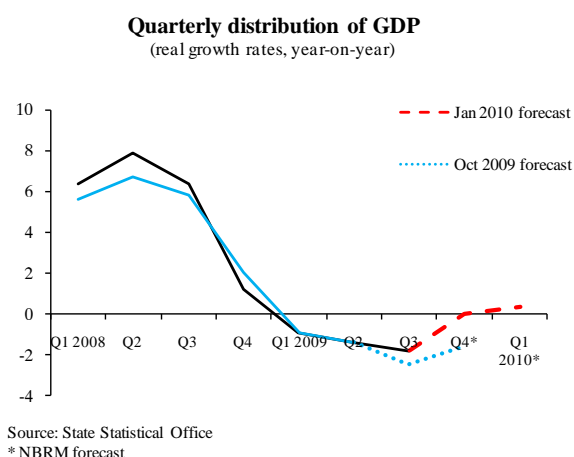


## IV. Macroeconomic projections

*The third quarter reported a faster annual fall of GDP, however, in a slower pace than projected. The latest estimations indicate interruption of the negative GDP trend and stabilization of the domestic economy in the last quarter of 2009. Taking into account the performances in the first three quarters of 2009 and the assessment for the last quarter, the projection for the annual GDP growth for 2009 was revised. Thus, current estimations for 2009 show a decrease of 1%, compared to the previous expectations for faster contraction of 1.6%. In 2010, the external demand recovery is expected to transmit into a mild growth of the domestic economy. Thus in the first quarter of 2010, the growth is expected to be moderate (0.4%) and driven by the exports and the moderate revitalization of the household consumption.*



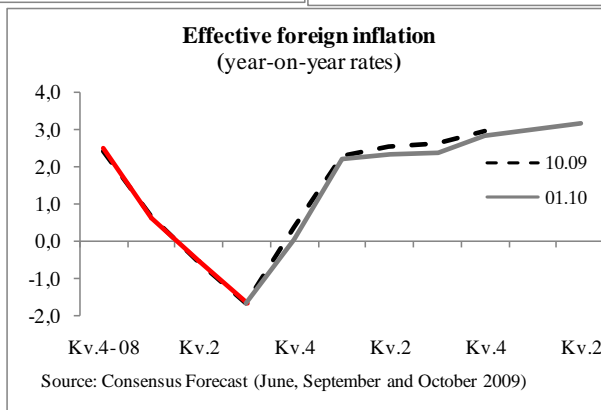
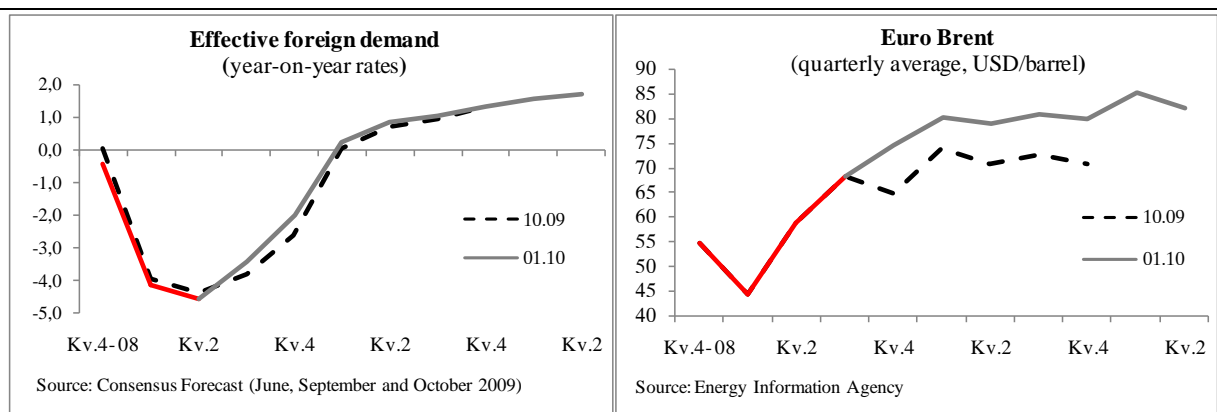
*As expected with the NBRM projections, in the third quarter, the contraction of the economic activity accelerated to 1.8%. However, the contraction is milder compared to the projection of 2.5% fall for the third quarter. This deviation could be partially explained with the almost as twice as lower fall of the personal consumption compared to the projection. It was perceived that the prudence of agents and lower lending will lead to faster deceleration of the personal consumption in the third quarter. Still, the latest revised GDP data indicate that the most extensive negative adjustment of household consumption occurred in the second quarter of the year, with the fall in the third quarter being more moderate. The slower contraction of economic activity was under the influence of the positive contribution of the joint consumption, as well (in spite of the projections for its contraction in the third quarter) and the moderately higher positive contribution of the net-exports than projected. Yet, the downward adjustment of the domestic demand and its negative contribution to the GDP growth, with a positive contribution made to the net-export demand in the third quarter of 2009, are consistent with the NBRM projections.*

### Annex 1

#### Assumptions for exogenous variables

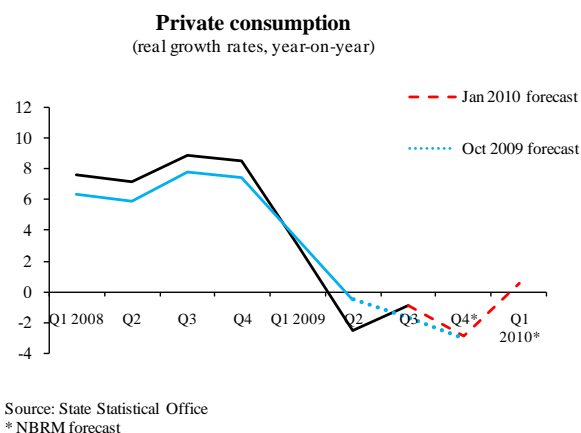
In the first half of 2009, the economic developments of our main trading partners were even more negative than previously assessed. On the other hand, the performances in the third quarter of 2009 were better than expected; the projections for the external effective demand for the next period were further upwardly revised. The external effective demand for the last quarter of 2009 suffered the highest revision (fall of 2% instead of 2.6%, previously), with the expectations for 2010 moderately improving. Thus in 2010, **the external effective demand<sup>1</sup>** is expected to go up by 0.9%, unlike the previously expected growth of 0.7%. The growth of the external demand becomes positive in the first quarter of 2010, and it is expected to reach 0.2% annually.

<sup>1</sup> Effective external demand is a sum of weighted GDP indices of the most important trading partners of the Republic of Macedonia, through the stabilization of their share in the Macedonian exports. The calculation of this indicator includes Germany, Greece, Italy, the Netherlands, Belgium, Spain and Serbia.



The higher oil prices at the end of 2009, plus the expectations for demand recovery, triggered further upward revisions of the projected oil prices. In the fourth quarter of 2009, the average *oil price* was higher than projected in October (US Dollar 74.6 per barrel, compared to US Dollar 64.9). This is the major factor that contributed to the expectations for higher prices in 2010, when it is projected the moderate uptrend of oil prices to continue, i.e. average oil price of US Dollar 80 over the year.

Expectations for the developments of the *foreign effective inflation*<sup>2</sup> have been downwardly revised, which is contrary to the upward revisions of the external demand and the oil prices. Major driver of such developments is the lower initial base, i.e. unchanged prices in the fourth quarter of 2009 (on annual basis), compared to the expected growth of 0.4% in the October projection. Negative developments of foreign food prices remain one of the most significant elements of such tendencies. The postponed exit from deflation of the most important countries for our imports resulted in moderate downward corrections of the projections for each quarter of 2010, when the average total inflation is expected to equal 2.4%.

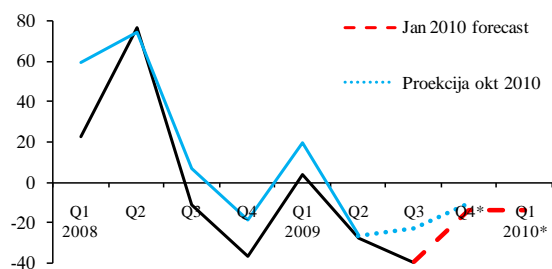


*The assessments indicate stabilization of the domestic economy in the last quarter of 2009, with GDP perceptions that it will remain unchanged on annual basis.* This is significant improvement compared to the previous projection for contraction of the economic activity of 1.6% in the last quarter. The decomposition of the movement between the two projections show dominant influence of the new assessments for greater downward adjustment of the import volume compared to the previous expectations, and therefore, higher positive contribution of the net-exports to the GDP growth. Faster downward adjustment of the imports is mainly explained with the revision of the joint consumption projection. According to the latest

<sup>2</sup> Effective foreign demand is calculated as a sum of weighted GDP indices of the most important trading partners of the Republic of Macedonia, through the stabilized share of these countries in the Macedonian exports. The calculation of this indicator includes Germany, Greece, Italy, the Netherlands, Belgium, Spain and Serbia.

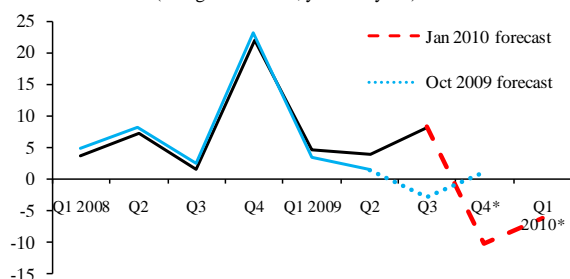


**Gross investments**  
(real growth rates, year-on-year)



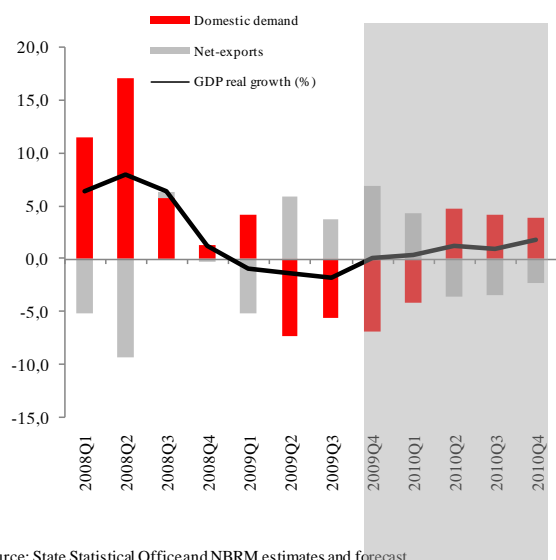
Source: State Statistical Office  
\* NBRM forecast

**Public consumption**  
(real growth rates, year-on-year)



Source: State Statistical Office  
\* NBRM forecast

**Domestic demand and net-exports contributions to the real GDP growth**  
(in percentage points)



Source: State Statistical Office and NBRM estimates and forecast

budget performances as of December 2009, joint consumption is expected to fall in real terms on annual basis in the fourth quarter of 2009, which is contrary to the previously projected moderate annual growth. Estimations for other GDP components do not diverge significantly from the previous projection. It is further considered that perceptions for potential deterioration of the labor market conditions influence the consumer decision, which, together with the lower financial support, and the significantly higher comparison base of the last quarter of 2008, leads to a faster fall of personal consumption in the last quarter 2009. Thus, having relatively unchanged assessments for the negative contribution of the personal and the investment demand, as well as the exports, the improved estimations for economic growth in the last quarter of 2009 fully result from the higher positive effect of the net-export demand, which overpasses the negative effect of joint consumption.

*In line with the latest performances and assumptions, the previous assessment for GDP fall in 2009 has been revised from 1.6% to 1%. Still, the contribution of net-export demand is positive, conversely to the negative contribution of the domestic demand.*

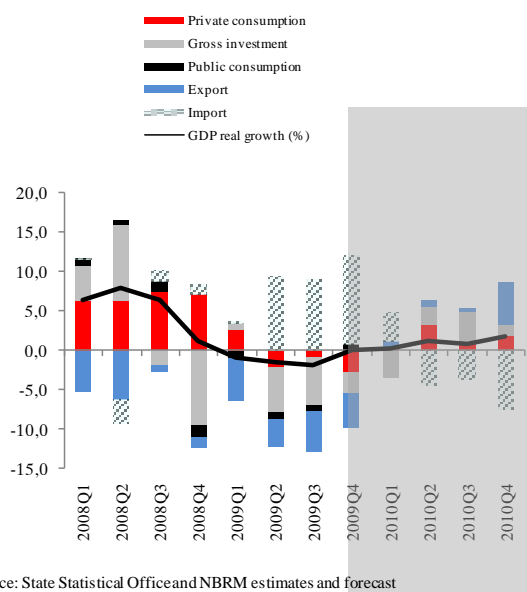
*Having relatively improved developments at the end of 2009 compared to expectations, and the optimistic expectations for the global economy, the GDP growth rate for 2010 is perceived to equal roughly 1%, with faster growth in the second half of the year, which is consistent with the NBRM November projections.<sup>3</sup> Unlike 2009, the domestic factors, i.e. personal and investment consumption are expected to drive the growth. On the other hand, the net-exports is expected to act divergently due to the faster imports recovery, reflecting the improved domestic demand and exports growth. These projections, however, are accompanied with high uncertainty for the labor market developments and the recovery pace of the global economy. Thus, the risks related to wage and employment are symmetrical, and the global growth is primarily under the threat of the risk of slow recovery or rapid growth deceleration.*

*In the first quarter of 2010, the Macedonian economy is expected to start recovering from the global shock, with estimations for the real annual GDP growth of 0.4%. The annual exports revitalization and the mild recovery of household consumption are factors that drive the growth, whereas investment and joint consumption are expected to keep their negative annual trend. Consequently, the change in the domestic demand is expected to trigger contraction of the import demand, but in a slower pace compared to preceding quarters. The above, together with the revitalized foreign demand, will result in a positive contribution of the net-*

<sup>3</sup>Published in "Monetary Policy Projection for 2010".

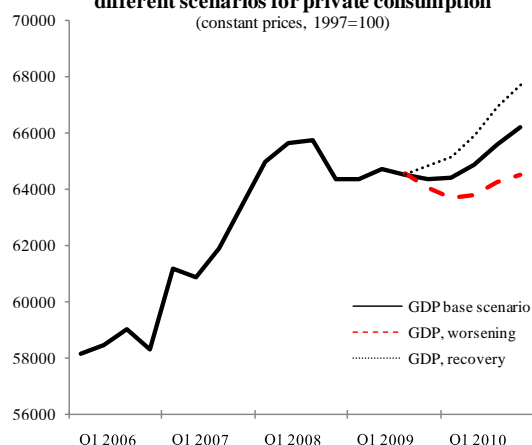


**Contributions to the real GDP growth, by components**  
(in percentage points)



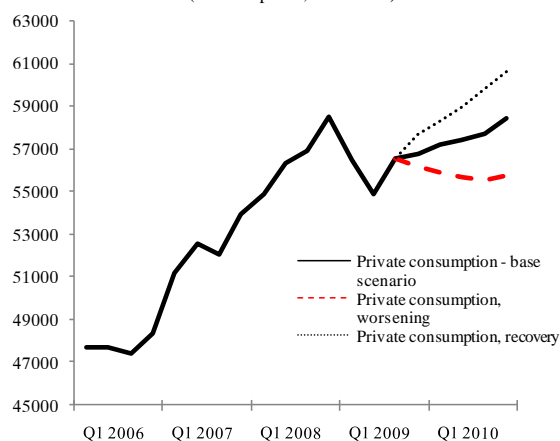
Source: State Statistical Office and NBRM estimates and forecast

**Base and alternative GDP scenarios conditional on different scenarios for private consumption**  
(constant prices, 1997=100)



Source: NBRM

**Base and alternative private consumption scenarios conditional on different scenarios for labour market**  
(constant prices, 1997=100)



Source: NBRM

exports to the annual GDP growth, same as in the previous three quarters.

**Contraction of the domestic demand, which started in the second quarter of 2009, is expected to continue in the first three months of 2010, but in a slower pace.** Such domestic demand trajectory is determined by the still weak investment consumption, the lower current government spending and the expected mild recovery of household consumption. **The annual real growth of personal consumption is projected to 0.5%** (in condition of quarterly fall of 8%, for the most part being seasonally determined). Such developments in the personal consumption are moderate and conditioned by the current assumptions for sustaining the positive tendencies on the labor market. In spite of the expectations for deterioration of the labor market tendencies, in 2009, the average wage in the economy registered no downward revision; on the contrary, it registered further growth. Also, the employee data show marginal improvement. If such tendencies, although in a slower pace, sustain in the first three months of 2010, one could expect alleviation of the current uncertainty of economic agents for keeping their jobs and wage levels. Such positive perceptions, together with the expectations formed on the basis of stabilization of the economic developments, would mean return of the consumers' trust. Additional sources of financing also encourage the household consumption recovery. Thus, in the next period, most of the gap between the income and the consumption is expected to be closed by private transfers. The perceived accelerated lending activity is also expected to move to this direction, driven by the improved banks' perceptions and recovery of the economic activity.

However, note that **labor market is the main point of uncertainty surrounding the GDP projections.** Personal consumption sensitivity to this market segment, also means high sensitivity of the total GDP, due to the high share of this structural component. Changes in positive or negative direction with respect to employment and wages will also mean various GDP growth scenarios. Thus, for example, the contracted economic activity in 2009 is expected to lower the company earnings. This could make the firms rationing their labor costs, through downward revision of wages and/or number of employees. Public sector wage policy could also contribute to the above, and it is certain, however, that it will remain the same for 2010. On the other hand, labor market trends could prove to be favorable compared to the basic scenario. For example, the potential intensive positive impetus from external demand would mean much positive prospects and expectations for the future pace of recovery of the domestic economy, and therefore, better tendencies on the labor market. Taking into account the above, apart from the basic GDP scenario, a sensitivity analysis has been conducted showing the effects on the personal



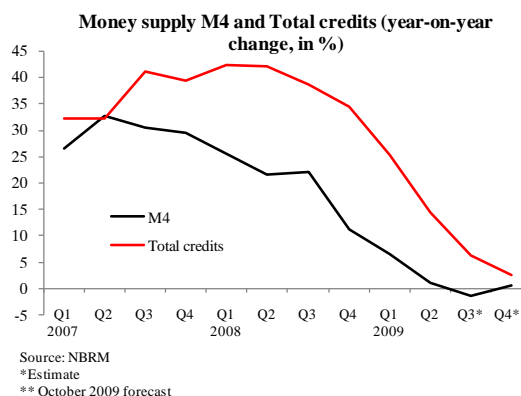
consumption and GDP, in environment of worse/better trends on the labor market (see figures for results)<sup>4</sup>.

## Annex 2

### Projections for the banks' credit activity in the first quarter of 2010

In the third and the fourth quarter of 2009, the trends with both the monetary and the credit aggregates registered an improvement compared to the first half of the year. More stable macroeconomic environment, primarily the favorable movements in the external sector in this period and the signs of recovery of the world economy were the main factors for such movement. *Thus in environment of high inflows from private transfers, increase in the capital flows, increase in the interests on the deposits and more stable expectations of the domestic entities, acceleration in the monetary growth rates in this period was registered. Although these trends were incorporated in the November monetary growth projection<sup>5</sup>, however the performances at the end of the year show more intensive growth in the money supply than estimated.* Thus in December 2009, the broadest money supply M4 went up by 6% annually, compared to the projected 2.3%, at the end of the year. *Estimating that the influence of these factors will continue also in the first quarter of 2010, in this period further broadening in the broadest money supply M4 is expected, with the annual growth rate in March 2010 being equal about 9% accordingly. For the end of 2010 the annual monetary growth rate is expected to equal about 7.5%.*

*At the end of the year the credit growth equals 3.5%, exceeding the November estimates pertaining to the annual credit growth of 2.6%. The higher level of saving than estimated and the improved expectations of the banks are the main factors for the deviations. Such positive impulses are expected to intensify in the following period, which would result in stabilization on the credit market in the first quarter of 2010 and the acceleration in the credit growth rates during the year. At the end of the first quarter, the credit activity is expected to increment by roughly 3%, annually. At the end of 2010, the annual rate of the credit growth is expected to equal about 9.2%.* The upward trend of the credits is expected to move mainly as a result of more optimistic perspectives for both the domestic and the global economy in 2010. On the side of the supply, these factors are expected to reflect in smaller crediting risks, which will increase the readiness of the banks for investment in this type of yield bearing assets. On the side of the demand, the recovery of the economic activity would effectuate in better quality of the credit demand and lower restraint from new indebtedness. However, one of the main factors which is expected to support the credit growth are better expectations for the domestic and the external sources of financing.

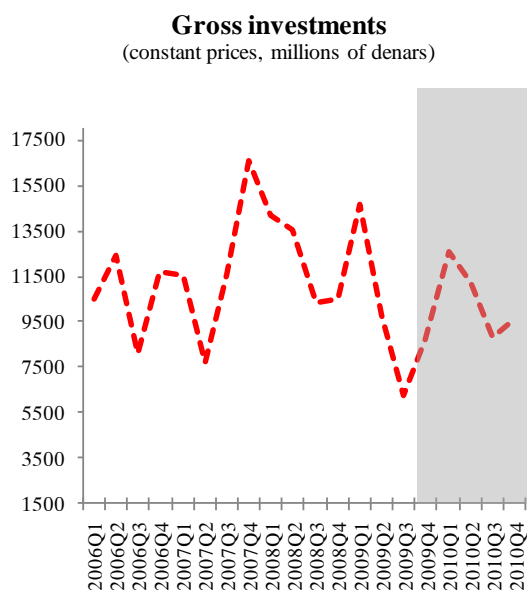


*In the first quarter of 2010, it is possible that the banks will retain the precautions approach in the credit policy. Despite the generally improved trends, the risks limiting the possibility for larger change in the banks' credit policy is still present.* The projections for the economic recovery are still followed by high degree of uncertainty. The effects of the crisis on the profitability position with the corporate sector will probably become apparent during 2010. Late reaction on the labor market is possible, through downward correction in wages and employment in the following period. Consequently, there is a probability that the risk of additional worsening in the quality of the banks' credit portfolios to prevail also in the first quarter of 2010. The possible recovery of the global economy and the international capital market than planned is estimated as additional risk in the following period. The process of credit loss absorption on the global financial market is still underway and imposes a need of accumulation of additional capital for credit activity support. For domestic banks, the effect of this global uncertainty would reflect in more difficult access to additional external sources of financing, which will increase the banks' dependence on the domestic deposit potential and the exposure to risk of possible non-realization of the projected movements on the deposit market.

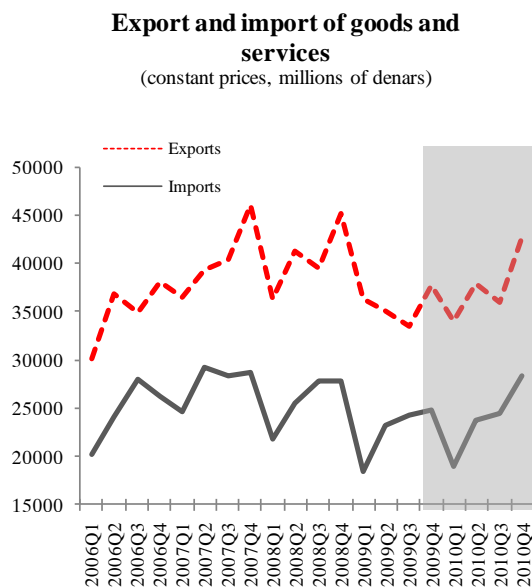
<sup>4</sup> Sensitive analysis has been made within the model for short-term GDP forecast, undergoing a testing stage.

<sup>5</sup> After October projection, in November 2009 new estimate for the movement of the money supply and the credit placements until the end of the year was made, published in the document titled "Monetary Policy Projection for 2010".





Source: State Statistical Office and NBRM estimates and forecast



Source: State Statistical Office and NBRM estimates and forecast

The influence of the global economic movements on the investment activities in the country is expected to continue also in the first three months of 2010, but with smaller intensity. **The projected annual decrease in the volume of the gross investments equaled 14.4%, which mostly originates from the base effect** (high investments in the first quarter of 2009). On quarterly basis (Q1 2010 compared to Q4 2009) the gross investments are estimated to grow, given the projected growth in the state capital investments and foreign direct investments. The banks credit policy is expected to be in favor of movements in the investment activity, through increase in the supply of credits and relaxation in the crediting terms of the enterprises. However, the uncertainty regarding the government capital investments and the readiness of the foreign investors for realization of the announced specific projects remains high.

In conditions of lower tax realization, the rationalization of the current spending of the Government, the pace of which intensified in the last quarter of 2009, is expected to continue also in the first three months of 2010. **The projected real decrease in the public consumption equals 5.6% on annual basis.**

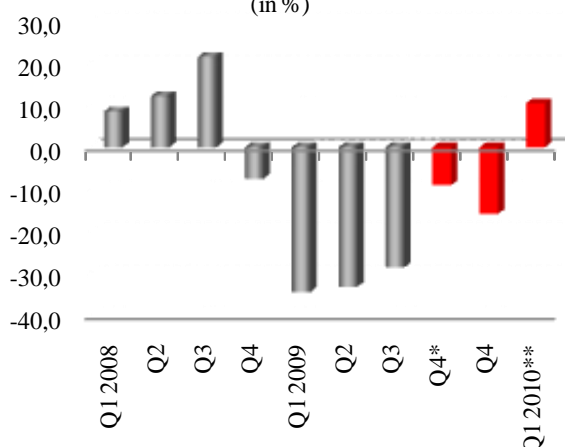
Opposite to the forecasts for still low domestic consumption, in the first quarter of 2010, the positive forecasts for the foreign demand and for the metal prices are expected to spread on the export sector. **The real annual growth in the export of goods and services is expected to equal 2.4%.** The moderate quantitative increase in the export partially reflects the low comparison base, i.e. the significant contraction of the export in the first three-years of the 2009, as a reaction of the global crisis. Opposite to such dynamics of the export, the low domestic demand, as well as late reaction of the import to the world recession, are expected to contribute to further decrease in the import volume (but with slower pace compared to the previous quarters). **The real decrease in the imports in the first quarter of 2010 has been estimated at 6.2% on annual basis.** However, the uncertainty related to the dynamics of the recovery of the foreign demand remains. The duration of the effects from the so-far monetary and fiscal stimulus and the return of the confidence of the economic agents are the main risk factors. This also creates risk related to the basic exports scenario, which, certainly, has implications on the total growth projections.

### Annex 3

#### Projections for the movements in the external sector

The realized surplus in the current account in the third quarter of 2009 (1.6% of the GDP) does not deviate from the projections<sup>6</sup>. On the other hand, the trends in the external sector in the last quarter of the year point to better movements than projected. Thus the deficit on the current account in 2009 is estimated at 7.5% of the GDP, opposite to the previous projection of 8% of the GDP. Such corrections in the estimates, is almost completely due to the more intensive growth in the private transfers, given higher level of trade deficit than projected. Thus the last available data (as of December 31, 2009) on the net turnover on the currency exchange market point to annual growth rate of 93.8%, compared to the projected 50% for the last quarter. On the other hand, in the fourth quarter of the year, the trade deficit is higher than projected, given poorer realization with the export and the smaller downward adjustment of the import (due to less intensive decrease in the import of consumer goods and investment goods and intermediate products than expected).

*Annual changes in the export of goods*  
(in %)

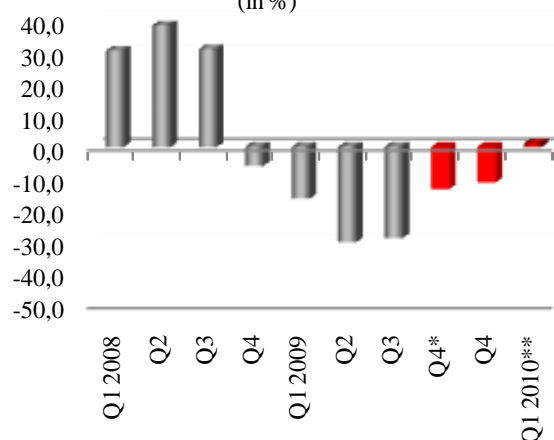


Source: NBRM

\* November 2009 - Estimate.

\*\* January 2010 - Projection.

*Annual changes in the import of goods*  
(in %)



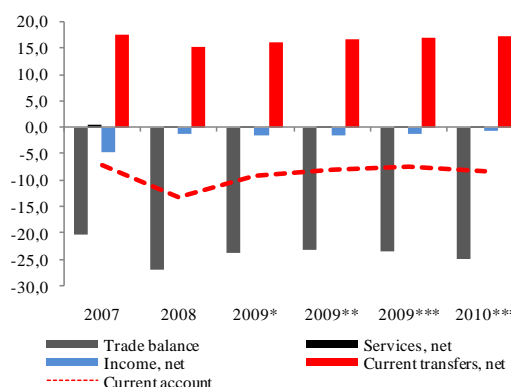
Source: NBRM

\* November 2009 - Estimate.

\*\* January 2010 - Projection.

*In the first quarter of 2010 within the balance of payments' current account negative balance of 3% of the GDP is expected (compared to the deficit of 5.2% of the GDP registered within the same period of 2009).* The trade deficit is estimated at 6.1% of the GDP, while through the private transfers inflows of 3% of the GDP are expected. The dynamics of the export of goods is mainly expected to be introduced by the foreign effective demand (where annual growth rate for the first time from the end of 2008 is expected), as well as for the deposit movements on the world stock exchange prices of metals. Thus the export is expected to register nominal increase of 10.5%, annually, which is partially a result of the low comparison base (in the first quarter of 2009 the first two-digit severe drop with the export was registered as a result of the global crisis). Slight nominal rise of 1.1% with the import of goods is expected, which is mainly due to the envisaged increase in the import of energy (rise in the oil prices on the international stock exchanges). In environment of accelerated increase in the export compared to the import of goods, in the first quarter of 2010 trade deficit contraction of 6.8%, annually is anticipated. The stabilized expectations of the domestic economic entities also in the first three months of 2010 are

*Current account and its main components*  
(as % of GDP)



\* October 2009 - Projection.

\*\* November 2009 - Estimate.

\*\*\* January 2010 - Projection.

Source: NBRM.

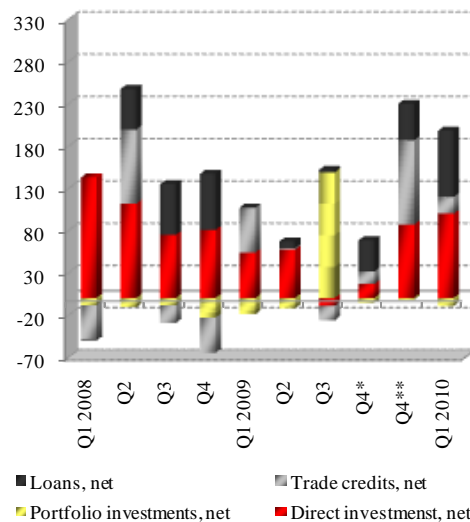
<sup>6</sup> It pertains to the November estimates published in the document titled "Monetary Policy Projection for 2010".

envisaged to have positive influence on the private transfers, i.e. on their dominant net cash component. Thus the net cash is expected to increase by 2.7 times on annual basis, with the exclusively low comparison base in the first quarter of 2009 should be taken into consideration, when the pressures on the demand for foreign exchange were most evident.

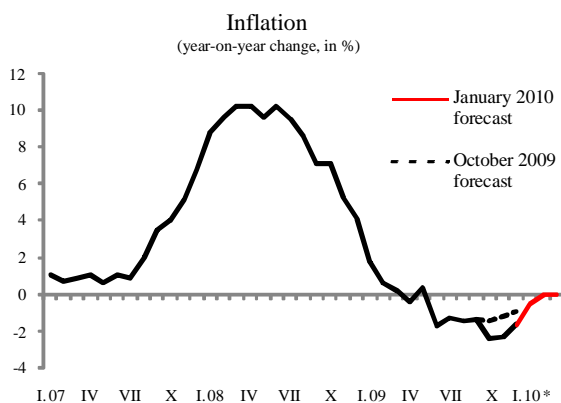
The financing of the current account deficit is almost completely expected to be carried out through the realized net inflows in the capital and financial account. However, the largest part of the capital inflows is envisaged to be generated through the net debiting abroad and foreign direct investments.

*Until the end of 2010, the deficit on the current account on the balance of payments is expected to equal 8.3% of the GDP, which is slight deterioration of 0.8 percentage points compared to 2009. The higher deficit on the current account originates from the deepening of the negative trade balance in 2010 to 24.8% of the GDP from 23.4% of the GDP in 2009 (mainly due to the worsening in the energy trade balance).*

**Capital and financial account and its more significant components**  
(in EUR millions)



*The disinflationary trajectory of the import prices contribute to large extent to the downward pressures on the domestic prices and their maintenance on a relatively low level. However, the registered annual change in the price level in the fourth quarter of 2.1% deviates from the October projection by -0.9 p.p. (anticipated decrease of -1.2%<sup>7</sup>). The deviation is completely explained with the almost twice deeper decrease in the food prices than expected. This mostly arises from the significantly smaller seasonal increase in the prices of fresh food, and movement in the seasonal effect at the end instead of the beginning of the quarter. Consequently, the common quarterly intensification in the general price level in the last quarter of the year was not realized.*



Source: State Statistical Office  
\* NBRM forecast

Oppositely, the changes in the prices of the non-food products mainly correspond to the expectations for their minimal decrease (realized decrease of 0.5%, compared to the projected drop of 0.4%). *The projection of the annual inflation growth rate for the first quarter of 2010 points to quarterly rise in the general price level of 1.5%, and thus to the significant slowing down of the prices, with the average annual inflation being expected to equal -0.2%.* Such trend arises from the upward corrections of the administrated prices (prices of electricity and heating energy), effective since 2010. However, the positive contribution of these prices is expected to be significantly neutralized by the negative contribution of the food component of the inflation, due to the still

<sup>7</sup> According to the November projection, in the last quarter annual inflation rate of -1.7% was expected.





present base effect, as well as the influence of the lower world food prices. Having in mind the estimates for slight recovery of the economy in the first quarter, the pressures on the inflation through the demand are not expected.

**The risks for the inflation perspective in the first quarter of 2010 are balanced.** The possibly more intensive growth in the foreign prices can easily result in larger inflationary pressures than expected. On the other hand, if the recovery pace of the domestic economy is less intensive, in that case lower pressures on the prices are possible. Additional source of risks are the possible more apparent transfer effects from the increase in the administrated prices on the prices of other products and services, but the probability for their effectualization in the first quarter of the year is minor. *The average annual inflation for entire 2010 is expected to be about 1%.*