

Republic of Macedonia  
Ministry of Finance

# QUARTERLY ECONOMIC REPORT

## Q3/2011

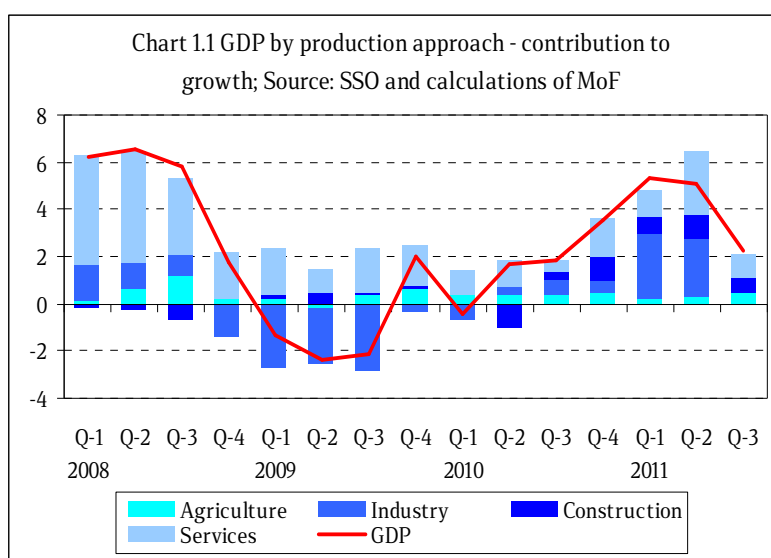
### Summary

- Real **GDP** growth reached 2.3% in Q3 2011 in relation to the same quarter in 2010. Except for financial intermediation and industry sectors, dropping by 2.5% and 0.4% respectively, all other sectors registered growth, construction sector and hotels and restaurants experiencing the highest growth of 26% and 7% respectively;
- **Unemployment rate** declined by 0.5 p.p. in Q3 2011 compared to the same quarter in 2010, accounting for 31.2%.
- **Inflation rate** in Q3 2011 amounted to 3.6% compared to the same quarter in 2010, measured according to CPI.
- Average **gross salary** in Q3 2011 amounted to Denar 30,528, experiencing nominal annual growth of 1.5%, while it declined by 2.1% in real terms.
- **Total budget revenues** were lower by 4.7% in Q3 2011 and **total budget expenditures** dropped by 1.5% compared to the same quarter in 2010;
- **Deposits** continued to increase in Q3 2011, realizing growth rate of 10.5%, compared to the end of Q3 2010, and 2,5% compared to the previous quarter; **Credits to private sector** surged by 8.1% in relation to end of Q3 2010, and by 1.4% on quarterly basis;
- **Macedonian stock exchange index** MSEI-10 grew by 3.8% in September 2011 compared to September 2010;
- In Q3 2011, on annual level (Q/Q-4), significant **increase of both export** by 20.3% and **import** by 22.4% was registered, whereby total **foreign trade**, expressed in euros, surged by 21.5%;
- **Trade openness** of the Republic of Macedonia in Q3 2011 was 110.8%, experiencing an upward trend compared to the same quarter in 2010 by 15.5 p.p..

## 1. Macroeconomic Trends and Real Sector

**Real GDP growth** in Q3 2011 was 2.3%, compared to the same quarter in 2009, following the increase of 5.1% in the first half of the year, whereby the average growth in the first three quarters in 2011 accounted for 4.1%. **Nominal GDP growth** in Q3 2011 accounted for 4.5% compared to the same quarter last year, implying that GDP deflator amounted to 2.2%. **Real GDP growth** in Q3 2011, compared to Q2 2011, amounted to 1.2%, due, to a certain extent, to the seasonal effects.

According to the **production side of GDP**, construction sector continued experiencing high two-digit growth rates, estimated at 12.3% in Q3 2011. Retail sale and wholesale registered growth rates of 3.1% on annual basis, showing growth slowdown in this sector, compared to the growth rate of 16.6% realized in the previous quarter.



Industrial production experienced a slight decline of 0.4% in Q3 2011, following the high growth rate of 14.9% in the first half of the year. Reduction of the growth rate in the industrial production was a result of the high comparative basis in the previous year, as well as the reduced foreign demand, taking into account the debt crisis developments in the Euro Area.

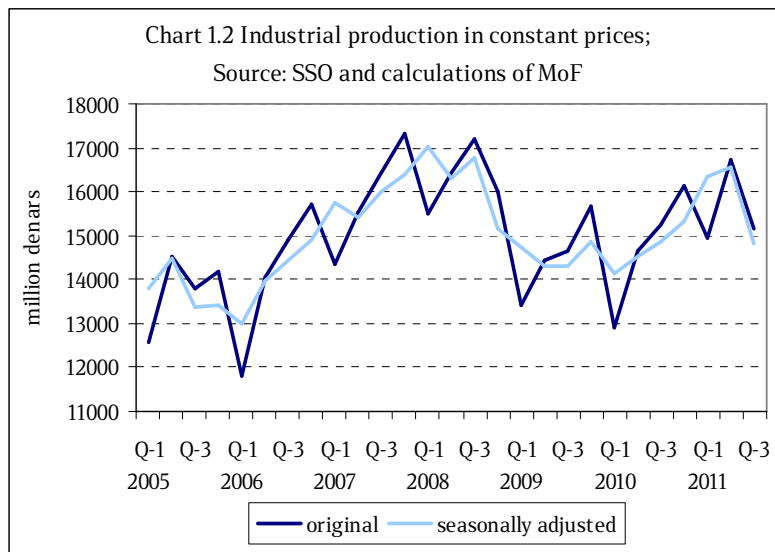
Hotels and restaurants sector and agriculture sector registered growth rates of 7% and 6% respectively. Positive contribution to growth was also registered in the public administration sector – 2.7%. Transport, storage and communications sector experienced 3.9% growth in Q3 2011. It is assumed that growth in this sector was driven by the communications activity, taking into account the stagnation in the industrial production.

Financial intermediation sector continued its trend of negative growth in Q3 as well, experiencing negative growth rate of 2.5%.

Drop in the growth rate of the **industrial production**<sup>1</sup> in Q3 2011 was mainly due to the decline in the production of furniture (19.4%), production of motor vehicles (16.5%), metal ore extraction (13.9%), production of chemicals and chemical products (5.6%), production of paper (5.1%), production of products from other non-metal minerals (2.9%), tanning and leather processing (2.4%), extraction of coal and lignite (0.4%) and wood processing (0.3%).

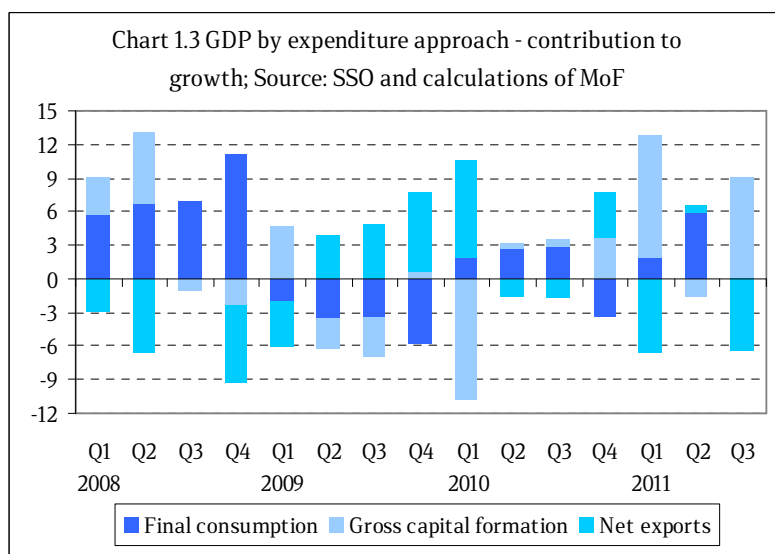
<sup>1</sup> Calculated on the basis of monthly releases of Industrial Production Index.

On the other hand, growth was observed at the following: other mining and quarrying (50.3%), production of other traffic means (45%), production of tobacco products (37.4%), manufacture of machinery and equipment n.e.c. (27.7%), production of electrical machines and devices (26.1%), recycling (25.3%), production of base metals (18.4%), textile production (12.5%), production of coke (10.8%), production of clothing (9.2%), publishing activity (9%), production of rubber products (8.2%), electricity supply (8.0%) and production of food products and beverages (7.3%).



Analyzed by **expenditure side**, GDP growth in Q3 2011 was driven by domestic demand, in particular gross investments, which experienced high increase of 42.5%. Increase of investments corresponds to the growth in the construction sector, high increase of domestic production of capital goods, as well as the solid growth of import of investment goods.

Taking into account the lower capital budget expenditures in Q3 on annual basis, it is assumed that growth of investments was driven by the private sector, all the more because increase of long-term credits to enterprises accounted for 15.7% at the end of Q3, as well as the solid amount of foreign direct investments.



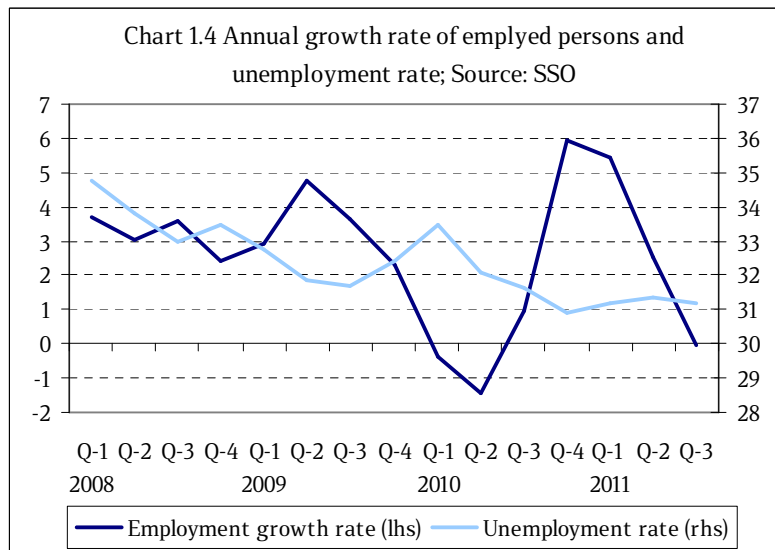
Final consumption in Q3 had a neutral contribution to the economic growth. In fact, private consumption registered moderate growth of 1.8%, corresponding to the increase of trade and higher VAT revenues collected, as well as positive growth of consumer goods production.

Public consumption registered relatively high decline of 7.9%, pointing to continuous negative growth of public consumption observed in the first half of the year.

With respect to net export demand, it has negative contribution to the economic growth. Export of goods and services in Q3 showed real growth of only 3.4%, continuing

the downward trend of export growth, due to the slowdown of the economic growth in the EU. Import of goods and services in Q3 registered higher real growth than the export, amounting to 12.3%.

According to the [Labour Force Survey](#), active population in Q3 2011 declined by 0.7% compared to the same quarter in 2010. This was a result mainly of the decline in the number of unemployed persons, being lower by 2.2% annually, while number of employed on Q3 2011 dropped by 156 persons. Working-able population in Q3 2011 recorded growth of 0.5%.

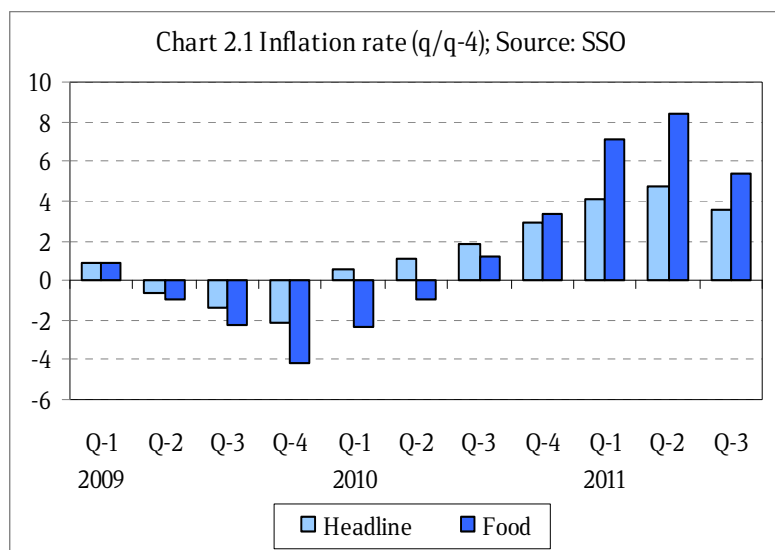


Such labour market trends caused for **unemployment rate** to decrease by 0.5 p.p.

in Q3 2011 compared to the same quarter in 2010, amounting to 31.2% (see Chart 1.4). Employment rate was 39.1%, decreasing by 0.2 percentage points compared to the same quarter in 2010, while activity rate dropped to 56.9% from 57.6% in Q3 2010. In fact, number of employees, analyzed by the type of ownership of business entities, surged by around 200 persons in the private sector annually, while in the other parts of the economy, number of employees dropped by 350 persons.

## 2. Prices, Costs and Productivity

**Inflation rate**, measured according to CPI, was 3.6% in Q3 2011 compared to the same quarter in 2010. Highest price increase was registered in the Food category - 5.4%, followed by price increase in the Housing category - 3.9%, mostly due the increase of electricity prices by 5.4%. Prices in the Hygiene and Health category surged by 3.8%, while prices in the Means of Transport and Services category were higher by 2.6%, as a result of the higher prices of liquid



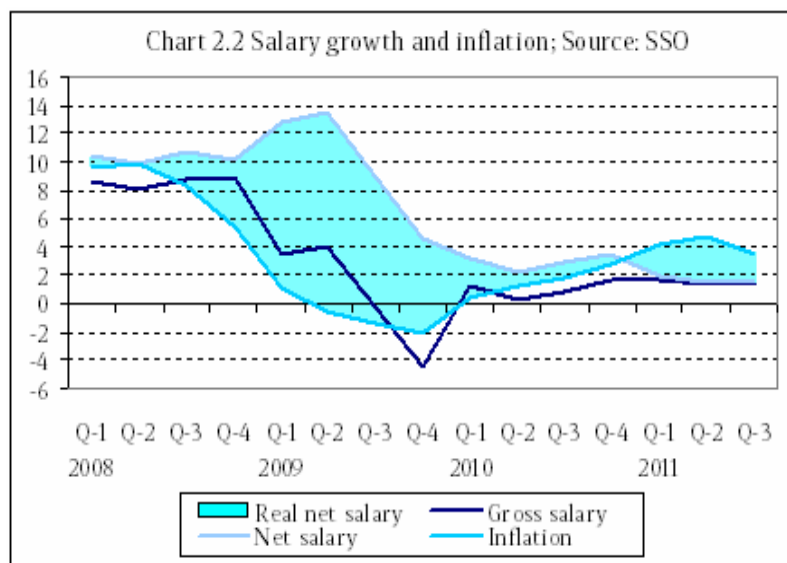
fuels and oils by 11.8%. Price increase was also registered at administrative and financial services by 2%, hotels and restaurants by 1.6%, clothing and footwear by 1.5% and

tobacco and beverages by 1.2%. Reduction of prices was observed only at the Culture and Entertainment category – 0.8%.

**Core inflation** (which excludes the effect of food and energy) was 1.3% in Q3 2011, being at approximately the same level compared to the core inflation in the previous quarter (1.2%).

**Retail prices** in Q3 2011 increased by 3.8% compared to the same quarter in 2010. Prices of industrial products, which surged by 5.4%, contributed the most (with 3.1 p.p.) to the total increase of the retail prices. Within this category, highest price increase was recorded at food products – 6.3%. Prices of non-food products surged by 5.7%. Retail price of tobacco increased by 2%, while retail price of beverages surged by 1.2%. Prices in the Agricultural Products category experienced slight increase of 0.7%, compared to the price increase of 10% in the previous quarter.

Average **net salary** in Q3 2011 amounted to Denar 20,795, being higher by 1.6% in nominal terms, compared to same quarter in 2010. On real basis, net salary dropped by 1.9% (shaded field in Chart 2.2). Average **gross salary** amounted to Denar 30,528, increasing by 1.5% in nominal terms, while it dropped by 2.1% in real terms.



Increase in economic activity in Q3 2011 was not followed by increase in the number of employees, implying increase in **labour productivity** by 2.3%, following the increase of 2.4% in the previous quarter. In fact, in parallel to the increase in the number of employees, physical capital also increased by around 3.3% in Q3 2011. Such trends of growth factors caused for **total factor productivity (TFP)** to increase by 1% in Q3 2011, following the increase of around 3% in the previous quarter.

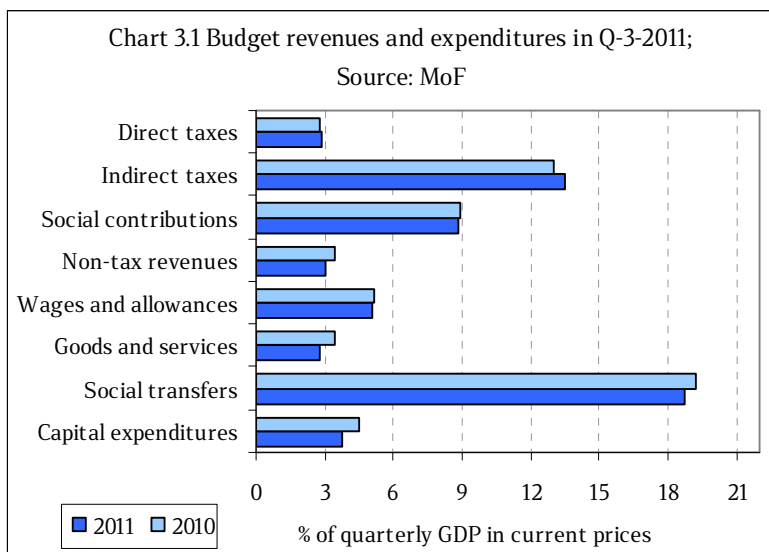
### 3. Fiscal Sector

Lower performance of budget revenues was observed in Q3 2011, compared to Q3 2010, accompanied by relatively lower budget expenditures. Budget deficit was in the amount of Denar 1,659 million in Q3 2011, being 1.5% of GDP realized in this quarter (central budget deficit amounted to Denar 889 million, i.e. 0.8% of GDP).

Anti-cyclical fiscal policy continued to be conducted in the third quarter in 2011 as well, aimed at mitigating the consequences of the global economic crisis on the Macedonian

economy and maintaining macroeconomic stability. Thereby, fiscal sustainability of public finance was not jeopardized.

Total **budget revenues** were lower by 4.7% compared to the same quarter in 2010, and it was not due to the lower performance of tax revenues, i.e. contributions, which increased by 5.4%, whereby social contributions were higher by 3.0% and non-tax revenues dropped by 9.9%. Thereby, higher collection of VAT and personal income tax was registered, as well as moderate increase of excises collection, while profit tax



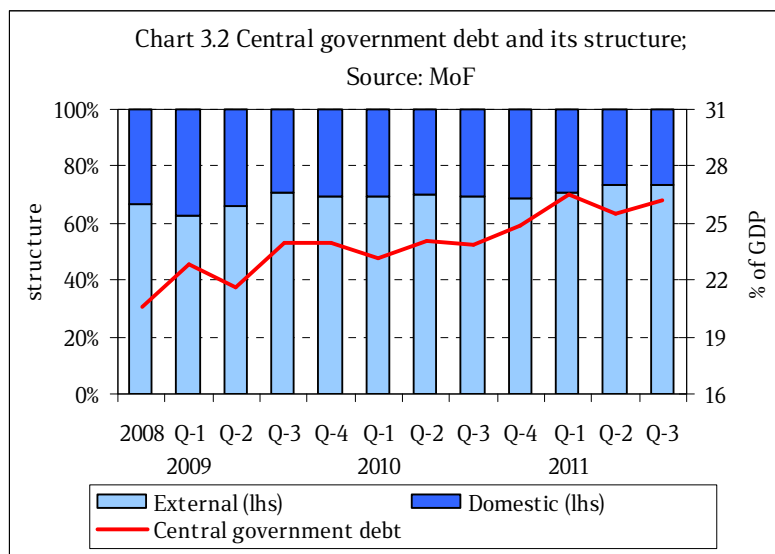
performance declined by 36.7%. VAT revenues, accounting for 54.5% of total tax revenues, increased by 11.2% in Q3 2011, compared to the same quarter in 2010, i.e. they dropped by 7.0 p.p. compared to the collection in the previous quarter. Regarding the structure of gross VAT revenues, there was an increase in VAT collection on the basis of import, as well as increase of sales in the country in line with the trade sales, and dynamics of VAT refund was also intensified. Excise revenues were higher by 0.5%, compared to the same quarter in 2010, while collection of customs duties surged by 13.7%. As for direct taxes, profit tax revenues dropped by 36.7% (one should take into account that starting 2009, only profit distributed for dividend is taxed and, starting April 2010, revenues on the basis of tax on paid dividend and other distribution of profit are recorded, participating with significant percentage in the structure of this tax). Revenues on the basis of personal income tax were higher by 9.7%. Collection of social contributions was higher by 3.0%, whereby higher collection was recorded at all contributions, i.e. pension insurance contributions increased - 2.7%, health insurance contributions - 3.3%, employment contributions - 5.3%. Non-tax revenues, accounting for 9.9% of total budget revenues, were lower by 9.9% in Q1 2011 compared to the same period in 2010. Revenues on the basis of donations were lower by 9.6%.

In Q3 2011, total **budget expenditures** were lower by 1.5% compared to the same quarter in 2010. Current expenditures, accounting for 88.2% of the total expenditures, increased by 0.4% on annual basis. Capital expenditures, participating with 11.8% in the total expenditures, were lower by 13.5% compared to Q3 2010, whereby their performance in Q3 2011 was with better dynamics than in the previous years, accounting for 20.4% of the total planned funds for 2011. As for current expenditures, expenditures for goods and services dropped by 17.4%, while expenditures related to salaries and allowances experienced relatively moderate rise, i.e. they increased by 4.2% compared to the same quarter in 2010. Funds for transfers, participating with almost 2/3 (59.3%) in the total expenditures, were higher by 2.1% on annual basis, while the share of the category

„Other Transfers“ in the total transfers accounted for 21.1% (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 27.0% in total expenditures, were higher by 3.8% compared to the same quarter in 2011, i.e. they were higher by 2.5% compared to Q2 2010. Interest-related expenditures increased by 8.7%, whereby domestic debt interest-related expenditures increased by 21.1%, and expenditures related to interest on foreign debt surged by 6.7%.

**Fiscal burden**, measured as participation of budget revenues<sup>2</sup> in relation to nominal GDP, was 27.4% in Q3 2011, increasing by 1.1 p.p. in relation to Q2 2011. Total budget expenditures accounted for 31.7% of GDP, which was by 3.0 p.p. lower compared to Q2 2010.

Total **central government debt** at the end of Q3 2011 accounted for 26.2% of GDP, increasing by 0.9 p.p. compared to Q2 2011. Share of central government external debt in the total central government debt increased by 0.1% compared to Q2 2011, while share of central government domestic debt in the total central government debt dropped by the same amount. Hence, share of



central government domestic debt decreased to 26.4% 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, having the limits set at budget deficit of 3% of GDP and government debt of 60% of GDP.

#### 4. Monetary and Financial Trends

In the third quarter in 2011, there was no change registered in the set-up of the monetary policy. In conditions of reduced inflationary pressures and favourable macroeconomic climate, reference interest rate remained at the same level of 4% compared to the previous quarter. However, in the coming period, increased

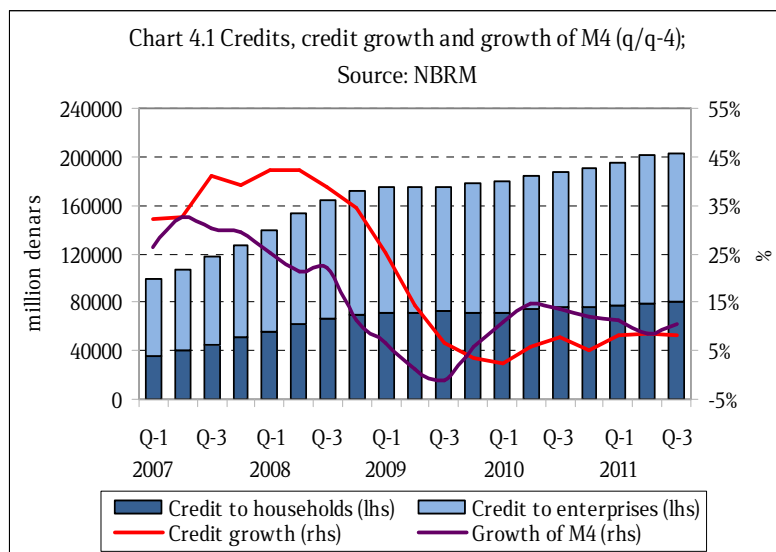
<sup>2</sup> It included tax revenues, social contributions and administrative fees and duties and road toll.

vulnerability of the national economic activity is expected, in line with the increased risks at global level, caused by the deepening of the debt crisis in the Eurozone.

In Q3 2011, **primary money**<sup>3</sup> dropped by 4.0% in relation to the previous quarter. Drop in primary money was a result of the decline in the total liquidity of banks by 7.6%, while ready money in circulation grew by 1.1%, on quarterly basis.

**Monetary aggregate M1** declined by 0.9% compared to Q2 2011, mainly as a result of the decline of deposit money of enterprises and households. Broader monetary aggregates **M2 and M4** grew by 2% and 4% respectively in Q3 2011, compared to the previous quarter.

Total **deposit potential**<sup>4</sup> of the private sector increased by 2.5% on quarterly basis, being driven by the growth of deposits of private enterprises by 3.8% and deposits of households by 2.1%. Decline was registered at deposit money by 2.1% compared to the previous quarter, as well as long-term foreign currency deposits (5.9%).



From the point of view of currency, the new saving was dominantly in domestic currency (contributing with 54.2%). Domestic currency deposits increased by 2.7%, while growth of foreign currency deposits surged by 2.2%. Therefore, the level of euroization, measured through the share of foreign currency deposits in the total deposit potential, reduced to 50.9% (51.1% in Q2 2011).

According to maturity, short-term deposits increased by 3.9% in Q3 2011 compared to the previous quarter, while growth of long-term deposits slowed down to 1.6%.

**Credit activity of banks to non-government sector** registered a growth rate of 1.4 in Q3 2011 on quarterly basis, being a decline in relation to the quarterly growth of 3% registered in the second quarter.

From the point of view of sector structure, growth of credits to households of 2.1% was observed, dominantly contributing with 57.8% in the total credit growth, while credits to private enterprises surged by 0.9%, significantly contributing to the new crediting (39.3%).

From currency point of view, foreign currency credits showed intensified growth of 6% on quarterly basis (compared to the growth of 4.1% in Q2 2011). Denar credits dropped by

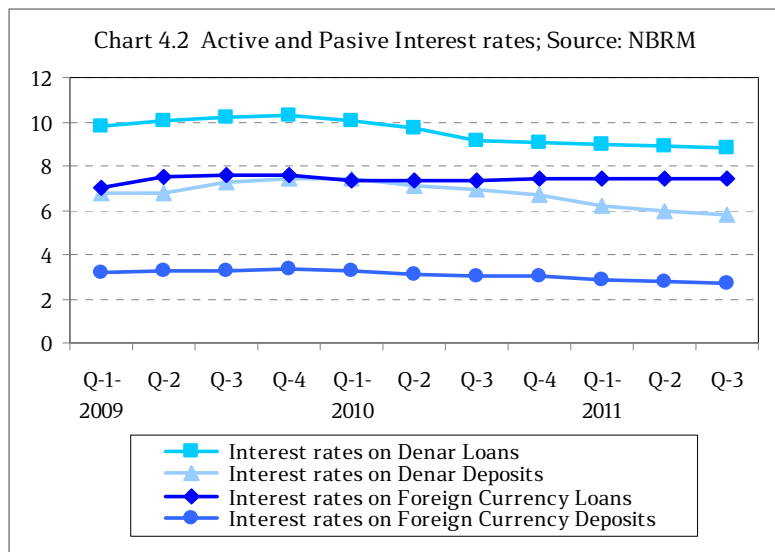
<sup>3</sup> It includes ready money in circulation (including cash in hand), Denar and foreign currency reserve requirement and the surplus of liquid assets over the reserve requirement (in Denars).

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



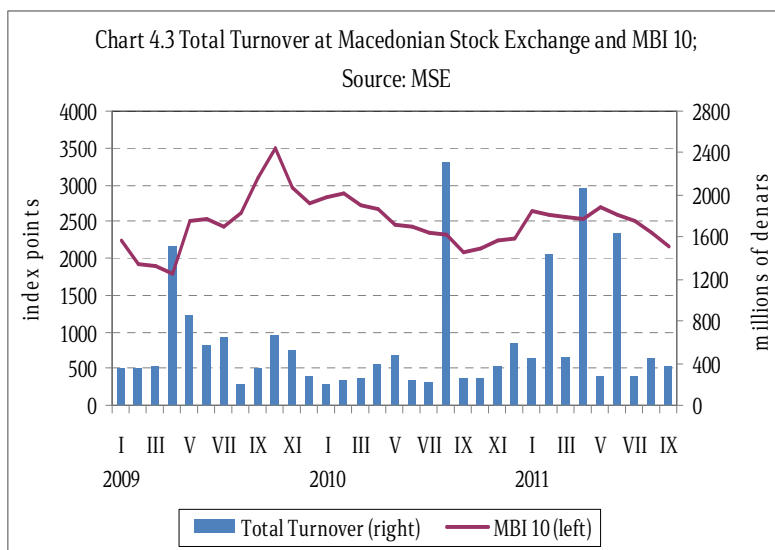
0.2% in relation to the previous quarter. From maturity point of view, long-term credits remained to be the main driving force of the new crediting on quarterly basis, increasing by 1.6% in relation to Q2 2011, while short-term credits experienced a decline of 1.3%.

In the third quarter in 2011, NBRM kept the reference **interest rate** unchanged at the level of 4%. Interest rates on foreign currency deposits of deposit banks dropped by 0.1 p.p. in Q3 2011 compared to the previous quarter. Interest rate on total foreign currency deposits reduced to 2.7% in the third quarter, while interest rate on foreign currency credits remained unchanged, amounting 7.4%.



Interest rates on Denar credits and Denar deposits remained unchanged, amounting to 8.8% and 5.8% respectively. Interest rate on newly approved Denar credits was 8.3%, showing 0.1 p.p. increase on quarterly basis, while interest rate on newly approved foreign currency credits remained unchanged, amounting to 7.4% on quarterly basis.

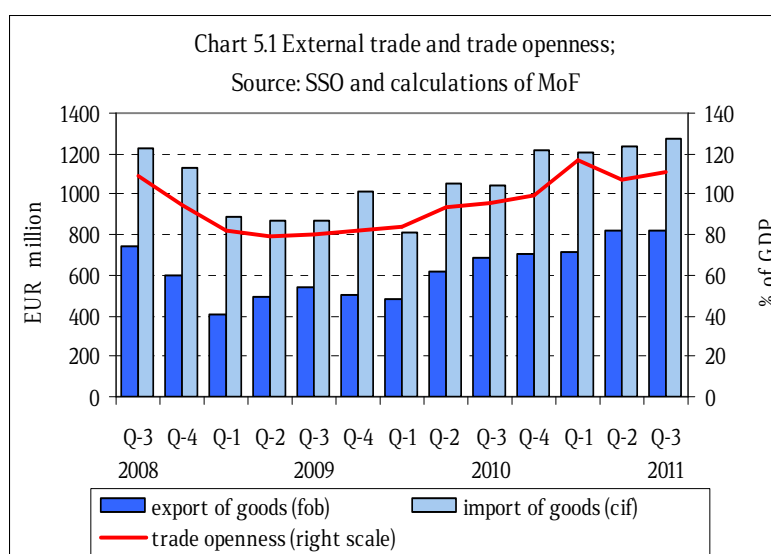
**Capital market** experienced decline in the total turnover of 72.4% in the third quarter in relation to the previous quarter, due to the decline in the turnover at almost all market segments on the stock exchange, the highest quarterly decline being registered at the block transactions. During the same period, traditional trading turnover surged by 5.5%, while in relation to the same period last year, it dropped by 57.9%. Like the decline in the total turnover on the stock exchange, Macedonian Stock Exchange Index MSEI-10, as aggregate indicator of stock market trends, dropped by 16.6% compared to June 2011, while compared to September 2010, it surged by 3.8%.



## 5. External Sector and Balance of Payments

In Q3 2011, total foreign trade (f.o.b. basis) amounted to EUR 2,052.6 million, being the highest amount since 2003 onwards, increasing by 21.5% compared to the same quarter in 2010, as a result of simultaneous increase of export and import of goods and lower comparison basis than the same quarter in the previous year.

In Q3 2011, **export** of goods amounted to EUR 824.3 million, being the highest export since 2003 and, compared to the same quarter in the previous year, it increased by 20.3%.



Analyzed by SITC sectors

(Standard International Trade Classification), positive trends in the export were registered at the following:

- chemical products, i.e. chemical materials and metal products – by EUR 54.3 million, contributing to growth with 7.9 p.p. (such trends were due to the high growth of export of “catalysts with precious metals or precious metal compounds by “Johnson Matthey”);
- machines and transport equipment by 100% (electrical machines and spare parts and industrial machines and spare parts by EUR 33.6 million or contributing to growth with 5 p.p.);
- oil and oil products by EUR 21.6 million, contributing to growth with 3.2 p.p.
- products classified by material by 7% (iron and steel by EUR 16.7 million or contributing to growth with 2.4 p.p.), etc.

In Q3 2011, observed by economic purpose, intermediary goods intended for industrial production contributed the most to the annual growth of export with 63.8%, followed by energy with 9% and consumer goods with 8%.

**Import of goods (f.o.b.)** in Q3 2011 amounted to EUR 1,228.3 million, increasing by 22.4% (EUR 224.6 million) compared to Q3 2010, while in relation to the previous quarter, it increased by 3%. Analyzed by SITC sectors, in Q3 2011, in addition to the highest positive movement, as regards import of the category non-ferrous metals by EUR 72 million, participating with 31% in the total increase, such growth was also observed at the following categories: mineral oils and lubricants (oil and oil products by EUR 56 million, electricity by EUR 20 million), followed by electrical machines and spare parts by EUR 15 million, industrial machines and spare parts by EUR 10 million, etc. Import growth at these categories of goods, which are intermediary inputs in the production process, points out to preconditions ensured for the production activity in the next quarters. Import at categories transport equipment and non-organic chemical products

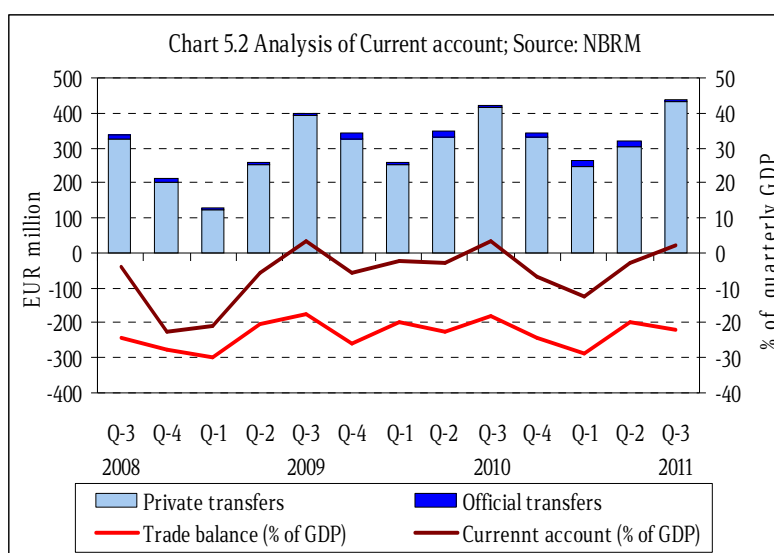
decreased by 90% and 42% respectively. However, the numbers should be taken with caution since they include the base effect of the third quarter last year.

Observed by economic purpose, in Q3 2011, products intended for industrial production and energy to the annual increase of import with 57% and 33.7% respectively.

**Trade openness of the Republic of Macedonia** in Q3 2011 amounted to 110.8%, an increase compared to the same quarter in 2010 by 15 p.p., as a result of the more intensive increase of trade and slower increase of the level of GDP in this quarter.

In Q3 2011, in conditions of improved trade with the European Union (EU 27), in relation to Q3 2010, by 22%, share of trade with the EU in the total foreign trade increased by only 0.2 percentage points, accounting for 56.1%, whereby export of goods participated with 58% and import of goods accounted for 54.7%. As a result of the structural changes in trade with abroad, in the third quarter in 2011, 43.8% of the trade deficit of the country was a result of the trade deficit with Great Britain and Russia, followed by Greece, Turkey, Bulgaria, China, Serbia, etc. Trade surplus was realized with Kosovo, Germany, Albania, Croatia, etc.

In Q3 2011, positive BOP balance, compared to the same quarter in 2010, was narrowed by 28.2%, amounting to EUR 43.6 million or 2.4% of GDP (accounting for 3.4% of GDP in the third quarter in 2010). In Q3 2011, improved positive balance of services, unchanged deficit at the sub-balance of income and increased net current transfers by EUR 120



million were the main factors for the current account to experience a surplus in the amount of EUR 43.6 million in Q3 2011, compared to the deficit of EUR 58 million in the previous quarter.

In Q3 2011, **trade balance** (-21.8% of GDP) dropped compared to the previous two quarters in 2011 and in the last quarter in 2010, returning to the level of Q2 2010 (-22.1% of GDP). Annual increase of export in Q3 2011 was lower compared to the previous two quarters, while annual surge of import in Q3 was lower than the surge in Q1, exceeding the import growth in Q2 2011. Such trends in both import and export caused for the level of trade deficit in relation to GDP to increase by 3.8 p.p. compared to Q3 2010.

In the same quarter, **net current transfers** increased by 4.6% in relation to Q3 2010, being a result, to a great extent, of the higher private transfers. Private transfers registered an increase of 4.9% (EUR 20.3 million), continuing to have dominant share (98%) in the current transfers.

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