lemp
Lab for Economic Modeling and Programming

University American College Skopje

Analyses
Corporate Research
Studies
Surveys

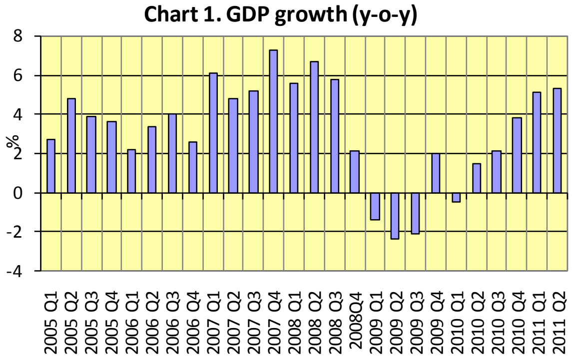
University American College Skopje Quarterly Outlook

Volume 2, Issue 2, Q2-2011

1. The real economy[1]

The growth of the gross product continues its pace in Q2-2011. The economy in Q2-2011 grew by 5.3% which is further acceleration of the growth rates recorded the quarters before (chart 1). The growth rate in Q2 is above the UACS Quarterly Outlook projection of 4% in March 2011, mainly due to the higher-than-expected improvement in the external demand, as well as the forcible execution of the government construction activity.

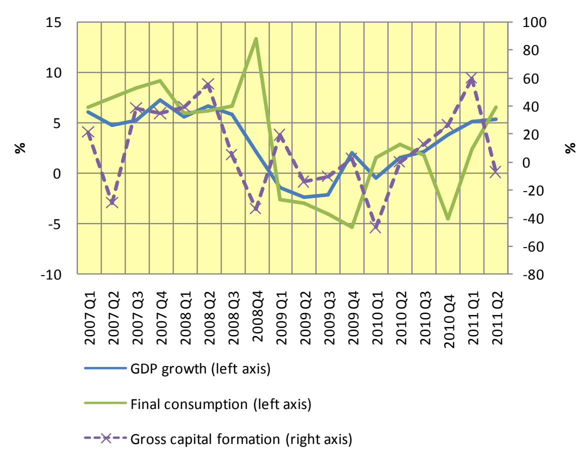
Chart 1. GDP growth (y-o-y)



Source: State Statistical Office (SSO)

The main drivers of growth have been consumption and export. Final consumption grew by 6.6 % (chart 2) despite external uncertainties. This was largely driven by strong household expenditures (growth of 8.4%), while government stimulus was fading out in Q2-2011 (a 0.6% decline of government consumption). Unlike household expenditure, gross capital formation after the high growth in Q1-2011 (60.1%), fell in Q2-2011 (-7.5%), which still suggest a non-robust recovery.

Chart 2. Growth of GDP and its components



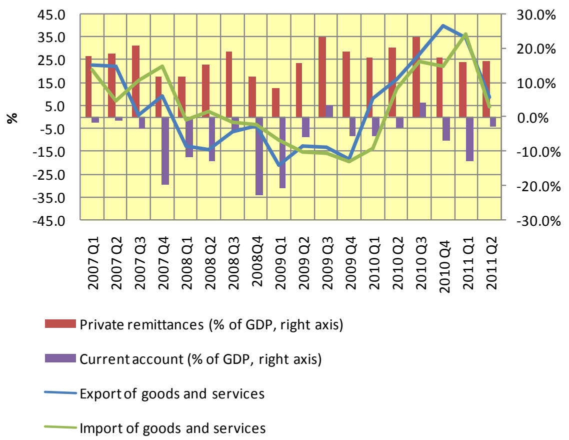
Source: State Statistical Office (SSO)

Current account deficit tightened in Q2 (-2.5% of GDP) as compared to Q1, mainly due to the stronger contribution of export. In Q2-2011 there is a slowdown of both export and import growth as a result of the hold up of the demand recovery in

[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.

advanced Europe. Still, the favourable conjunction of the metal prices provoked higher growth of export than import.

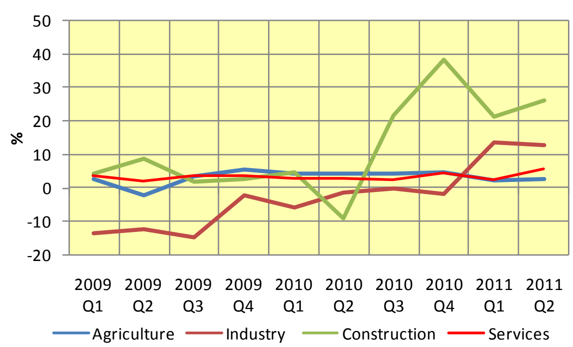
Chart 3. Foreign trade



Source: SSO and National Bank of Macedonia (NBM)

Given government investment activity, construction further boomed. The 26% annual growth is a continuation of the growth rates in the last couple of quarters. Besides, industry and trade boomed in Q2, with growth rates of 12.8% and 18%, respectively, reflecting the stirred economic activity due to the widespread construction expansion as well the rebounding external demand.

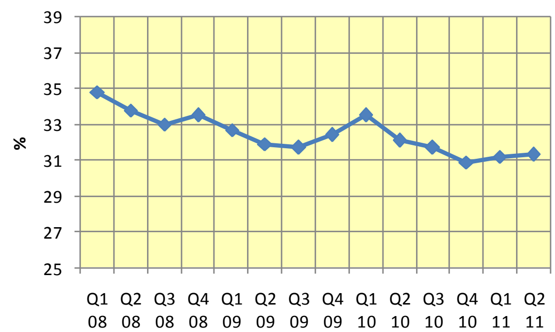
Chart 4. Production sectors growth rates



Source: State Statistical Office (SSO)

Following growth acceleration, the unemployment rate remained persistent, but declined by 0.8 p.p in Q2-2011 at the annual level (chart 5). Unemployment declined in each age group, supporting our previous suggestion that the improvement observed over preceding quarters is likely to be of more permanent nature. However, the booming construction sector still likely consumes mainly unskilled and semi-skilled workers (unemployment rate decline of 1.3 percentage points), while the unemployment in the higher-education group further worsens (by 2.1 percentage points).

Chart 5. Unemployment rate

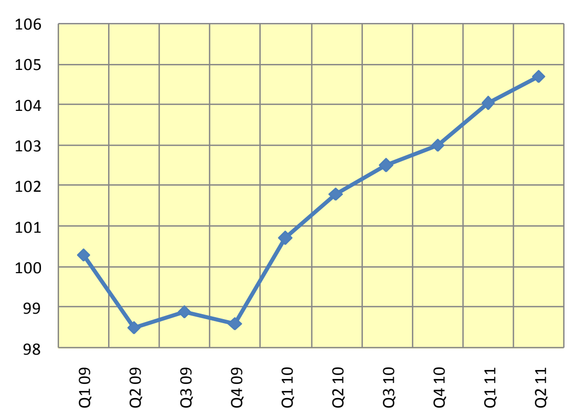


Source: State Statistical Office (SSO)

2. Inflation

The effect of the price hike earlier this year endured in Q2-2011, mainly due to the base effect. Prices in Q2 soared up by 4.7% on the annual basis, but the monthly dynamics suggests moderation of the price effect, but not accompanied with reversals. This dynamics is in accordance with the earlier UACS Quarterly Outlook prediction that prices will continue rising with slight moderation in the second half of the year should not another shock hit inflation.

Chart 6. Consumer price index

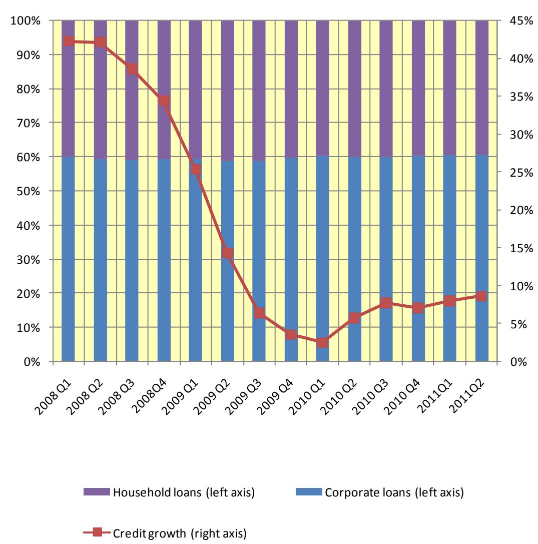


Source: State Statistical Office (SSO)

3. Financial intermediation and interest rates

Financial intermediation growth has been maintained in Q2-2011, with an annual credit increase of 8.6%. The same distribution of growth is maintained through the corporate loans (9.7%) and consumer loans (6.9%) (chart 7).

Chart 7. Credit



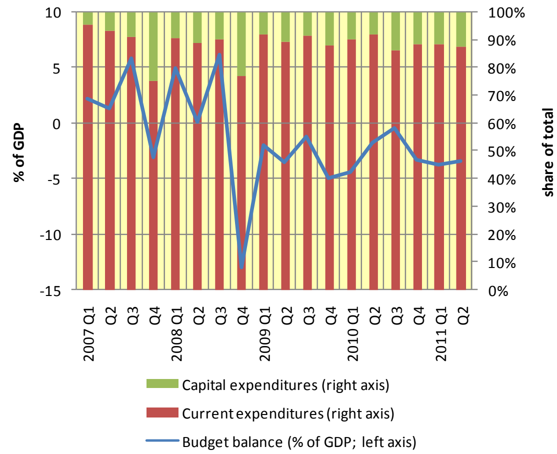
Source: National Bank of Macedonia (NBM)

Monetary policy retained its stance in conditions of stable money market and foreign-exchange market conditions. The reference interest rate of 4% has been maintained through Q2-2011**.** Both Denar- and forex-loan interest rate stood at 8.9% and 7.4% on a quarterly basis, respectively. 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 remained prudent, with a budget-deficit improving in Q2-2011 at -2.7% of GDP from -3.4% a quarter ago. While the current government expenditures, including wages, contractual services and furniture, have been rising with accelerated pace (12.5% annual growth compared to 3.4% a quarter ago), capital expenditures also marked a considerable increase of 78.9% (chart 8). The latter is in line with the booming investment and construction sector of the economy (section 1).

Chart 8. Government finance



Source: Ministry of finance (MoF)

5. Near-term economic outlook

The growth momentum of the global economy has been now lost and it most likely enters a new phase of economic slowdown. Following a barrage of unfavorable shocks in the first half of 2011, global economic activity has weakened and has become more uneven. A devastating earthquake and tsunami in Japan disrupted global manufacturing; the Arab spring drove up oil prices; financial strains in euro area financial and sovereign debt markets deepened; growth in the United States decelerated sharply; and the standoff about raising the ceiling on US government debt sapped confidence in policymaking. Against this backdrop, projections for global growth have been revised downward, especially for advanced economies. IMF projects real GDP growth worldwide at 4% for 2011 and 2012. Growth in emerging Europe is projected to remain unchanged from last year—at 4.4% in 2011—and then to decline to 3.4% in 2012, as rebounds run their course and the global slowdown makes itself felt.

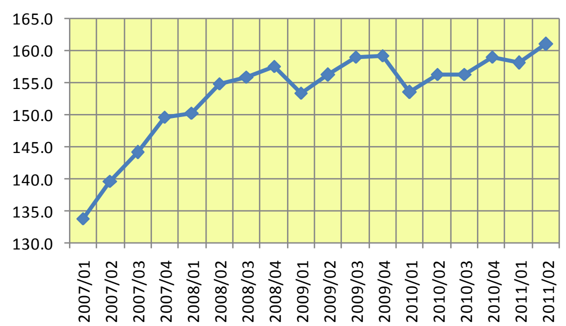
Commodity and oil prices currently eased. The progress in the resolution of the situation in Libya along the fade out of the commodity price-hike earlier this year puts downward pressure on prices. A second important downside risk on the global stage remains to be the fiscal imbalances in the euro area periphery. Finally, the global slowdown currently likely acts as the most important downward engine of prices and is expected to prevail in the course of the year.

The deceleration of the global rebound, the pessimism spread over global financial markets and

the pertaining fiscal problems on euro area's edge darken the economic outlook of Macedonia. The currently undergoing hold-back of the external demand will most likely retard the near-term growth of the economy. On the other hand, the intensified government construction activity might compensate part of the threat stemming from the external developments.

The leading index of the Macedonian economy, UACS LeadEcon predicted the current deceleration (last-quarter's decline), but now suggests a moderate increase at the beginning of the next year. In Q2-2011, the index increased by 4.7 index points compared to Q2-2010 (chart 9).

Chart 9. UACS LeadEcon



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

The new investment cycle that started, and is being supported by the government investment activity, is likely to be sustained throughout the entire 2011. Foreign-investors' confidence in emerging markets will be sustained, but uncertainties might appear amid the newest global developments. Domestic investment will be further pulled through by the intensified government construction activities, although the deceleration of the external demand, the soak-up of (global) liquidity and the subsequent deceleration of credit will cast gloom on investment activity at home (see Chart 7).

Consumption will likely continue growing, though sluggishly. The fade-out of the price shock relaxes households' decisions to spend and improves consumer confidence. The net-wage and consumer-loan growth are likely to be contained. In addition to the non-deteriorating labor-market conditions (chart 5), these trends are likely to contain the robust consumption growth.

Net external trade's contribution to growth will likely subside in the near term, in the context of the global downturn. As envisaged in the earlier UACS Quarterly Outlook, industrial production strongly benefited from the good performance of the exports to Germany, mainly. The trend is likely to be halted, though.

Core inflation is likely to remain subdued in the course of 2011, with food and oil prices probably declining in the second half of the year also. Inflation outlook will somewhat ease due to the progress in the conflict resolution in Libya and the stagnating outlook of the global economy.

Overall, downside risks for the growth elevated again and shadowed growth prospects became more likely. Foreign demand deceleration, the potential soak-up of global liquidity and the bound of government construction activity will determine future growth of Macedonian economy. External risks are again on the stage, mainly reflected into blurred euro area outlook given problems with its peripheral economies, one of which is a neighbor of Macedonia, the fourth trading partner and important investor in the financial sector. On the positive side, if not halted by the new way of global economic pessimism, the returning capital flows will likely further pull through domestic production. Policy responses at present remain appropriate, given inflation subsides and budget remains prudent.

Overall, Q2-2011 lays a basis for slight upward revision of 2011 growth projection from 3% at about 3.5%, while Q3-2011 growth is likely to be around 2.8%.

III Makedonska brigada, bb – 1000 Skopje - Tel: +389 2 2463 156 ext. 203 - marjan.petreski@uacs.edu.mk