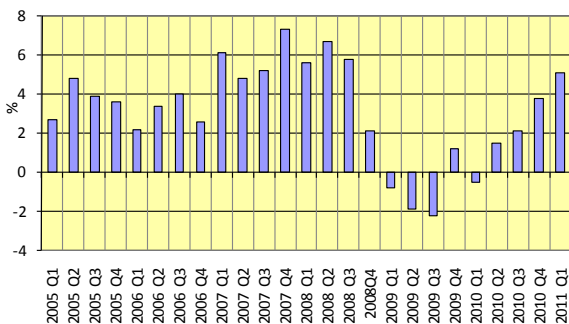


**1. The real economy<sup>1</sup>**

**After a period of shadowed economic activity, growth accelerated in Q1-2011.** The economy in Q1-2011 grew by 5.1% which is a further acceleration of the growth rates recorded over 2010 (chart 1). The growth rate in Q1 is above the UACS Quarterly Outlook projection of 3.5% in December 2010, mainly due to the higher-than-expected improvement in the external demand, as well as the forcible execution of the government capital investment.

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



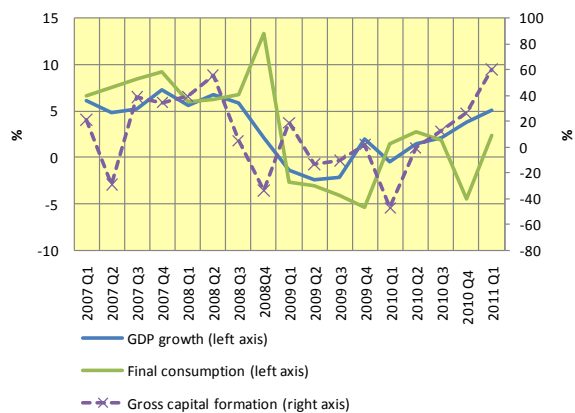
Source: State Statistical Office (SSO)

**Investment and export growth are the main drivers of the new growth.** The growth of investment (60.1%) has had the most significant influence on the economic activity in Q1-2011, continuing the row of large and positive growth rates that started in mid-2010. However, part of this growth still owes to the construction activities of the government which remained to be powerfully executed over Q1-2011. On the other hand, domestic consumption marks a shallow increase of 2.8%, which is though a positive signal, but still a reflection of the likely 'wait and see' attitude of consumers. This behaviour largely owes to

<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.

the food and oil price shock that materialised over Q1-2011 in its largest magnitude and has additionally reflected onto consumer confidence which in Q1-2011 deteriorated by nearly 7% compared to a quarter ago. Government current spending has been further rationalized and in Q1-2011 decreased by 3.2% on annual basis (see Chart 2).

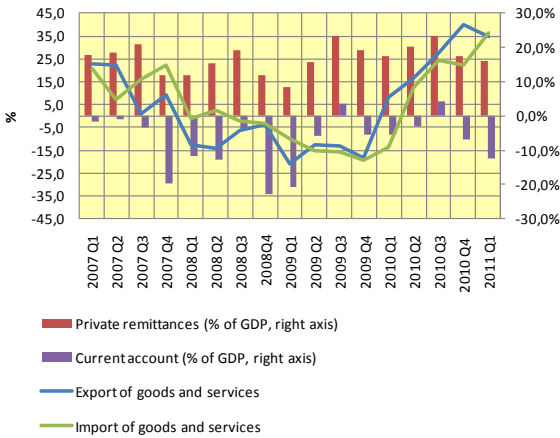
**Chart 2. Growth of GDP and its components**



Source: State Statistical Office (SSO)

**The first-quarter acceleration in GDP has been also a reflection of the spiky increase in export of 34.8%, mainly reflecting the rebounding global economy** (chart 3). However, while previously this trend has been accompanied by a slower import growth, now the import growth rate (36.5%) almost equalled the export one, which could be seen as an early sign of 'fuelling' the economy. As a result, the current account further deteriorated (-12.3% of GDP from -7% in the previous quarter).

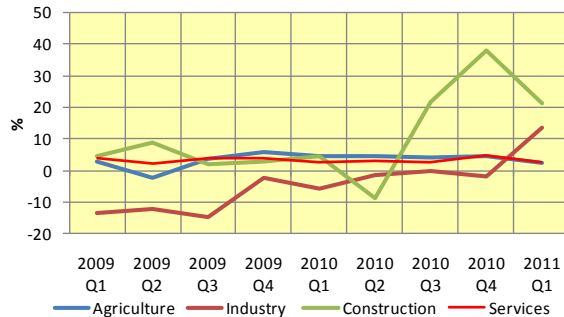
**Chart 3. Foreign trade**



Source: SSO and National Bank of Macedonia (NBM)

**Given government investment activity, construction further boomed.** The 21.2% annual growth is a continuation of the growth rates in the second half of 2010. In Q1-2011, contrary to the trend before, industry marked considerable growth, 13.7%, which partially reflects the changed methodology for calculating the industrial output. Still, the backward revision of this series suggests that the improving economy can explain majority of this industrial growth.

**Chart 4. Production sectors growth rates**

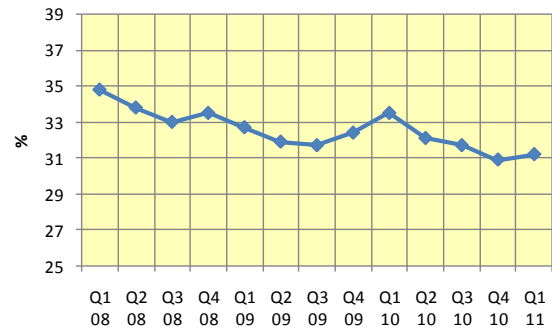


Source: State Statistical Office (SSO)

**Following growth acceleration, the unemployment rate remained persistent, but declined by 2.3 p.p in Q1-2011 at the annual level** (chart 5). Unemployment declined in each age group, supporting our previous suggestion that the improvement is likely to be of more permanent nature. Though, the booming construction sector still consumes mainly unskilled

and semi-skilled workers, while the unemployment in the higher-education group further worsens.

**Chart 5. Unemployment rate**

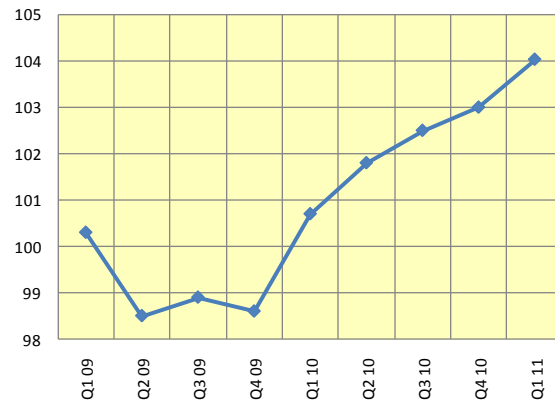


Source: State Statistical Office (SSO)

## 2. Inflation

**The hastened growth in Q1-2011 has been accompanied by rising prices. Prices in Q1 soared up by 4% on the annual basis.** However, the rising prices do not reflect the rebounding economy, but rather the price hike present on the world market, due to the climb in commodities and oil prices. This is in accordance to the earlier UACS Quarterly Outlook prediction that prices will continue rising.

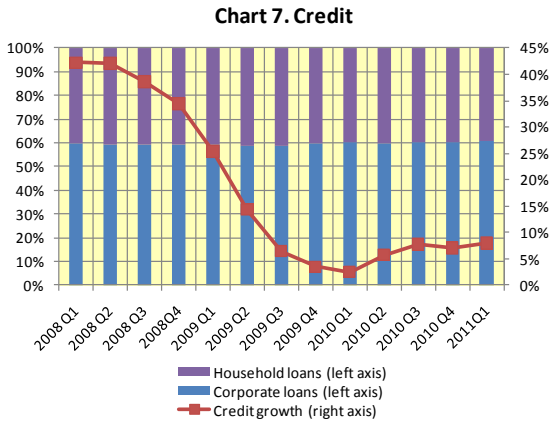
**Chart 6. Consumer price index**



Source: State Statistical Office (SSO)

## 3. Financial intermediation and interest rates

**Financial-intermediation growth has been maintained in Q1-2011, with an annual credit increase of 8%.** The same distribution of growth is maintained through the corporate loans (9%) and consumer loans (6.5%) (chart 7).

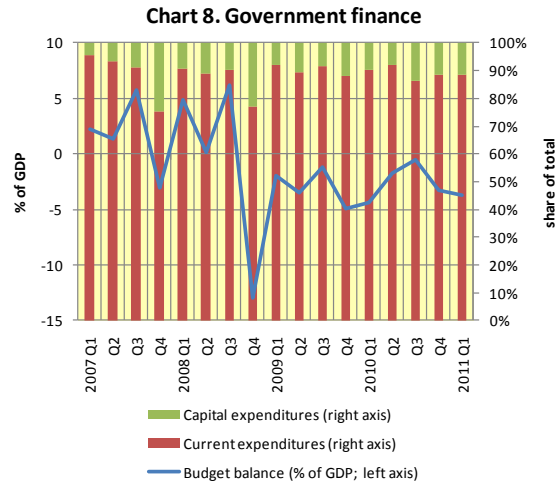


Source: National Bank of Macedonia (NBM)

**Monetary policy retained its stance in conditions of stable money market and foreign-exchange market conditions.** A new minimum of 4% of the reference interest rate has been reached in Q1-2011. Although highly staggering, Denar-loan interest rate further declined from 9% to 8.9% on a quarterly basis; while forex-loan interest rate has been maintained at 7.4%. These trends might reflect the risk perception of banks, but also the still contractive stance of the monetary policy in terms of the reserve requirement.

#### 4. Fiscal behavior

**Fiscal policy largely remained prudent, although Q1-2011 marked a budget-deficit worsening (-3.7% of GDP from -3.3% a quarter ago).** While the current government expenditures, including wages, contractual services and furniture, increased moderately (3.4%), capital expenditures which are envisaged to support overall economic activity in the medium term marked a considerable increase of 23.8% (chart 8). The latter is in line with the booming investment and construction sector of the economy (section 1).



Source: Ministry of finance (MoF)

#### 5. Near-term economic outlook

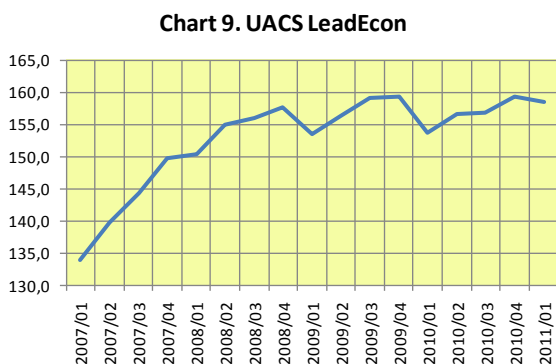
**The growth momentum on the global economic stage will be sustained, with the outlook to accelerate faster in the second half of the year.** Growth dynamics continue to be strong in emerging economies; monetary policies, in general, continue to be expansive while fiscal support fades out. However, downside risks threaten the upswing in advanced economies. Growth is set to be sluggish therein, facing fiscal and financial sector balance sheet problems, which will continue to be a drag on employment. IMF forecasts suggest the global GDP to expand by 4.3% in 2011, while the euro area will be still staggering behind with a forecasted 2011 growth of only 1.8%.

**Commodity prices currently eased somehow, but the unrest in Middle East poses further threat for oil prices.** Although pressures in food markets have, to an extent, rested, low inventories and weather-related supply disruptions present significant near-term upside risk for prices. A second important downside risk on the global stage remains to be the fiscal imbalances in the euro area periphery. Overheating pressures in some key emerging economies have also intensified as observed in elevated inflation pressures, and in some cases high asset prices.

**The rising external demand mainly pulled by the German economy, as well as the slow but stable fading out of the price hike suggests that the economic outlook for Macedonia improves.** The intensified external demand that started at end-2010

as well as improved investors' confidence and returning capital flows will most likely support the near-term growth of the economy.

The leading index of the Macedonian economy, **UACS LeadEcon** predicted the growth acceleration that is underway, but now suggests a moderate slowdown in the second half of the year. This prediction is expected, given that Q1-2011 growth is partially reflecting the low base effect which is expected to fade out. In Q1-2011, the index increased by 4.7 index points compared to Q1-2010 (chart 9).



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

The new investment cycle that likely started, and is being supported by the government investment activity, is likely to be sustained throughout the entire 2011. Foreign-investors' confidence will be further pulled through, while domestic investment will be steadily driven by the intensified government construction activities, the robust external-demand growth and the rebound of the corporate loans growth (see Chart 7).

Consumption will continue growing, though sluggishly. The still persistent price shock retreats people from spending and poses a further threat for the consumer confidence. The net-wage and consumer-loan growth are likely to be contained, though. In addition to the non-deteriorating labor-

market conditions (chart 5), these trends are likely to pull round consumption more robustly than before.

Net external trade's contribution to growth will be further intensified in the near term, despite euro-area's fiscal imbalances appearing on its periphery. As envisaged in the earlier UACS Quarterly Outlook, industrial production strongly benefited from the good performance of the exports to Germany, mainly. Also, we forecasted the current account worsening due to pulled import by the overall growth acceleration. Both trends are likely to continue over the near term.

Core inflation is likely to remain subdued in the course of 2011, but food and energy prices will probably in a while persist and then decline in the second half of the year. The uncertainty around the oil prices, as well as the upcoming harvests might further threaten consumption and the social edge of Macedonian citizens.

Overall, downside risks for the growth now somehow eased and accelerated growth prospects became more likely. Foreign demand momentum and the bound of government construction activity will further drive growth of Macedonian economy in 2011. Moreover, returning capital flows and improved investors' confidence will likely further pull through domestic production. On the negative side, though, foreign risks are still on the stage, mainly reflected into blurred euro area outlook given problems with its peripheral economies, one of which is a neighbor of Macedonia and the fourth trading partner. Moreover, inflation easing might be uncertain, given the hesitant expectations about the new weather season. However, policy responses at present remain appropriate, given no signs of second-round inflation effects as well of budget deterioration are visible on the horizon.

Overall, Q1-2011 lays a basis for slight upward revision of 2011 growth projection from 2.5% at about 3%, while Q2-2011 growth is likely to be near but below 4%.