

# Republic of Macedonia Ministry of Finance QUARTERLY ECONOMIC REPORT Q2/2012

## Summary

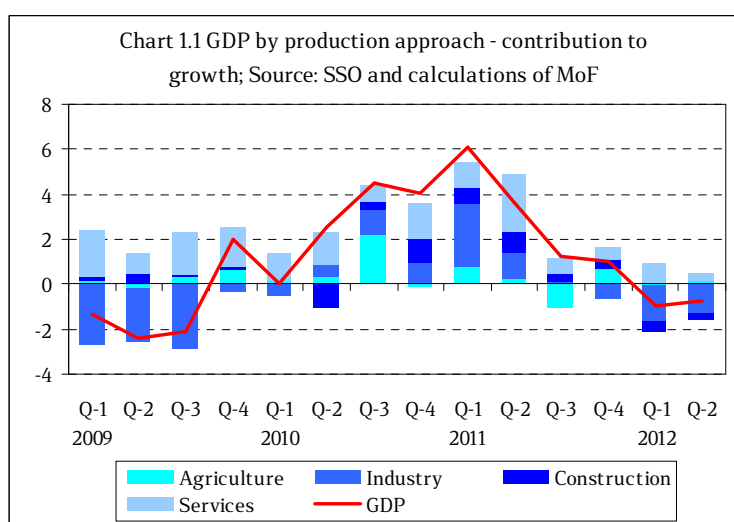
- According to the estimated data of the State Statistical Office, in Q2 2012, **real GDP growth** amounts to -0.9% on annual basis. Seasonally adjusted quarterly GDP growth in Q2 amounted to 0.2%.
- According to the Labour Force Survey, **number of employed persons** in Q2 2012 was higher by 0.8% compared to the same quarter of the previous year. Employment rate in Q2 2012 amounted to 38.8%, while unemployment rate decreased by 31.2%.
- **Inflation rate** in Q2 2012 experienced slowed down growth of 2.1% compared to the same quarter in 2011, measured according to CPI;
- Average **gross salary** in Q2 2012 amounted to Denar 30,468, decreasing by 0.5% in nominal terms, while it declined by 2.6% in real terms.
- Total **budget revenues** were lower by 2.5% in Q2 2012 compared to the same quarter in 2011; and total **budget expenditures** dropped by 3.5%;
- **Credit activity of banks** in Q2 2012 experienced growth rate of 2.5% on quarterly basis, in conditions of increased crediting to corporate sector and households sector.
- **Macedonian Stock Exchange Index MSEI-10** decreased by 8.3% in June compared to March 2012;
- In Q2 2012, there was **contraction of export** by 3.4% on annual basis (Q/Q-4), while **import increased** by 5.3%, whereby total **foreign trade**, expressed in euros, increased by 1.8%;
- **Trade openness** of the Republic of Macedonia in Q2 2012 amounted to 108.8%, narrowing by 2.7 p.p. compared to the same quarter in 2011.

## 1. Macroeconomic Trends and Real Sector

According to the estimated data of the State Statistical Office, in Q2 2012, **real GDP growth** amounted to -0.9% on annual basis, following the drop by 1.3% in Q1 2012. Such drop was partially due to the relatively high comparative basis, i.e. the economic growth of 3.7% registered in the same quarter of the previous year, however, it was even more due to the decreased external demand resulting in drop of both export and industrial production in the country. Average real GDP growth in the first half of the year amounted to -1.1%.

**Nominal GDP growth** in Q2 2012 accounted for -0.7% compared to the same quarter last year, implying that GDP deflator amounted to 0.2%. Seasonally adjusted **quarterly GDP growth** in Q2 was positive, amounting to 0.2%.

Analyzed according to the **GDP production side**, highest real growth rate in Q2 2012 was seen in the sector financial service 3.8%. Agriculture sector surged by 2.4% following the minimum drop by 0.1% in the previous quarter. Public administration sector continues with moderate positive growth, amounting to 2% in Q2. Hotels and restaurants sector surged by 0.2% following the high growth rates realized in the previous quarters.



Slowed down growth in trade sector in the last quarter, transferred into the negative zone in Q2 2-12, accounting for -2.2%. Transport, storage and communications sector experienced negative growth of -3%, arising from the industrial activity drop. Construction sector in Q2 dropped by 5.1%, corresponding to the drop of value of the carried out construction works. This is to a certain extent a result of the high comparative basis, given that high growth of 23.4% was realized in the same quarter of the previous year. Industry sector in Q2 decreased by 6.9%, following the drop of 9.6% in the previous quarter, coinciding with the deteriorated economic trends of the EU economy in the past two quarters.

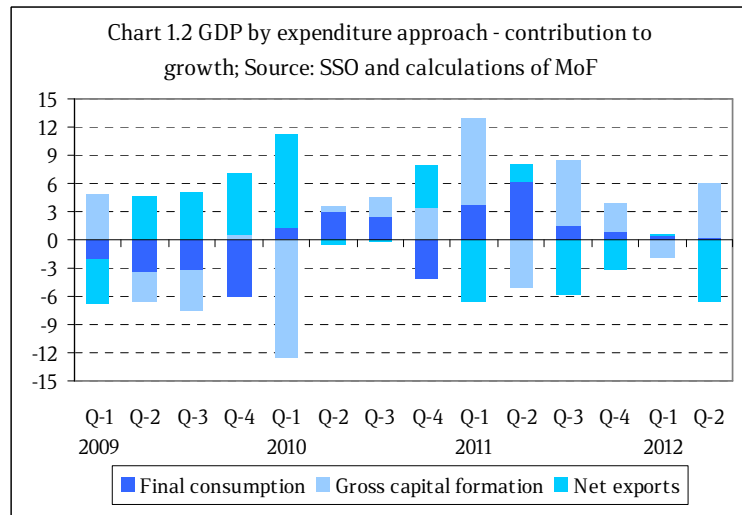
Drop in the **industrial production**<sup>1</sup> rate in Q2 2012 was mainly due to the decline in the production of coke and refined oil products (84.4%), production of electrical equipment (52.0%), production of furniture (30.6%), production of motor vehicles (21.5%), production of other non-metal minerals (21.3%), production of paper (16.2%), production of machines and devices (14.7%), production of clothing (13.7%), other mining and quarrying (12.4%), extraction of coal and lignite (8.8%), production of chemicals (8.2%), production of metals (7.3%), supply of electricity, gas, steam and air conditioning (3.9%), printing and

<sup>1</sup> Calculated on the basis of monthly releases of Industrial Production Index.

production of recorded materials (3.8%) and production of textile (3.5%). From the point of view of the structure of industrial production index, 64.2% of the branches experienced drop.

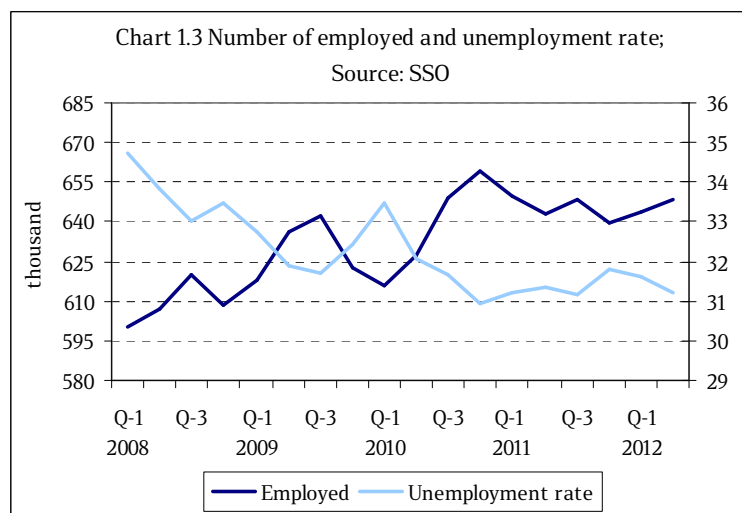
On the other hand, growth was observed at the following: Production of fabricated metal products (68.3%), production of wood and wood and cork products (39.7%), production of rubber products (27.4%), production of tobacco products (19.7%), production of pharmaceuticals (10.3%), production of leather (9.1%), metal ore extraction (5.3%) and production of beverages (3.6%).

Analyzed according to the expenditure side of GDP; in Q2 2012, highest growth was seen at gross investments, accounting for 32.1%. Final consumption in Q2 increased by 0.1%, being a result of the increase of personal consumption by 1%, while public consumption dropped by 3.9%. Increase of personal consumption is mainly driven by the high increase of private transfers, as well as the positive increase of granted household credits.



Drop of economic activity in the EU countries and respectively of the external demand resulted in the export of goods and services by 0.7% on real basis. On the other hand, import of goods and services increased by 6.1%, as a result of the increase of investments and personal consumption.

According to the **Labour Force Survey**, number of employed persons in Q2 2012 was higher by 0.8% compared to the same quarter of the previous year. Active population in the second quarter increased by 0.7%, accompanied with slight increase in the number of unemployed persons by 0.3% on annual basis. Such trends on the labour market caused for the unemployment rate in



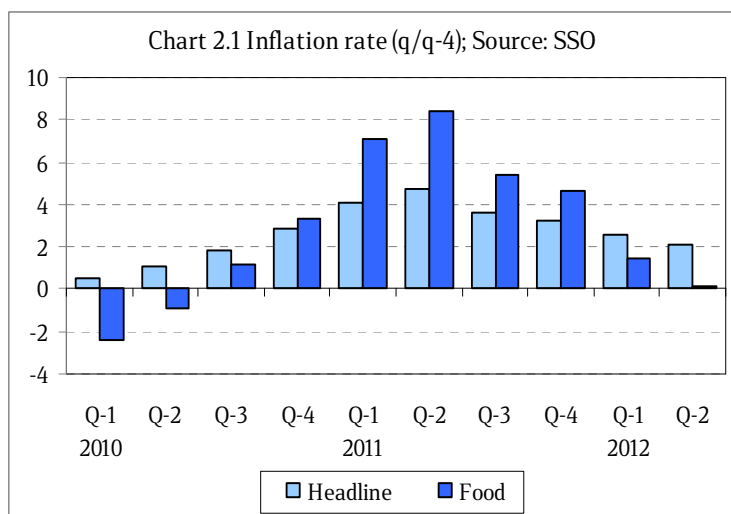
Q2 2012 to reduce to 31.2% from 31.3% in the same quarter of the previous year, i.e. by 0.4 p.p. compared to the previous quarter. Employment rate in Q2 2012 amounted to 38.8%, as it amounted in the same quarter of the previous year, while compared to the

previous quarter it was higher by 0.2%. Active population in the second quarter accounted for 56.5% of total working-able population.

## 2. Prices, Costs and Productivity

**Inflation rate**, measured according to CPI, was 2.1% in Q2 2012 compared to the same quarter in 2011, being slowed down increase compared to the previous quarter (2.6%). Highest price increase was registered in the in the housing category – 5.4%, being mostly due to the increase of electricity prices by 7.7%, as well as heating prices experiencing the same growth rate. Compared to the previous quarter, increase of prices in housing category slowed down by 1.4 p.p..

Increase of prices in the food category continued to slow down, increasing by 0.2% in Q2 2012, compared to the increase by 1.4% in Q1 2012. Prices in the category clothing and footwear surged by 4.2%, followed by the price increase in the category means of transport and services, increasing by 3.7%, mainly as a result of the increased prices of liquid fuels and oils. Prices



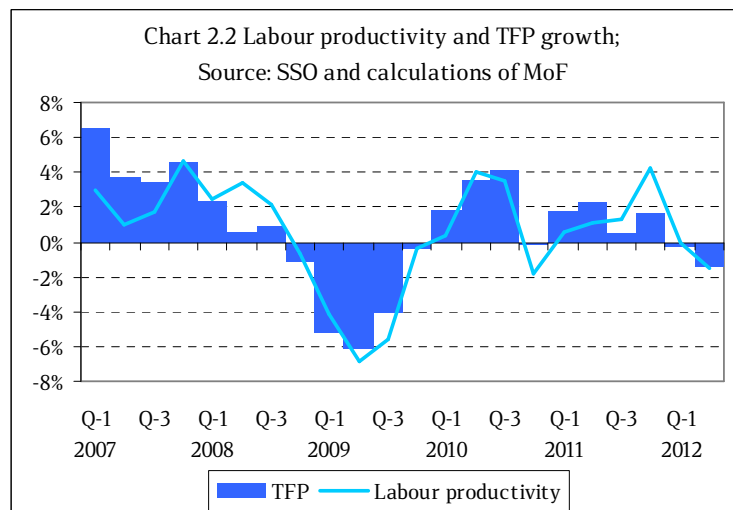
of restaurants and hotels category were higher by 2.8%, while prices of categories hygiene and health and culture and entertainment surged by 2.5% and 1.3% respectively. Reduction of prices was registered in the category administrative and financial services by 0.7%.

**Core inflation** (which excludes the effect of food and energy) was 1.7% in Q2 2012, being higher by 0.4 p.p. compared to the core inflation in the previous quarter (1.3%).

**Retail prices** in Q2 2012 experienced slowed down by 2.7% compared to the same quarter in 2011. Prices of industrial products, which surged by 4.3%, contributed the most with 2.3p.p. to the increase of the retail prices. Within this category, highest price increase was recorded at non-food products – 6.1%. Prices of food products surged by 1.5%. Retail price of beverages increased by 0.8%. Retail prices in agricultural products category decreased by 2.1%.

Average **net salary** in Q2 2012 amounted to Denar 20,754, being lower by 0.5% in nominal terms, compared to same quarter in 2011. Net salary decreased by 2.6% in real terms. Average **gross salary** amounted to Denar 30,468, decreasing by 0.5% in nominal terms, while it declined by 2.6% in real terms.

Positive annual increase in the number of employees in Q2 2012 was not followed by increase in of the economic activity, resulting in drop of **labour productivity** by 1.8%, following the drop of 0.4% in the previous quarter. In fact, in Q2 2012, physical capital experienced slight increase by 0.5%. Such tendencies of growth factors caused for **total factor productivity**



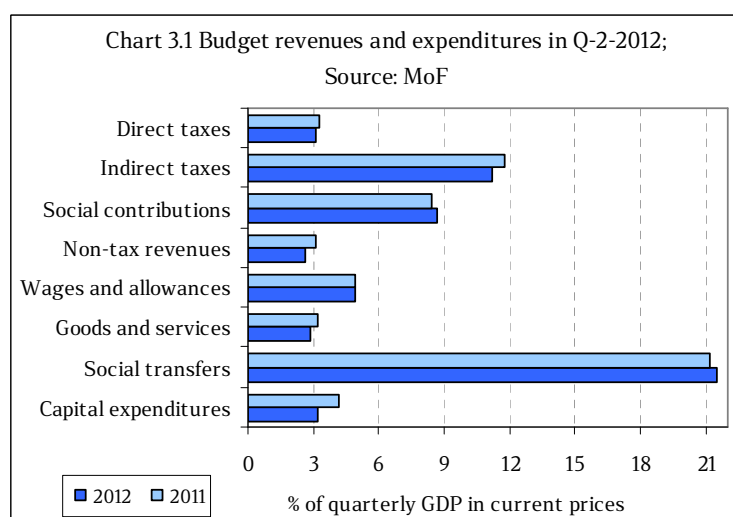
(TFP) to decrease by 1.6% in Q2 2012, followed by the drop of 0.7% in the previous quarter. Chart 2.2 shows TFP and labour productivity trends.

### 3. Fiscal Sector

Lower performance of budget revenues was observed in the second quarter of 2012, compared to same quarter in 2011, accompanied by lower higher budget expenditures. Budget deficit was in the amount of Denar 3,517 million in Q2 2012 or 3.0% of GDP realized in this quarter (central budget deficit amounted to Denar 3.158 million, i.e. 2.7% of GDP, dropping by 0.6 p.p. compared to the previous quarter).

Anti-cyclical fiscal policy continued to be conducted in the second quarter of 2012 as well, aimed at mitigating the consequences of the global economic crisis on Macedonian economy and maintaining macroeconomic stability. Thereby, fiscal sustainability of public finance was not jeopardized.

Total **budget revenues** were lower by 2.5% compared to the same quarter in 2011, being mostly due to the lower performance of tax revenues by 4.2%, while contributions surged by 2.2%, and at the same time, non-tax revenues were lower by 15.4%. Thereby, there was significantly lower collection of Value Added Tax and profit tax, while excises, personal income tax and customs duties experienced growth. VAT revenues dominated, accounting for 48.9% of the total tax revenues, being lower by 10.3% in Q2 2012 compared to the same quarter of 2011, i.e. they were lower by 9.9% than the performance in the previous quarter. At the



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same time, dynamics of VAT refund intensified by 3.7%. Excise revenues were higher by 9.4% compared to the same quarter in 2011, increasing by 8.7 p.p. compared to the first quarter. As for direct taxes, profit tax decreased from 12.3% to 7.5 p.p. compared to the previous quarter (one should take into account that revenues on the basis of tax paid for dividend and other distribution of profit participated with significant percentage in the structure of this tax). Revenues on the basis of personal income tax were higher by 1.6% compared to the previous year. Observed from the point of view of structural share of GDP, direct taxes reduced their share in GDP by 0.1 p.p. on annual basis, while indirect taxes dropped by 0.3 p.p..

Collection of social contributions was higher by 2.2%, whereby higher collection was recorded at all contributions, i.e. pension insurance contributions - 2.0%, health insurance contributions - 2.4% and employment contributions - 2.8%. Non-tax revenues, accounting for 2.6% of total quarterly GDP, were lower by 15.4% compared to the same period in 2011.

Capital revenues in Q2 2012 were higher by 8.1% on annual basis (these revenues include revenues on the basis of lease of construction land, as well as sale of flats and revenues on the basis of dividends). Revenues on the basis of grants were higher by 6.9%, compared to Q2 2011.

In Q2 2012, total **budget expenditures** were lower by 3.5% compared to the same quarter in 2011. Current expenditures, accounting for 90.4% of the total expenditures, decreased by 0.6% on annual basis. Capital expenditures participated with 9.6% in the total expenditures. As for current expenditures, expenditures for goods and services decreased by 11.7%, while expenditures related to salaries and allowances experienced relatively moderate drop, i.e. they decreased by 1.2% compared to the same quarter last year. Funds for transfers, participating with 65.0% in the total expenditures, were higher by 0.7% on annual basis, while the share of the category „Other Transfers“ in the total transfers accounted for 30.5% (including transfers to local government - block and earmarked grants, as well as other subsidies and transfers). Transfers to the Pension and Disability Insurance Fund, accounting for 26.5% in total expenditures, were higher by 4.4% compared to the same quarter in 2011, i.e. they were higher by 1.3% compared to Q1 2012. Interest-related expenditures increased by 16.9%, whereby domestic debt interest-related expenditures dropped by 21.8%, and expenditures related to interest on foreign debt surged.

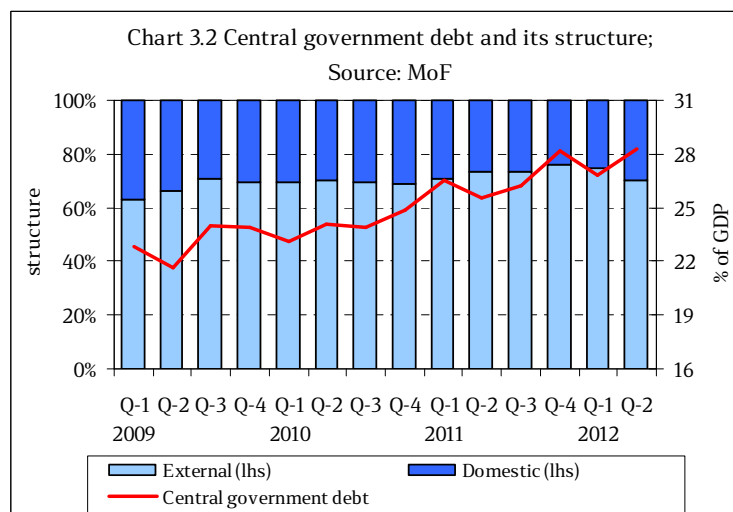
Fiscal burden, measured as participation of the budget revenues<sup>2</sup> in relation to nominal GDP, was 25.5% in Q2 2012, dropping by 1.8 p.p. in relation to Q1 2012. Total budget expenditures accounted for 33.1% of GDP, which was by 1.8 p.p. lower compared to Q1 2012, decreasing by 0.5% on annual basis.

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<sup>2</sup> It included tax revenues, social contributions and administrative fees and duties and road toll



Total central government **debt** at the end of Q2 2012 accounted for 28.3% of GDP, increasing by 2.2 p.p. compared to Q1 2012. Share of central government external debt in the total central government debt decreased by 4.8% compared to Q1 2012, while share of central government domestic debt in the total central government debt surged by the same amount. Hence, share of central



government domestic debt increased to 29.9% of the total central government debt. Such trends point out that additional borrowing, which is inevitable for conducting more expansive fiscal policy, whether externally or internally, would not jeopardize fiscal sustainability, whereby coordination with monetary policy is needed. Sound fiscal policy is one of the Maastricht Criteria for convergence, having the limits set at budget deficit of 3% of GDP and government debt of 60% of GDP.

#### 4. Monetary and Financial Trends

During the second quarter of 2012, NBRM made changes in the set-up of monetary instruments, reducing the reference interest rate by 0.25 percentage points, from 4% to 3.75%. In fact, the National Bank assessed the performance in the first quarter of 2012 as favourable, while the macroeconomic projections for the next period also pointed out to relatively favourable climate for conducting monetary policy, which created possibility for monetary easing for support to the domestic economic activity.

**Primary money**<sup>3</sup> in Q2 2012 surged by 7% on quarterly basis, in conditions of increase of both ready money in circulation and total liquidity of banks by 5.1% and 8.4%, respectively.

During the second quarter of 2012, the narrowest money supply **M1** experienced quarterly increase by 3.1% compared to Q1 2012, as a result of the increase of ready money in circulation and deposit money by 5.4% and 2.1% respectively. **Monetary aggregate M2**, in Q2 2012 dropped by 0.7%, while the widest **monetary aggregate M4** surged by 0.3%, compared to the previous quarter.

**Total deposit potential**<sup>4</sup> of banks in the second quarter of the year reduced by 0.1%, being a result of the drop of deposits of private enterprises by 7.5%, which was a result

<sup>3</sup> It includes ready money in circulation (including cash in hand of banks), denar and foreign currency reserve requirement and the surplus of liquid assets over the reserve requirement (in denars)

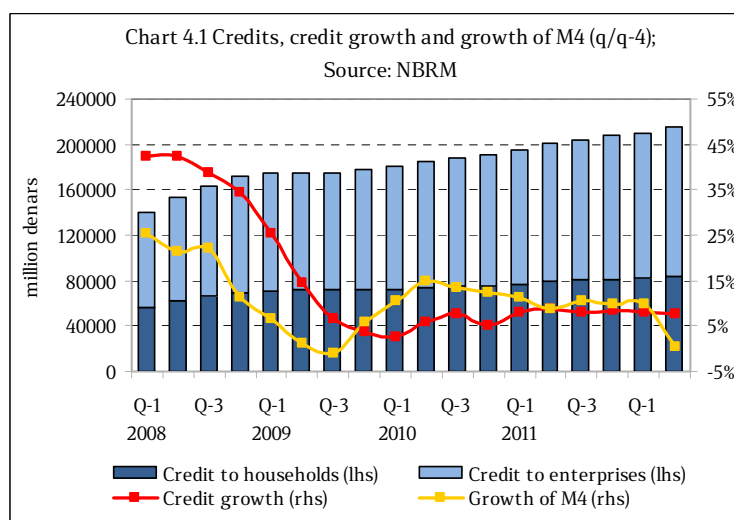
<sup>4</sup> Deposits also include calculated interest

of withdrawal of funds by certain large company for payment of dividend towards the state and the foreign investor, as well as the weakened economic activity in the country. Deposits of households increased by 2.2% compared to the previous quarter.

From currency aspect, Denar deposits increased by 0.6% on quarterly basis, while foreign currency deposits reduced by 1%, positively contributing to the further reduction of the euroization degree to 46.8% (from 47.2% in Q1 2012) measured through the share of foreign currency deposits in the total deposit potential.

According to maturity, short-term deposits decreased by 2.4% in Q2 2012 compared to the previous quarter, while growth of long-term deposits accelerated to 6.5% (5.3% in Q1 2012).

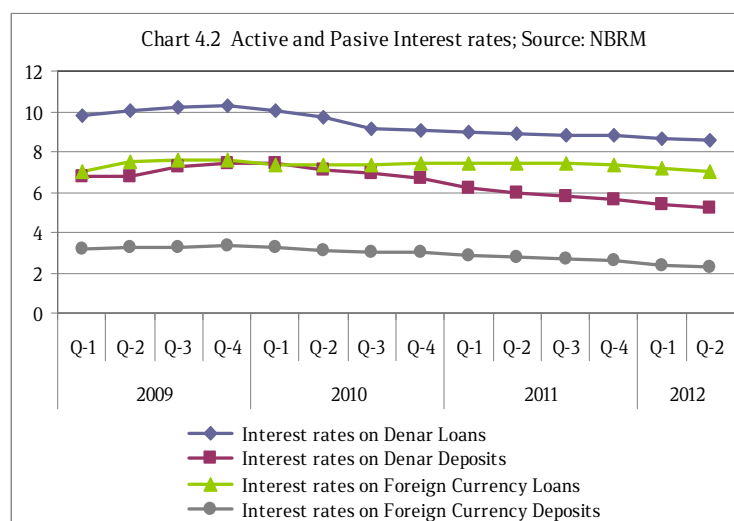
**Credit activity of banks to non-government sector**, in Q2 2012 experienced growth rate of 2.5% on quarterly basis, in conditions of increased crediting to corporate sector and households sector. Increased crediting to private enterprises by 2.3% had dominant contribution to growth of credit activity, while growth of credits to households increased to 2.7% compared to the previous 0.8% in Q1 2012.



From currency point of view, foreign currency credits dropped by 1.3% on quarterly basis (compared to the growth of 1% in Q1 2012). Denar credits surged by 4% on quarterly basis in Q2 2012.

From maturity point of view, long-term credits remained to be the main driving force of the new crediting on quarterly basis, increasing by 2.6% in relation to Q1 2012, while short-term credits increased by 3% on quarterly basis.

In the second quarter of 2012, NBRM reduced the **reference interest rate** by 0.25 p.p., accounting for 3.75%. Interest rates of deposit banks in Q2 2012 experienced certain swings. In fact, interest rate on Denar credits of deposit banks reduced by 0.2 p.p. compared to the previous quarter, amounting to 8.5%.

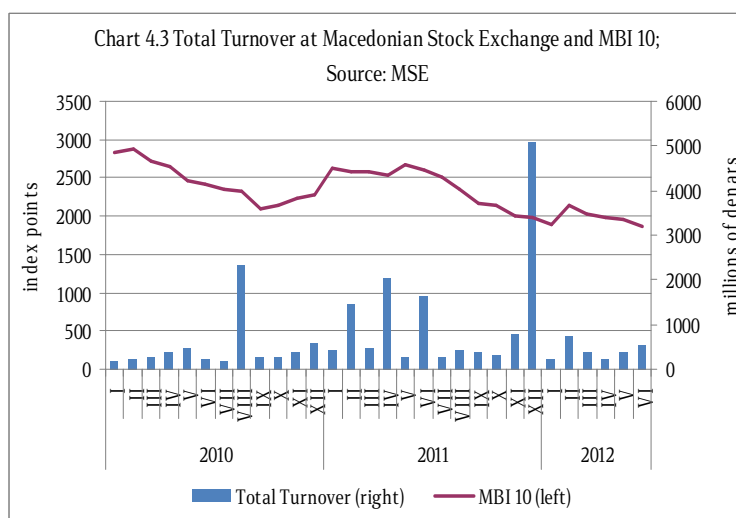




Thus, the downward trend of this interest rate, which started at the beginning of 2010 continued. Interest rate on foreign currency credits, reduced from 7.2% to 7% on quarterly basis. On the other hand, interest rates on Denar and foreign currency deposits reduced by 0.2 p.p. and 0.1 p.p. respectively on quarterly basis, accounting for 5.2% and 2.3% respectively.

Interest rate on newly approved Denar credits remained unchanged on quarterly basis, amounting to 7.9%, while, interest rate on newly approved foreign currency credits, surged by 0.1 p.p., accounting for 6.8%. Interest rate on new Denar deposits dropped by 0.2 p.p. compared to Q1 2012, accounting for 3%, while interest rate on new foreign currency deposits was lower by 0.1 p.p., amounting to 0.7%.

As for the **capital market**, in the second quarter of the year, there was increase in sales realized through traditional trading by 3.1% compared to Q1 2012. However, as a result of the lower amount of block transactions, total sales decreased by 15.7% on quarterly basis. Compared to the same period last year, traditional trading dropped by 9.8%.



Macedonian Stock Exchange Index MSEI-10, as aggregate indicator of stock market trends, decreased by 8.3% compared to March 2012, while compared to June 2011, it decreased by 28.4%.

## 5. External Sector

### 5.1. Foreign Trade

According to the data of the State Statistical Office in Q2 2012, total foreign trade amounted to Denar 2.103 million, increasing by 1.8% compared to the same quarter in 2011.

In Q2 2012, **export** of goods amounted to Denar 796.3 million and compared to the same quarter of the previous year, it contracted by 3.4%, while compared to the previous quarter, it increased by 11.2%.

Analyzed by **SITC sectors** (Standard International Trade Classification), positive trends in the export in Q2 2012 compared to the same quarter in 2011 were registered at the following:

- machines and transport equipment by 29.2% (within which category of industrial machines and spare parts surged by 45.1% or EUR 11.3 million);

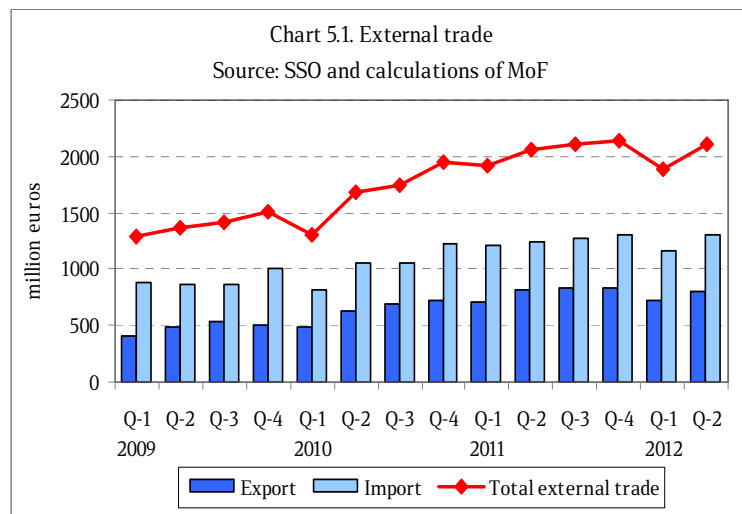
- beverages and tobacco by 15.3% (tobacco by 55.3% or EUR 9.0 million)

On the other hand, negative trends in export were seen at the following:

- mineral oils and lubricants by 34.6% (within which category oil and oil products reduced by 33.4% or EUR 21.9 million);
- products classified by material by 5.2% (iron and steel by 4.3% or EUR 8.4 million and metal products by 35.8% or EUR 4.5 million),
- food products by 4.7% (fruit and vegetables by 7.8% or EUR 3.2 million and meat and meat products by 19.8% or EUR 2.5 million);
- chemical products by 2.0% (chemical materials and metal products by 5.3% or EUR 5.2 million);

In Q2 2012, observed by **economic purpose**, the following products were most exported: goods for industrial production (52.9%), followed by personal consumption goods (31.5%), investment goods (9.5%) and energy (6.1%).

**Import of goods** in Q2 2012 amounted to EUR 1,306.8 million, increasing by 5.3% compared to Q2 2011, while in relation to the previous quarter, it increased by 12.2%.



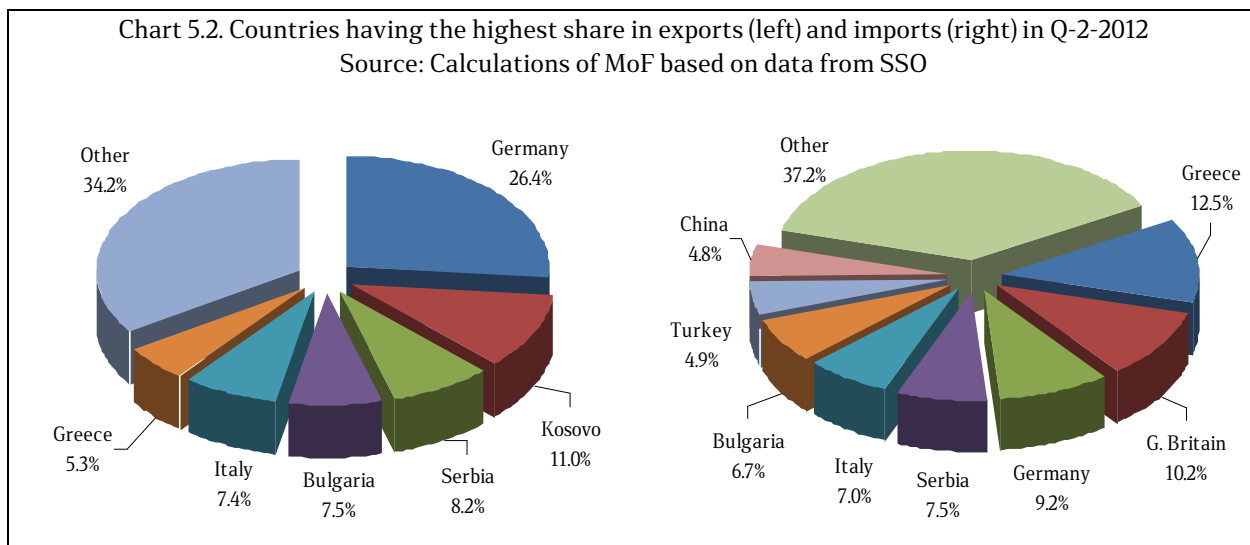
Analyzed by **SITC sectors**, most positive movement of import in Q2 2012, compared to Q1 2011, was seen at:

- products classified according to the material by 17.7% (whereby increase was seen at the following categories: non-ferrous metals by 67.2% or EUR 52.7 million; iron and steel by 21.3% or EUR 14.9 million);
- raw materials except fuel by 36.3%, whereby category metal ore and metal scrap surged by 55.3% or EUR 24.5 million.
- Food products by 18.2%, whereby category cereals and cereal processings increased by 66.5% or EUR 10.5 million, while category meat and meat products grew by 12.4% or EUR 3.5 million.
- chemical products by 0.1% (being a result of the mutual effect of the increase at the following categories: products for colouring and tanning by 8.9% or EUR 1.2 million, plastic materials in primary forms by 6.7% or EUR 1.3 million, plastic materials in other forms by 6.6% or EUR 1.1 million, while there was significant decrease at the category non-organic chemical products by 25.0% or EUR 4.0 million);

- beverages and tobacco by 0.8%, whereby category beverages increased by 7.9% or EUR 0.6 million.

Most negative movement of import was seen at the following:

- mineral oils and lubricants by 5.1%, whereby category oil and oil products reduced by 13.6% or EUR 23.4 million;
- machines and transport equipment by 11.2% (within which category electrical machines and spare parts by 23.7% or EUR 12.1 million; road vehicles by 18.5% or EUR 11.4 million; industrial machines and spare parts by 8.0% or EUR 3.1 million).



Observed by economic purpose in Q2 2012, goods for industrial production (47.9%) were most imported, followed by: personal consumption goods (22.5%), energy (16.1%), and investment products (13.3%).

In Q2 2012, foreign trade of the Republic of Macedonia with the European Union (EU 27), in relation to Q2 2011, reduced by 4.6%, whereby share of trade with EU in the total foreign trade increased by 2.4 p.p. compared to the same quarter in 2011, accounting for 60.3%, whereby export of goods participated with 60.6% and import of goods accounted for 60.1%.

As a result of the structural changes in the trade with abroad, in Q2 2012, 74.8% of the trade deficit of the country was a result of the trade deficit with Greece, Great Britain, Indonesia, Turkey and China, while the rest of the deficit was a result of the trade with: Serbia, Italy, Bulgaria, Russia, Switzerland, and others. Surplus was realized in the trade with Germany, Kosovo and Bosnia and Herzegovina.

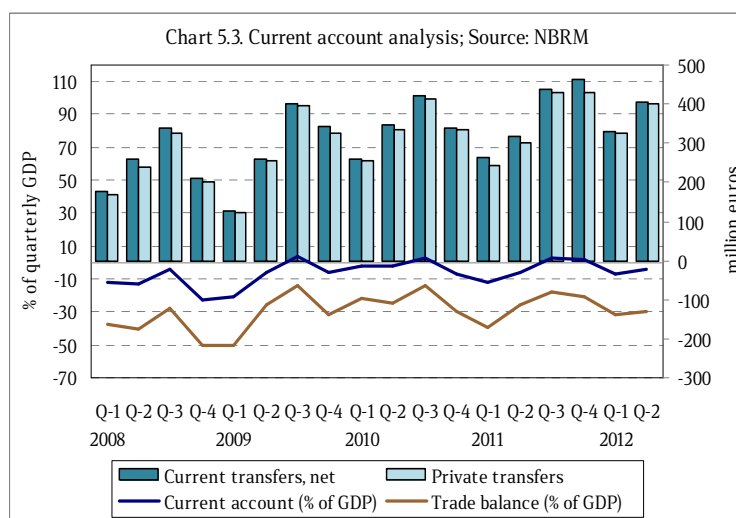
## 5.2. Balance of payments

According to the National Bank data, in the second quarter of 2012, the BOP current account deficit was EUR 80.2 million, narrowing by 30% on annual basis. Narrowing was mainly a result of the increased inflows on the basis of net transfers, as well as the reduced negative gap as regards net income. On the other hand, within larger downward adjustment of export compared to import, trade account registered

widening compared to the previous quarter, acting in opposite direction, reducing the positive effect from the increased transfers. In such conditions, the current account balance registered improvement on annual basis, as well as improvement compared to the previous quarter.

In Q2 2012, negative **current account** balance accounted for 4.3% of GDP, being higher by EUR 34.4 million compared to Q2 2011.

Deficit narrowing was due to the increase of net current transfers, which in Q2 2012, amounted to EUR 404.6 million, surging by 28% compared to Q2 2011, as well as due to the reduced deficit of net income by 60% compared



to Q2 2011. Reduced balance of services and the deepening of the trade deficit by 24.5% or by EUR 91.9 million in conditions of larger downward adjustment of export compared to import acted in opposite direction. Balance of services in Q2 2012 amounted to EUR 13.3 million, i.e. it decreased by 43.4%, compared to Q2 2011.

**Trade openness** of the Republic of Macedonia in Q2 2012 amounted to 108.8%, narrowing by 2.7 p.p. compared to the same quarter in 2011.

In Q2 2012, trade balance (-24.8% of GDP) experienced moderate negative movement compared to the previous four quarters and positive movement compared to the first quarter in 2011 (when trade balance amounted to -28.8% of GDP).

Net current transfers in Q2 2012 amounted to EUR 404.6 million, being higher by EUR 88.4 million or by 28% compared to Q2 2011. Increase is due to the private transfers, increasing by 32.4% and participating with 98.8% in the total net transfers. Private transfers in Q2 2012 amounted to EUR 399.6 million. More thoroughly analyzed, other transfers (87.3%) had dominant share in the private transfers, increasing by 37.8% and amounting to EUR 348.9 million, while remittances from employees surged by 4.5% compared to Q2 2011, amounting to EUR 50.7 million.

Compared to the previous quarter, net current transfers grew by 22.3% or by EUR 73.9 million, mainly due to the increase of private transfers by 21.9% or EUR 71.8 million.

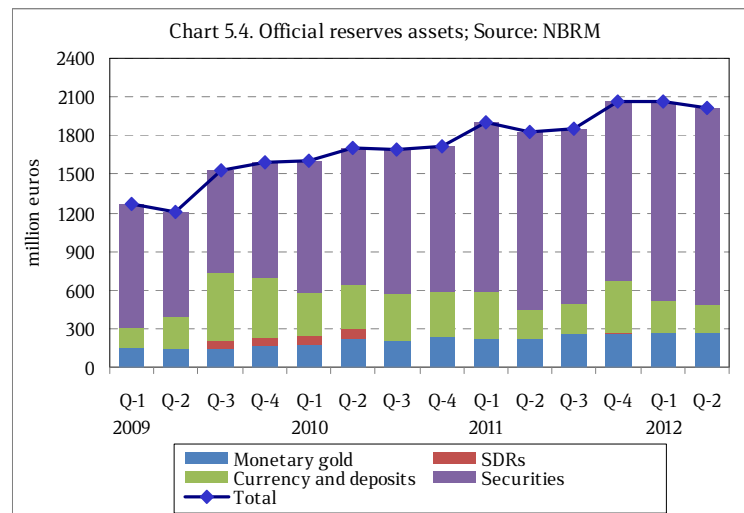
Coverage of trade deficit with private transfers in Q2 2012 accounted for 85.7%, increasing by 5 p.p. on annual basis.

### Capital and financial account

in Q2 2012 experienced surplus and the balance amounted to EUR 71.9 million, narrowing by EUR 52.4 million compared to Q2 2011. Financial account shows that in Q2 2012, net direct investments in the amount of EUR 7 million, being positive movement compared to Q2 2011, when deficit in the amount of EUR 6.8 million was realized. In Q2 2012, in April, direct

investments in the Republic of Macedonia decreased, as a result of the reinvested profit. Unlike this, in May, highest increase of direct investments in the amount of EUR 31.3 million was registered.

In the end of Q2 2012, gross official reserves amount to EUR 2,018.7 million, being higher by 10.2% compared to Q2 2011. Foreign currency reserves, i.e. securities had dominant share in the official reserves, participating with 76% or EUR 1,538.7 million and the values and deposits with EUR 206.6 million (10.2%), while the monetary gold participated with 13.5% or EUR 272.2 million in the total official foreign currency reserves.



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