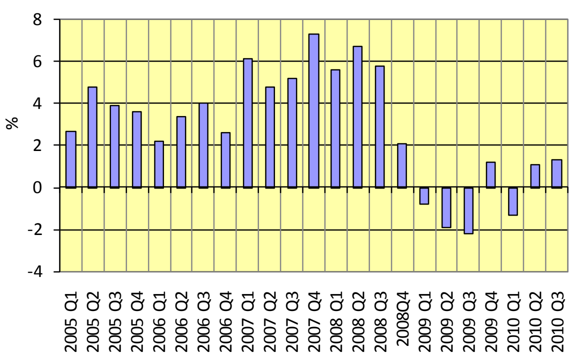
Quarterly Outlook

Volume 1, Issue 2, Q3-2010

1. The real economy[1]

Slow but steady recovery continued in the third quarter of 2010 (Q3-2010) as the economy grew by 1.3% on an annual basis. The slight momentum achieved in Q2-2010 has been retained in Q3-2010, after the plunge in Q1-2010 and over entire 2009 (chart 1).

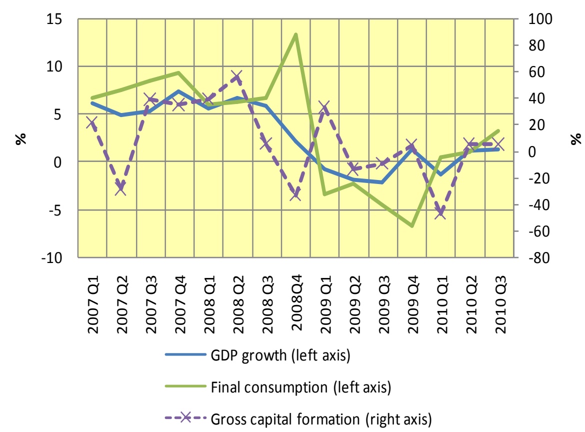
Chart 1. GDP growth (y-o-y)



Source: State Statistical Office (SSO)

The steady recovery in Q3-2010 reflects the growth of nearly all expenditure segments. The recovery of the gross capital formation, as well the growth of the household consumption continued in Q3-2010 (chart 2). After the deep decline in Q1-2010, gross capital formation begun to show signs of revival (growth rates in Q2-2010 and Q3-2010 of 4.7% and 4.8%, respectively), but, given its volatility in the past, any optimistic prognoses about its near-term trend would seem premature. On the other hand, the growth trend of household consumption seems more robust. It mainly reflects the favorable conditions on the labor market (see chart 5) as well the continued ease of credit activity (see chart 7), despite the slight worsening of the consumer confidence (of about 7.6% on a quarterly basis). Even though government-stimulus impact was fading out in Q3-2010 (0.4% decline of government consumption), the fiscal stimulus package implemented earlier maintained the temporary boost of the domestic demand.

Chart 2. Growth of GDP and its components

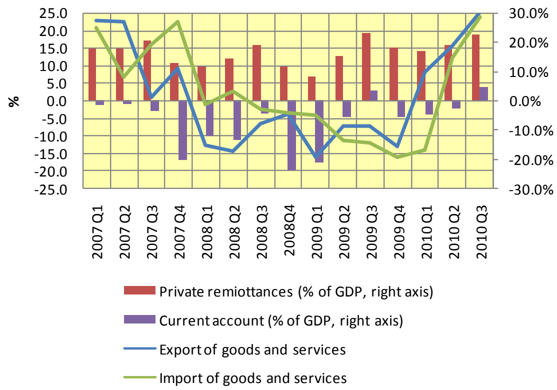


Source: State Statistical Office (SSO)

The containing of the recovery was strongly supported by the growth of export and import in Q3-2010, of 25.2% and 23.8%, respectively. These reflections of a rebounding global economy, alongside the stable and growing level of private remittances (22.8% of GDP in Q3-2010), contributed to positive current account, which in Q3-2010 positioned at 4.6% of GDP, suggesting reduced external vulnerability (chart 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.

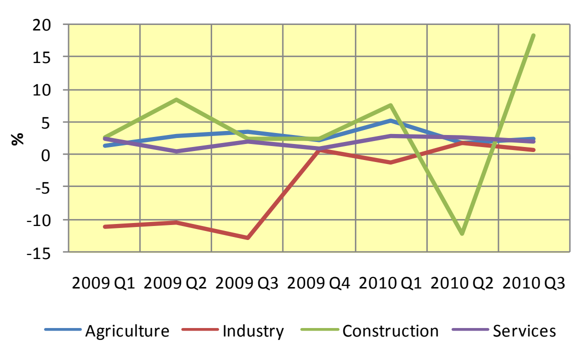
Chart 3. Foreign trade



Source: SSO and National Bank of Macedonia (NBM)

Agriculture and industry continued their moderation in Q3-2010, while construction boomed. Agricultural production growth slightly increased, from 1.8% in Q2 to 2.4% in Q3-2010, while that of industrial production slightly decreased from 1.8% in Q2 to 0.7% in Q3-2010. The favorable trends in the agricultural sector reflect the favorable seasonal conditions in the period, as well as the lagged effect of government subsidies, while industrial production still reflects the still slow recovery of the domestic and foreign consumption. After the sharp fell by 12.1% in Q2, construction grew by 18.4% in Q3-2010, which could be ascribed to the inherent lags in the transmission of government measures and government construction activities on output in this sector (chart 4).

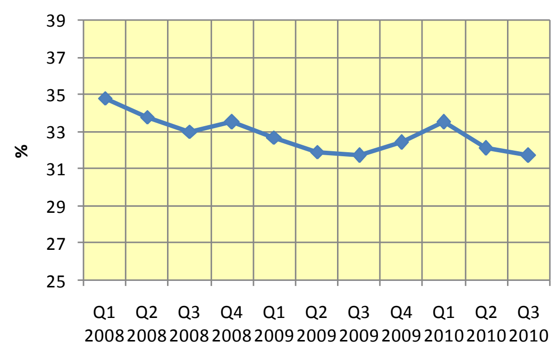
Chart 4. Production sectors growth rates



Source: State Statistical Office (SSO)

Following all above trends in the economy, the unemployment rate in Q3-2010 remained high and persistent, 31.7%, but marked a small decline compared to the previous quarter (chart 5). The unemployment rate mainly declined in the marginal age groups (15-24 and 50-64), while increased in the dominant working-age population (25-49) by 1.2 p.p. These unfavorable developments might reflect the increase of inactive population (students and retirees), at the cost of slow recovery of industry, which mainly employs working-age population. Given this and the slow recovery of the economy, it is likely the high unemployment rate to be retained in a foreseeable future.

Chart 5. Unempoyment rate

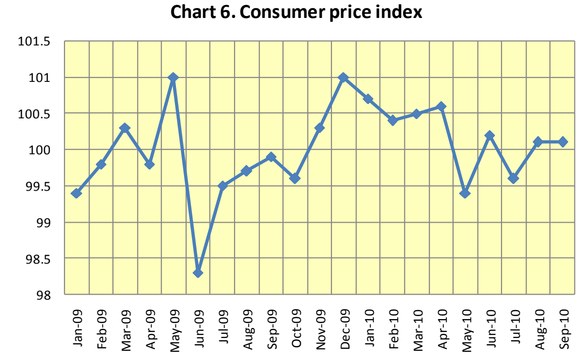


Source: State Statistical Office (SSO)

2. Inflation

Following the slow economic recovery in Q3-2010, inflation remained further subdued. Compared to Q2-2010, CPI further declined by 0.2 index points in Q3-2010, but compared to Q3-2009, it increased by the same amount (chart 6). Spare capacity, both in the labor market and within companies, is likely to be bearing down on costs and prices. Much of the strength in CPI inflation reflects components like food and beverages; and housing, water, electricity, gas and other fuels.

Chart 6. Consumer price index

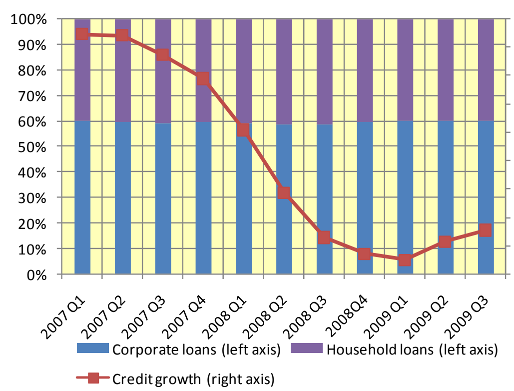


Source: State Statistical Office (SSO)

3. Financial intermediation and interest rates

Financial intermediation kept improving in Q3-2010, with an annual credit increase of 7.7%. The credit growth continues to be more emphasized through the corporate loans (10.2%) than with consumer loans (4.3%) (chart 7).

Chart 7. Credit



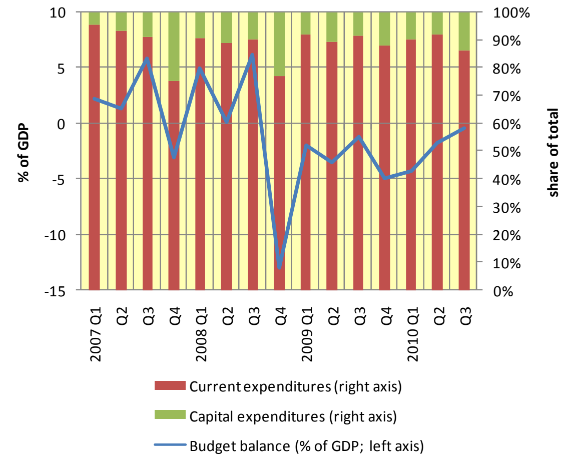
Source: National Bank of Macedonia (NBM)

Monetary policy further relaxed. After a cumulative decline of 3.5 p.p. in the first half of 2010, the reference interest rate further reduced in Q3-2010 and reached a historical minimum of 4.5%. Although staggering, Denar-loan interest rate further declined from 9.6% to 9.2% on annual basis; while forex-loan interest rate slightly increased, from 7.3% to 7.4%. These trends might reflect the still contractive stance of the monetary policy in terms of the reserve requirement.

4. Fiscal behavior

Fiscal policy largely remained prudent, sustaining the budget deficit at 0.5% of GDP in Q3-2010. While the current government expenditures, including wages, contractual services and furniture, increased moderately (5.0%), capital expenditures which are envisaged to support overall economic activity in the medium term considerably increased by 78.5% in Q3-2010 on an annual basis, compensating the sharp decline in the previous quarter (-25.6%) and improving their share in the total government expenditures (chart 8).

Chart 8. Government finance



Source: Ministry of finance (MoF)

5. Near-term economic outlook

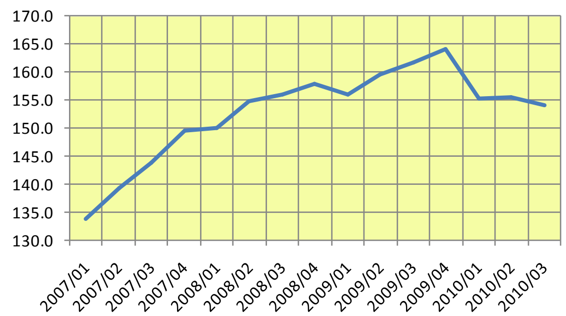
Economic recovery on the world stage keeps on moderating and downside risks remain elevated. Large adjustments are taking place in many advanced and emerging markets, while the pertaining upside risk to unemployment poses significant social threat. However, the recovery rests on two rebalancing acts: internal rebalancing, with a strengthening of household demand in advanced economies, allowing for fiscal consolidation; and external rebalancing, with an increase in net exports in deficit countries, and a decrease in net exports in surplus countries, notably emerging Asia. However, the outlook for the foreign demand is now likely to be better than before. IMF forecasts suggest the global GDP to expand by 4.8% in 2010 and by 4.2% in 2011.

Commodity prices have stabilized after an initial upturn. Crude oil and metal prices are higher than usual at this stage of the recovery, mainly due to the enduring effect of tight markets before the crisis. However, there is currently plenty of spare capacity in the extractive industries, likely enough to meet demand through 2011. Consistent with this view, forward markets see broadly unchanged prices for oil and many other commodities over the near term.

The sluggish recovery of the external demand over the near term and the non-rising raw-commodity prices suggest that Macedonian economic outlook is likely to remain further subdued. External trade will further drive Macedonian growth prospects, but also a shift in global asset allocation and expectations for low interest rates in mature markets will continue to boost capital flows toward emerging markets.

The leading index of the Macedonian economy, UACS LeadEcon suggests slow and shadowed near-term recovery for Macedonia. In Q3-2010, the index fell by 1.4 index points compared to Q2-2010 and by considerable 7.7 index points compared to Q3-2009 (chart 9).

Chart 9. UACS LeadEcon



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

Investment is likely to be sustained in 2011, though. Foreign-investors' confidence will be slowly pulled through, while domestic investment will be steadily driven by the robust external-demand growth and the rebound of the corporate loans growth (see chart 7). As suggested in Q2-2010, due to the inherent lags, construction marks a sort of boom in Q3-2010, further supporting investment activity now and over the near term. Still, in Q3-2010, constructors' assessment of the current construction-orders provision is far away from the pre-crisis level, although improved by about 3% compared to the previous quarter.

Consumption will continue growing. The net-wage and consumer-loan growth are now stabilized. Amidst the non-deteriorating labor-market conditions (chart 5), wage and consumer-loan growth are expected to remain robust, while consumer confidence to further recover.

Net external trade is likely to have a further positive contribution to growth in the near term. In most trading partners, the recovery seems to have entered a self-sustaining phase, beyond inventory rebounding and on to consumption and fixed investment, which are strong because large increases in industrial production have eroded excess capacity. However, the rising import growth (chart 3) will suppress any sporadic current-account surpluses as the one in Q3-2010.

Core inflation is likely to remain subdued in the course of 2011, but food and energy prices upraise to be an important threat. The sluggish global recovery will act on the negative side, but the impact of rising cereal prices is expected to be pronounced and potentially exert social pressure in Macedonia over the near term.

Overall, signs of faster recovery are still absent. Foreign-trade momentum and the slight step up of investment activity will drive growth of Macedonian economy in 2011, but the sluggish recovery in Europe does not guarantee any satisfactory pace. Rising food and energy prices will put on further social strain on the average Macedonian citizen. Domestic policy responses, although being presently appropriate, entail some risks and uncertainties, given: the necessity to potentially tighten the currently eased monetary policy due to pertaining sources of inflation; and the arguably non-productive nature of part of the planned public investment.

Overall, Q3-2010 holds on to Q2-2010 forecasts for 2010 and 2011 of 1% and 2.5%, respectively, but with pronounced downside risks.

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