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MACEDONIAN QUARTERLY ECONOMIC MONITOR

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1. Resent economic developments and current political environment

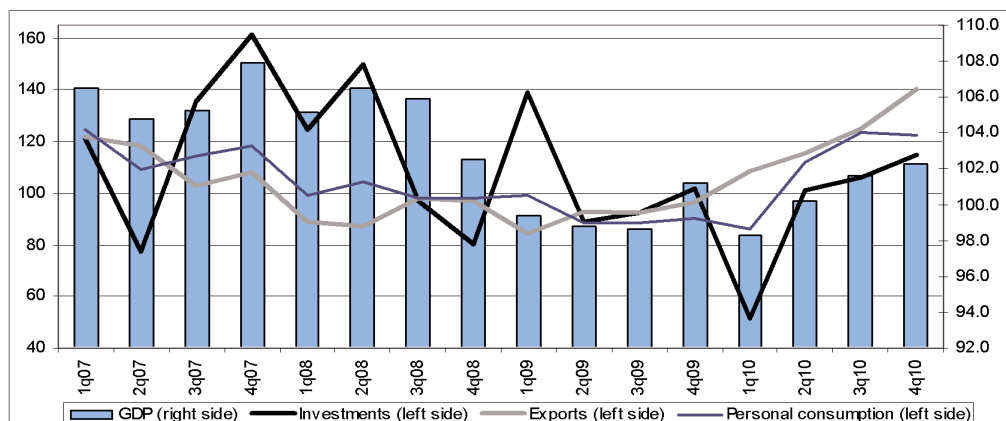
Economic recession in Macedonia is finished and GDP has grown three quarters in a row. Strong growth in export and investments were able to cover weak private and government consumption, reaching GDP growth of 2.3% in the fourth quarter of 2010 in favor of the same period of last year. Private consumption in the last quarter of 2010 declined by 3.1% (yoy) and increased inflation will further endanger weak recovery.

The biggest opposition party blocked the work of Macedonian Parliamentary which resulted in early elections on fifth of June 2011. Current political developments in Macedonia are creating an uncertain atmosphere as if the economic priorities might be endangered with new political campaigns. Finding solutions for the name issue between Macedonia and Greece might not happen in near future thus, blocking joining NATO membership and EU negotiations.

2. GDP developments

Starting from the second quarter of 2010 recovery continued till the end of 2010. After decline of 0.9% in 2009, GDP in 2010 showed small, but very significant growth of 0.7%. GDP kept the momentum from the previous two quarters, reaching grow of 2.3% (yoy) in the last quarter of 2010. This growth, mainly is driven by the strong recovery of the construction sector (38.2% yoy), which is the result of the Government investments and on-going reforms for simplifying the procedures for obtaining working permeations and other related documents. Also the trade and handicraft sector continued with strong growth in the fourth quarter (11.5% yoy). Agricultural sector kept a declining trend from the previous 3 quarters, declining by 3.7% (yoy) in the last quarter of 2010. Increased amount of subsidies and IPARD program were not able to pull agriculture from declining. In the fourth quarter, the number of nights spent by tourists increase by 3% (yoy), but sector of Hotels and restaurants during the same period declined by 6.3% (yoy). Analyzed by expenditure side, in the fourth quarter, strong growth had export (40% yoy) and investments (14.8% yoy). While personal consumption, after the increase in the previous two quarters, had negative growth of 3.1% in the last quarter of 2010. Government consumption during all four quarters of 2010 was declining, showing -3.3% (yoy) decrease in the fourth quarter.

Chart 1. GDP growth rates (yoy)



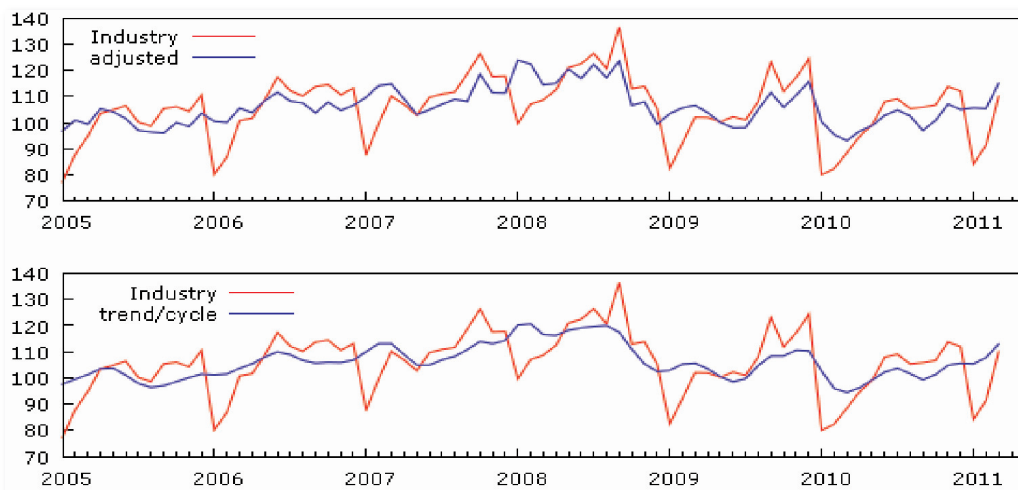
Source: State Statistical Office

3. Real sector

Increased industrial production...

Industry had negative growth during the last quarter of 2010, strongly increasing in the beginning of 2011,¹ by 24.5% (yoy) in March 2011. This was due to the increase of metal and energy prices on the global markets, mining and quarrying had a growth of 24.4% (yoy) in March 2011. Manufacturing, as the biggest industrial sector (participating with 83.7% in the industry), had growth of 28.9% in March 2011 in comparison with March 2010, driven mostly by the increase in the textile sector and production of iron and steel.

Chart 2. Industrial production – seasonally adjusted and industry cycle



Source: State Statistical Office, authors' calculations.

1) Here must be mentioned that at the beginning of this year, the State Statistical Office, for the purpose of collecting and processing data on Industrial production volume indices used the new National Nomenclature of Industrial Products 2008, while for calculation and publication of industrial production volume indices the new National Classification of Activities Rev.2 was used. Part of the growth is result of the changes in the sample, by involving new opened facilities/observations.

Serious slowdown in the construction sector....

After strong expansion in the second half of 2010, the construction sector in the beginning of 2011 is facing a serious slowdown. Issued construction permits in March continue a sharp drop, having 35.9% less value (yoy). The value of completed construction works abroad in 2010 is 15.1% less compared the previous year, and more concerning is that contracted construction works abroad in the first quarter of 2011, which is in period of economic recovery, are having 52.1% less value compared with the same period of the previous year.

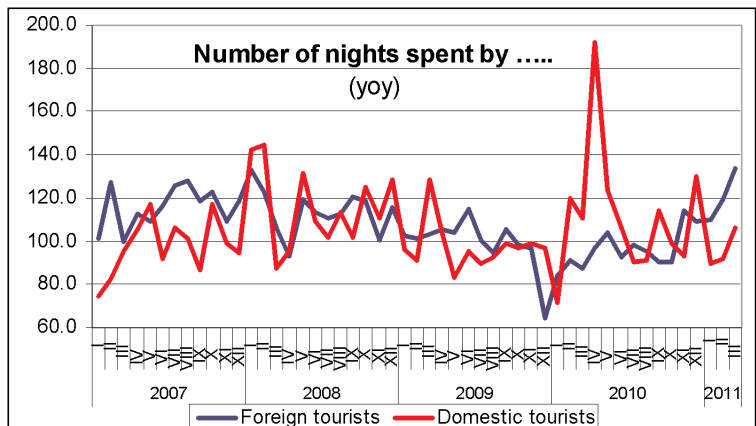
Growth in the retail is kept....

Trade had stable growth in the fourth quarter of 2010, turnover in the retail and wholesale trade were increased by 5.8% and 10.4% respectively. Increased food and oil prices influence on the decreasing the growth rates of the retail sector, from 83.1%² (yoy) in January to 36.8% (yoy) in February 2011, but still there is strong growth. Decrease of growth rates in the retail sector is expected to continue in the following months due to the weakened purchasing power of Macedonia households.

More foreign tourists...

Number of domestic tourists at the beginning of 2011 had small increase, but number of foreign tourists is having strong stable growth of 14.8 and 31.6 percentages in February and March 2011 compared with previous year, respectively. Number of spent nights by tourists in March 2011 had strong increase of 19.9 % (yoy). On average, each tourist is staying 2.3 nights on its destination in Macedonia.

Chart 3.



Source: State Statistical Office

4. External Sector

Stronger export growth.....

Export in 2010 recovered much faster from the import. High export in 2010 growth of 22.7% is driven by the increased demand in the main trade partner of Macedonia, European Union, and favorable global prices of commodities, especially metals. Import also had significant growth, but with slower dynamic from the export, reaching 8.1% growth in 2010. In the beginning of 2011, export kept its momentum, growing by 40.2% (yoy)

2) State Statistical Office starts publishing monthly data about retail and wholesales from January 2011.

in the period of January-March. Import also had sharp increase of 44.2% (yoy) in the first quarter of 2011. Very high import growth rates are mainly caused by the import of materials for manufacturing car parts, catalysts, which were not previously included in the statistics. Strong increase in the import of equipment, machinery and various materials is showing that crisis has been overcome and conditions in the Macedonian economy are considerably improved.

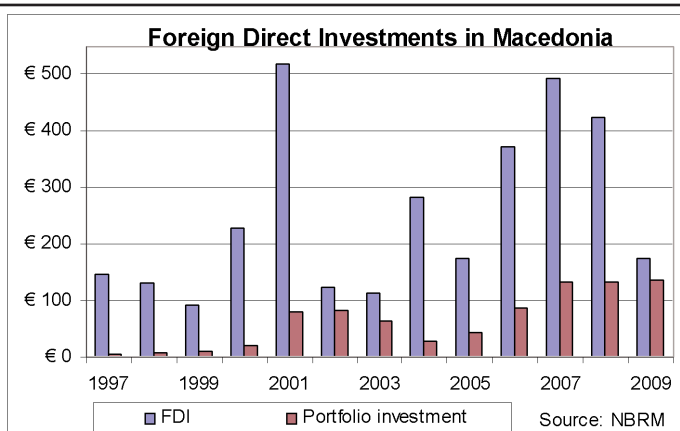
Decreased current account deficit and increased external debt...

Current account deficit in 2010 was 2.8% of GDP and is significantly lower from the previous year (6.7% in 2009) due to the strong export growth and increased transfers. Net FDI in 2010 were increased 52.7%, amounting 221.4 millions of Euro, which is 2.2% of the nominal GDP. 96.3% of FDI came from only 4 countries: France, United Kingdom, Austria and Bulgaria. As a result of the economic crisis in the Advance European Economies it was expected that current transfers will be decreased. Fortunately net current transfer continued its growth in 2010 reaching 1,366 million of Euros, representing 19.8% of the nominal GDP. In spite of the relatively favorable balance between net FDI and current account deficit, gross external debt was increased by 5.8% in 2010 in favor of 2009, reaching 62.4% of GDP. This was mainly result of the increase in the private debt, mostly due to the increased in the trade credits, bank loans and debt liabilities to the direct investors.

Chart 4.

Foreign direct investments
in Macedonia

Source: National Bank of Republic of
Macedonia



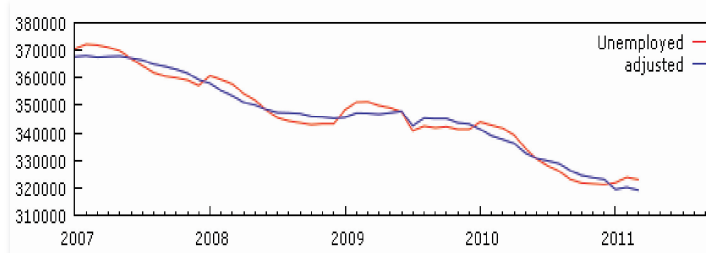
5. Labor market

Number of unemployed, according Employment Service Agency, continues to drop in the fourth quarter of 2010 and beginning of 2011. After the increase of 2 600 new unemployed in January and February, in March 764 unemployed are removed from the list. Unemployment in the fourth quarter of 2010 was decreased by 1.5% (yoy), but is still on a high level of 30.9 percentages. During the same period; there was increased employment rate by 2% and activity rate by 1.7% (yoy). During the same period, number of employed in the agricultural sector was increased by 22.1% (yoy), as a result of the program for registering of farmers, in which Government is providing pension, social and health security for a very low price. Increase of metal prices on the global markets, after the economic crisis, contributes to increasing the number of miners by 24.3%. Also, number of employees in the hotels and restaurants was increased by 15% (yoy) in the fourth quarter 2010.

Chart 5.

Number of unemployed by
Employment Service Agency of
RM seasonally adjusted

Source: ESA statistics, authors'
calculations.



Average monthly gross wage, paid per employee in February 2011 is 30,032 MKD (around 500 Euros). Due to the high inflation gross and net wage in real term was decreased by 2.8% (yoy). Biggest increase of gross salaries is noticed in the export oriented sectors, such as mining and quarrying, manufacturing machinery, equipments and motor vehicles. Highest decrease in February 2011 was noticed in the trade and insurance sector by 3.7 and 3.9 percentage (yoy) respectively.

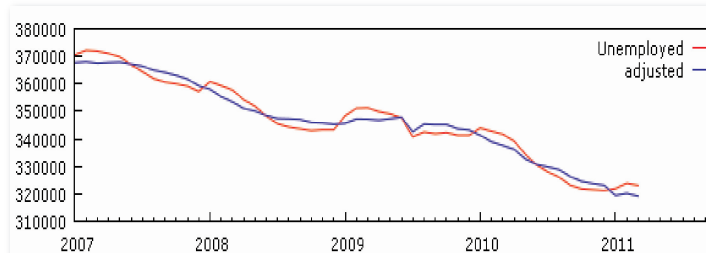
6. Monetary developments

After reaching 5.2% in March, inflation stopped to grow in April 2011 and leveled at 4.8% (yoy). National Bank of RM increased projection about the inflation in 2011 from 3 to 4.5-5 percentages. This is imported inflation resulting from the increase of commodity prices, mainly oil and food, on the global markets. Prices of Food products and fuels had the biggest increase in Macedonia. Sharply increased food prices further are worsening life conditions for 1/3 of Macedonian population who lives in poverty.

Chart 6.

Consumer Price Index and
Food inflation

Source: State Statistical Office



Growth of broad money (M4), continue in the fourth quarter of 2010 reaching a 12.2% increase (yoy). The same situation is with narrow money (M1), after two digits growth in the second and third quarter, finished the year with increase of 9.8%. Total amount of deposits was by a 14% increase in December 2010, compared with the same month from the last year. Household savings were increased by 17.4% in the end December 2010, in favor with the same period of last year. Positive pace in savings with two digits growth continued in the beginning of 2011.

Credit activity during the whole 2010 had stable growth, which continues in the beginning of 2011. Enterprise borrowing in December 2010 is increased by 8.4% (yoy), and by 5.1% is increased household borrowing, for the same period. In March 2011 both, enterprise and household savings continued to grow reaching 10.4 and 14 percentage (yoy), respectively. Credit activity in March 2011 was also increased by 9% for loans given to enterprises and household's loans increase by 6.6%. Weighted interest rates on loans in MKD decrease by 1.5 p.p. in December 2010, on 8.6%, and continue to decrease in 2011 reaching 8.1% in March 2011. High inflation of around 5% will influence decreasing interest rates to stop in the rest of 2011. Relaxed monetary policy and historically lowest level of CB bills on 4% in March 2011 would not be able to compensate inflation for further decreasing of interest rates.

7. Fiscal sector

Revenues in the fourth quarter of 2010 were higher by 1.6% from the last quarter of 2009. Taxes, as a biggest source of budget revenues, were higher by 2.2% (yoy). In the same period profit tax was increased by 25%, which is strong sign of the recovery of enterprises and increased profits, while import duties and VAT were lower by 21.1% and 1.5% respectively (yoy). This is mainly the result of the lower import in the last quarter of 2010. Social contributions in the last quarter of 2010 declined 0.9% (yoy), which is an unusual situation having in mind that number of employed during the same period was increased by 5.9% (yoy).

After strong increase of the expenditures of 11.2% in the third quarter on yearly level, spending was stabilized in the next quarter, with increase of 0.9% (yoy). Government decrease costs for salaries and allowances by 0.6% (yoy). Also, expenditures for goods and services were lower by 6.6%, from the fourth quarter of 2009. Decreased revenues from the social contributions, contribute to increasing budget transfers by 2.8% in the fourth quarter of 2010. After big fluctuations capital expenditures were relatively stable, with increase of 1.4% on yearly basis.

Budget deficit in 2010 was MKD 10.5 billion, realizing 100 percent of the fiscal target, and representing 2.5% of GDP. Total public debt in 2010 was 3 p.p. higher from 2009, amounting 35.1% of GDP. Debt structure in the end of 2010 was worsened compared to the end of 2009, by 4.1 p.p. and increased domestic borrowing causing "crowding out effect". To improve this situation and decrease the negative "crowding out" effects Macedonian government must provide precautionary credit line (PCL) from IMF in amount of 390 Million Euro, from which 200 Million Euro (2.9% of GDP) are drawn in April 2011.

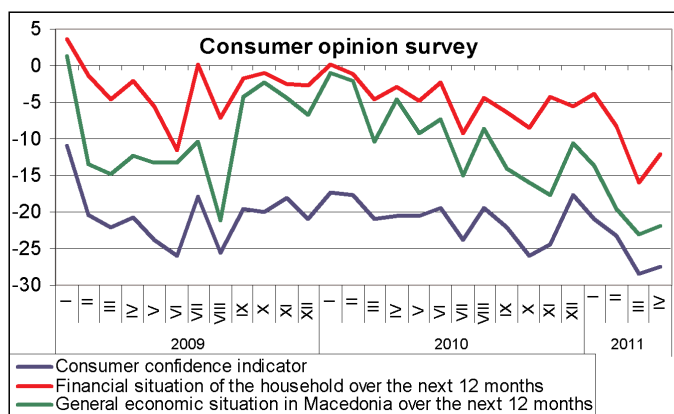
8. Expectations and uncertainties

Current situation in the Macedonian economy is dominated by positive developments in almost all sectors. Due to the increased customer confidence, export, industry and lending in the first quarter of 2011 are expected higher growth of GDP, from 2.3 percentage increase (yoy) in the fourth quarter of 2010. Also, as the GDP is growing three quarters in a row we expect sustainable growth prospects of the GDP in midterm.

Economic situation of households is expected to start improving in the mid term. While financial situation of the households in April 2011 is improved and over the next year is expected to be further improved, with tendencies for keeping the pace of growth in savings. Weak private consumption is expected to start growing due to increased consumers' confidence, expected improved of the general economic situation in Macedonia and reduced unemployment.

Chart 7.

Consumer opinion survey



Source: State Statistical Office

Increased domestic demands in our biggest trade partners European Union and Western Balkans countries is expected to continue during 2011, which will increase Macedonian export. Increased export and increased

prices of commodities on the global markets will keep pace of industrial production and growth is expected to continue during the next quarters. Number of foreign tourists is expected to have stable growth, due to the global economic recovery, modernized Ohrid Airport and introduced direct flights from some of the European biggest cities during the tourist season.

In the financial sector, banks are expected to further increase lending to the enterprises and households due to the favourable monetary tendencies. During 2010 and beginning of 2011 deposits were growing very fast, and affordable credits from European Investment Bank are available for medium and big enterprises with low fixed interest rates in the first 3 years. Also, Ministry of Finance drew 200 million Euros from the IMF precautionary credit line (PCL), for covering budget deficit and returning money to the real sector of the economy. Last but not least positive factor, which will stimulate banks to increase lending to the real sector, is the historically lowest level of CB bills of 4%.

Uncertainties

Strong negative tendencies are present in the construction sector, agriculture has negative growth during the whole 2010, inflation is higher from previous expectations and outcome from the elections is making uncertainties regarding economic policies in the country.

During the campaign opposition political parties are announcing big changes in the economic policies. This may slow down current economic growth during the implementation of the reforms now with more balanced power at the Parliament. Current biggest ruling party is saying that they will continue with the same policies. In this situation, big shifting in the current constellations is not expected but the Government must work more on consensus building.

Inflation is decreasing purchasing power of Macedonian households which will cause strong negative effect in the growth of personal consumption and retail and wholesale sector. Also interest rates can be under pressure to start growth if inflation continues to growth in the upcoming months. All this has strong potential to injure weak recovery of the personal consumption.

Labor market in Macedonia is not following the same trends as GDP. During 2009 when GDP was falling, number of employees was increased and number of unemployed decreased. This shows that it is very difficult to predict what will happen in the labor market in near future. General tendency is that situation will be improved with continued decrease of unemployment and increasing active population and employment.

Table 1: Main economic indicators

	2009	2010	2010			
			Q1	Q2	Q3	Q4
Economic Activity						
Real GDP (% change, yoy)	-0.9	0.7	-0.9	0.4	1.3	2.3
Real private consumption (% change, yoy)	-3.9	5	3.9	6	9.8	0.8
Real government consumption (% change, yoy)	1	3,4	3.3	-6.5	-0.7	14.8
Real investment (% change, yoy)	-0.6	-8.4	-78.9	14.3	14.9	10.9
Industrial output (% change, yoy)	-7.7	-4.3	-9.1	-1.5	2.8	-4.5
Unemployment rate (ILO, %)	32.2	32.05	33.5	32.1	31.7	30.9
Nominal GDP (EUR million)	6,677	6,892	-	-	-	-
GDP per capita (EUR)	3,253	3,358	-	-	-	-
Prices, Wages and Exchange Rates						
Consumer prices (% change, yoy, pa)	-0.8	1.6	0.5	1.1	1.8	2.9
Retail prices (% change, yoy, pa)	-1.4	2.6	2.0	2.3	2.4	3.5
Average gross wage (% change, yoy, pa)	14.1	1	1.1	0.7	0.9	1.7
Average exchange rate MKD / USD	44.1	46.5	44.4	48.4	47.8	45.3

Exports of goods (USD million)	2,692	3,302	667	781	888	966
Exports of goods (USD, % change, yoy)	-32.6	22.7	27.9	16.5	16.4	31.1
Imports of goods (USD million)	3,472	5,451	1,117	1,335	1,349	1,648
Imports of goods (USD, % change, yoy)	-26.7	8.1	-2.5	13.5	8.8	11.4
Current account balance (EUR million)	-449.3	-191.1	-81.8	-50.5	77.3	-136.0
Current account balance (% of GDP)	-6.7	-2.8%	-	-	-	-
Gross foreign direct investment (EUR million)	175.7	221.4	50.9	76.34	6.2	88
Foreign exchange reserves (EUR million, eop)	1,598	1,715	1,607	1,708	1,689	1,715
Foreign debt ((% of GDP, eop)	56.6	62.4	55.3	58.8	58.7	62.4
Foreign public debt (EUR million, eop)	1,325	1,416	1,343	1,393	1,378	1,416
Foreign private debt (EUR million, eop)	2,455	2,884	2,466	2,661	2,665	2,884
Government Finance						
Revenue (MKD million)	128,498	132,150	29,521	32,325	36,133	34,173
Expenditures (MKD million)	139,393	142,692	33,619	34,298	36,705	38,130
Net = Gross operating balance (MKD million eop)	-10,895	-10,542	-4098	-1973	-572	-3957
General government debt (EUR million, eop)	1,597	1,711	1,601	1,664	1,651	1,711
Total public debt (as % of GDP eop)	32.1	35.1	32.3	33.7	34.1	34.2
Domestic debt as % of total public debt, eop	35.5	39.6	37.6	38.0	38.1	37.9
Monetary Indicators						
Narrow money, M1 (% change, yoy, eop)	-3.5	9.8	7.4	10.3	12.2	9.8
Broad money, M4 (% change, yoy, eop)	6	12.2	10.7	14.8	13.4	12.2
Total deposits (EUR million, eop)	3,050	3,467	3,129	3,272	3,312	3,467
Total Loans (EUR million, eop)	2,897	3,103	2,939	3,012	3,067	3,103
Total domestic credit (% change, yoy, eop)	3.5	7.1	-	-	-	-
Loans to households (% change, eop)	3.5	5.1	-	-	-	-
Loans credit to enterprises (% change, eop)	3.7	8.4	-	-	-	-
Interest rate on CB bills (% , eop)	8.5	4.1	7.3	5.5	4.5	4.1
Loans rate for enterprises, short-term with a currency clause (% , pa)	8.5	8.5	8.8	8.5	8.3	8.3
Loans rate for households, short-term with a currency clause (% , pa)	8.2	7.8	7.9	7.8	7.7	7.6

Notes: Conventional abbreviations: pa - period average; eop - end of period; yoy - year on year; MKD – Macedonian Denar; EUR – Euro; US\$ - US dollar.

Sources: State Statistical Office, National Bank of Republic of Macedonia and Ministry of Finance.

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