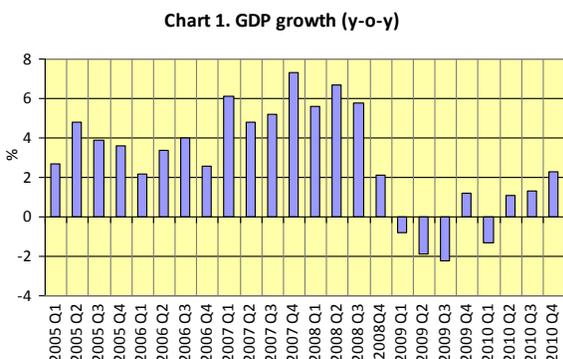


### 1. The real economy<sup>1</sup>

**Slow but gradual recovery continues in Macedonia in Q4-2010, after a period of shadowed economic activity.** After losing momentum during 2009, growth rates show modest performance as of Q2-2010 but with likely sustainable and growing dynamics. Real GDP in Q4 increased by 2.3% on an annual basis (Chart 1). The entire 2010 closed with only 0.7% real GDP growth, which is in line with UACS Quarterly Outlook forecasts for 2010 growth of about 1% with pronounced downside risks.

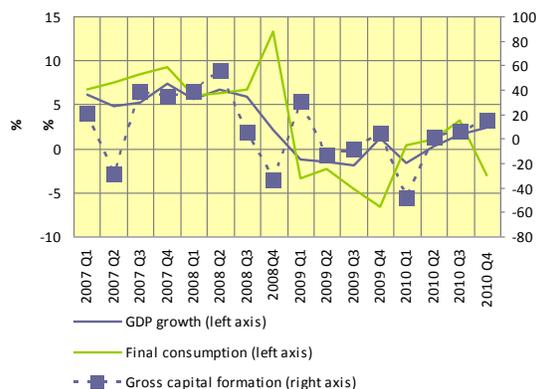


Source: State Statistical Office (SSO)

**The steady recovery in Q4-2010 mainly reflects government construction activity, but also the gradual improvement of investors' confidence.** The growth of investment (14.8%) has had the most significant influence on the economic growth in Q4-2010, but is mainly due to the construction activities of the government. Hence, any judgement about investment without having decomposed picture might seem inappropriate. On the other hand, despite the overall recovery, and pressed by the rising prices and

the still-contracted credit activity, domestic consumption fell by 3.1% on an annual basis in Q4-2010, in spite of the consumer-confidence increase of 4.3% at the quarterly level. Government spending has been further rationalized amid the slow recovery, and decreased by 3.3% on annual basis in Q4-2010 (see Chart 2).

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

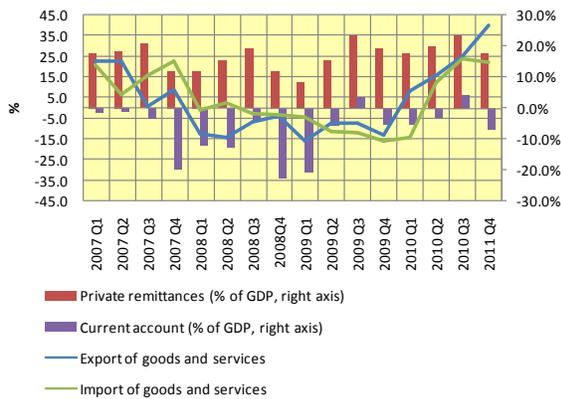


Source: State Statistical Office (SSO)

**The fourth-quarter acceleration in GDP considerably reflected the spiky increase in export of 40%, mainly reflecting the rebounding global economy (Chart 3).** Although import increased by less than export (22.1%), the lower level of foreign remittances (17.7% of GDP) resulted in a negative current account of -7.1% of GDP. At the annual level though, external vulnerability was lower (current account of -2.8% of GDP), due to the more favourable movements earlier the same year.

<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.

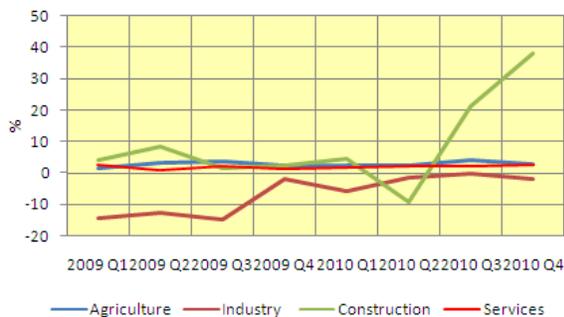
**Chart 3. Foreign trade**



Source: SSO and National Bank of Macedonia (NBM)

**Agriculture and industry further continued their moderation in Q4-2010, while construction boomed.** Services have had modest growth acceleration of 2.6% compared with 2.3% in Q3-2010 (Chart 4). The construction continued to grow and reached record level compared to the previous period (38.2%). As suggested in the earlier reports, this is partly a result of the inherent lags in the transmission of government measures and government construction activities, but in a small extent it also reflects the higher certainty among investors about the economic recovery.

**Chart 4. Production sectors growth rates**

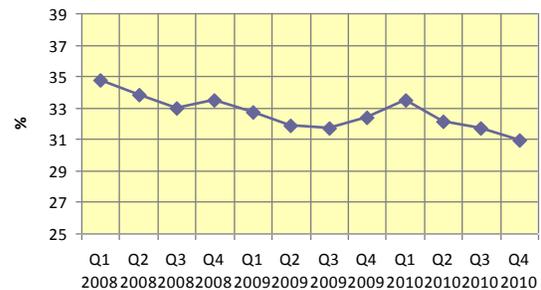


Source: State Statistical Office (SSO)

**Following the slow recovery, the unemployment rate remained persistent, but declined at 30.9% in Q4-2010** (Chart 5). Notable favourable trend is that unemployment declined in each age group, suggesting that the improvement is likely to be of more permanent nature. However, in terms of qualification

structure, the unemployment rate decreased in the unskilled and semi-skilled workers, and increased in the group of highly qualified workers, by 28%, compared with the same period last year. This might be a reflection of the booming construction sector which mainly consumes low-skilled workers.

**Chart 5. Unemployment rate**

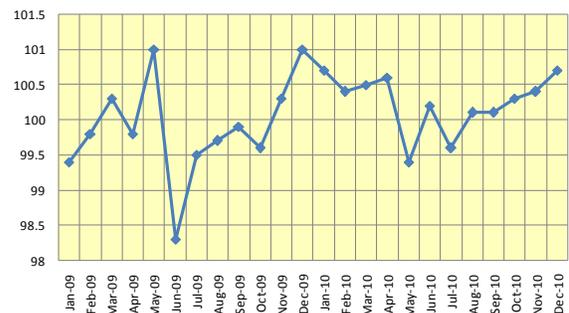


Source: State Statistical Office (SSO)

## 2. Inflation

**The modest recovery did not manage to keep prices low, though. Slight inflation pressures appeared at the end-2010. Inflation went up by 3% in December 2010, while the entire year finished by 1.6% rise in prices.** This is an early reflection of the rises in energy prices and the continued pass-through of import prices on domestic inflation. To illustrate, the Brent oil prices on the London stock exchange have risen by about 28.7% in 2010. Inflation is, hence, likely to increase in the following period, since energy prices and prices of some agricultural inputs are still rising.

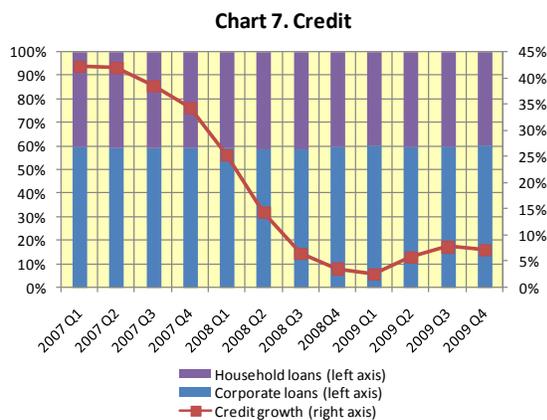
**Chart 6. Consumer price index**



Source: State Statistical Office (SSO)

### 3. Financial intermediation and interest rates

Financial-intermediation growth has been maintained in Q4-2010, with an annual credit increase of 7.1%. The credit growth continues to be more emphasized through the corporate loans (8.4%) than with consumer loans (5.1%), albeit growth decelerated with the former and accelerated with the latter (chart 7).



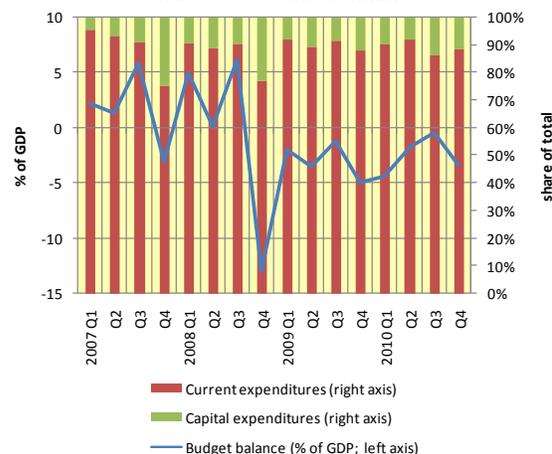
Source: National Bank of Macedonia (NBM)

**Monetary policy further relaxed. After a cumulative decline of 3.5 p.p. in the first three quarters of 2010, the reference interest rate further reduced in Q4-2010 and reached a historical minimum of 4.1% in December 2010.** Although staggering, Denar-loan interest rate further declined from 10.3% to 9.0% on an annual basis; while forex-loan interest rate decrease has been less pronounced, from 7.6% 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, although Q4-2010 marked a budget-deficit worsening (-3.4% of GDP). While the current government expenditures, including wages, contractual services and furniture, increased moderately (2.7%), capital expenditures which are envisaged to support overall economic activity in the medium term marked an unnoticed increase of 1.3%, compared to the 78.5% increase in Q4-2010 on an annual basis (chart 8). However, 2010 overall closed with prudent budget deficit of -2.4% of GDP, which is in line with the projected values.

Chart 8. Government finance



Source: Ministry of finance (MoF)

### 5. Near-term economic outlook

**Economic recovery on the world stage continues its upswing, with some risks still pertaining on the horizon.** Growth dynamics continue to be high in emerging economies; monetary policies, in general, continue to be expansive; and factors that dampen the recovery in many advanced economies are now slowly declining. However, there are two main downward risks for this prospect: first, low interest rates and high credit growth might drive commodity prices to disruptive levels. Second, waning confidence in financial markets might enhance volatility and enforce further extensive measures of consolidation in advanced economies. In addition to this, rising headline inflation due to rising energy and commodity prices poses a further serious threat to the recovery. IMF forecasts suggest the global GDP to expand by 4.8% in 2011, while the euro area will be still staggering behind with a forecasted 2011 growth of only 1.5%.

**Commodity prices continued their upswing as well, after a little moderation.** At present, they pose a threat to convert into second-round inflation effects and exert pressures onto wages. However, at places where labor markets are particularly strained, wages and labor costs also tend to fall, but not enough to compensate the increase in food and energy prices. The present uncertainty about the extent of the Libyan conflict and the final impact of the Japanese natural disaster, it becomes even more difficult to predict the evolution of commodity prices and its impact on inflation in the short- to medium term.

Hence, at this moment, commodity prices are likely to persist but remain stable.

**The sluggish recovery of the euro-area demand over the near term, as well the persistent high fuel and commodity prices suggest that Macedonian economic outlook is likely to remain further jeopardized.** However, reaching and maintaining the pre-crisis export growth rates is likely to continue, while the improvement of investor confidence will boost some capital flows toward emerging markets.

**The leading index of the Macedonian economy, UACS LeadEcon suggests moderate near-term recovery for Macedonia, but with strengthened and more stable outlook than before.** In Q4-2010, the index increased by 2.6 index points compared to Q3-2010, which is still below the Q4-2009 value by 7.4 index points (Chart 9). Index growth marked over 2009 has materialized as of the second half of 2010. The index growth now likely suggests that the growth of the economic activity over the near term will not mark a substantial upswing from the level it reached in Q4-2010.

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 intensified government construction activities, the robust external-demand growth and the rebound of the corporate loans growth (see Chart 7).

**Consumption will continue growing, but at a steady rate mainly due to the higher food and energy prices.** The net-wage and consumer-loan growth are now stabilized. Amidst the non-deteriorating labor-market conditions (Chart 5), consumer confidence will further recover, but wage and consumer-loan growth might be threatened by the rising commodity prices.

**Net external trade's contribution to growth is likely to be intensified in the near term, despite euro-area' growth being below the world average.** In this context, industrial production, and mainly its two heaviest components (intermediate goods and capital goods), will, most likely, strongly benefit from the good performance of the euro-area exports. However, the further rising import growth (Chart 3) might threaten the current account and worsen economy's external vulnerability.

**Core inflation is likely to remain subdued in the course of 2011, but food and energy prices are likely to persist over the year and hence make further social constrain.** The uncertainty around Libya and the price of oil will further build up energy prices, which might threaten consumption and the social rest of Macedonian citizens.

**Overall, while downside risks for the growth somehow rested, faster recovery is likely to be later on the horizon.** Foreign-trade momentum and the slight step up of government construction 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 are likely to convert into threatening second-round effects, making inflation more persistent later in 2011. Domestic policy responses, although being presently appropriate, entail some risks and uncertainties, given: the likely immediate necessity to potentially tighten the currently eased monetary policy due to pertaining sources of inflation; and, in part, the arguably non-productive public capital investment.

**Overall, Q4-2010 holds on to Q3-2010 forecasts of 2011 growth of about 2.5%, while Q1-2011 growth is likely to be about 3.5%.**