

Republic of Macedonia
Ministry of Finance

QUARTERLY ECONOMIC REPORT Q1 2011

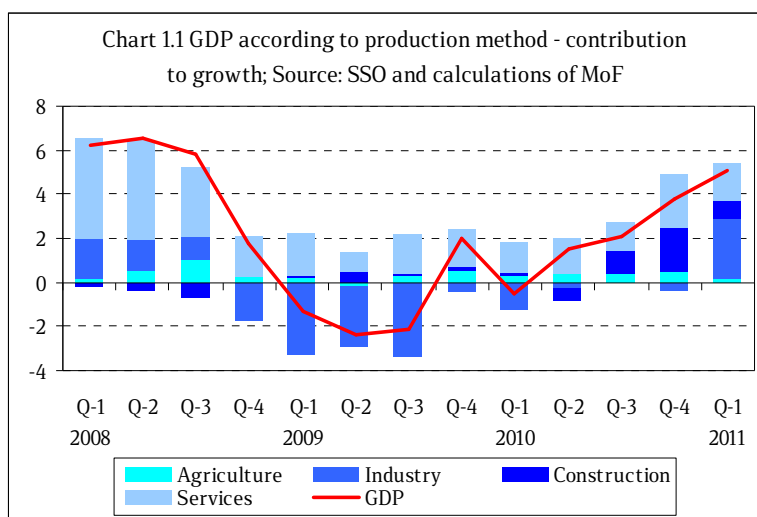
Summary

- **Real GDP growth** reached 5.1% in Q1 2011 in relation to the same quarter in 2010. Except for financial intermediation, all other sectors registered growth, construction sector and industry sector experiencing the highest growth of 21.2% and 13.7% respectively;
- Trend of high **increase of number of employees** continued in Q1 2011 as well, registering 5.5% growth rate on annual basis, compared to the 5.9% increase in 2010. Such trend was accompanied with **decline in the number of unemployed persons** of 4.8% on annual basis;
- **Inflation rate**, measured according to CPI, was 4.1% in Q1 2011 (Q/Q-4).
- **Net salary** increased by 1.9% in nominal terms, and it experienced a decline of 2.1% in real terms,
- In Q1 2011, **total budget revenues** experienced higher performance by 6.5% and **total budget expenditures** increased by 4.5% compared to the same quarter in 2010;
- **Deposits** continued to increase in Q1 2011, realizing growth rate of 12.4% compared to end of Q1 2010, and of 1.4% compared to the previous quarter; **Credits to private sector** showed upward trend, increasing by 8% in relation to end of Q1 2010, and by 2.3% on quarterly basis;
- **Macedonian Stock Exchange Index** MSEI -10 in March 2011 dropped by 5.1% compared to March 2010. Turnover realized on the Macedonian Stock Exchange through traditional trading in Q1 2011 surged by 37% compared to the same period in 2010;
- **In Q1 2011, on annual level (Q/Q-4)**, significant increase of both export by 44.4% and import by 49.2% was registered, whereby total foreign trade, expressed in euros, surged by 47.4%;
- **Trade openness of the Republic of Macedonia** in Q1 2011 was 109.5%, whereby level of trade openness increased compared to the previous quarter.

1. Macroeconomic Trends and Real Sector

Real GDP growth in Q1 2011 amounted to 5.1%, compared to the same quarter in 2010, showing growth acceleration, following the growth rate of 3.8% in Q4 2010. **Nominal GDP growth** in Q1 2011 accounted for 12.3%, compared to the same quarter in 2010, implying that GDP deflator was 6.8%.

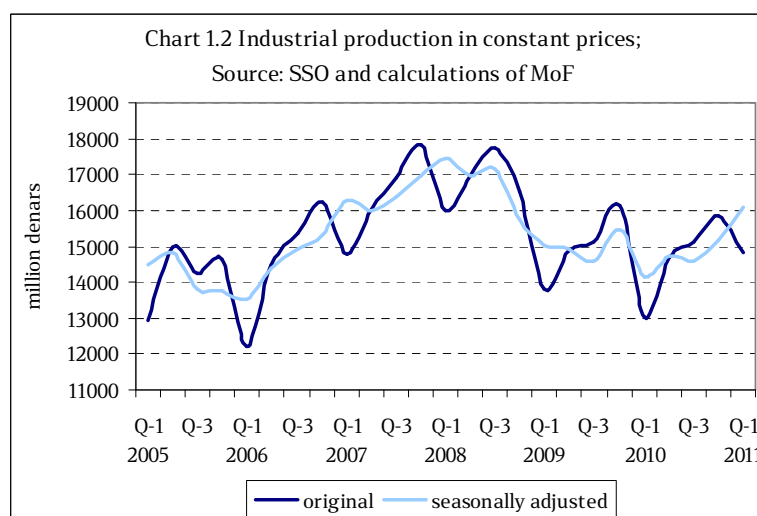
According to the **production side of GDP**, the highest annual real growth rate in Q1 2011 was registered in the construction sector – 21.2%. Retail sale and wholesale registered growth rates of 6.8% on annual basis, showing growth acceleration in this sector, compared to the growth rate of 5.2% realized in the previous quarter. Positive trends in trade were mostly



due to the growth registered in the retail sale. Transport, storage and communications sector experienced 7.3% growth rate, mostly as a result of the positive trends at road transport (freight and passenger), as well as telecommunications. Hotels and restaurants sector and agriculture sector registered growth rate of 3.6% and 2.3% respectively. Positive contribution to growth was also registered in the public administration sector – 1.5%. In Q1 2011, financial intermediation sector experienced negative growth of 1.9% for the first time after five years.

Industrial production grew significantly by 13.8% in Q1 2011, as a result of the positive performance by the processing industry and mining. Business trends in the processing industry and the structural dynamics of import of goods in 2011 showed continuation of the sound growth in the industry sector.

Growth in the **industrial production**¹ in Q1 2011 was mainly a result of the realized positive rates at: mining and quarrying (7.9%), production of



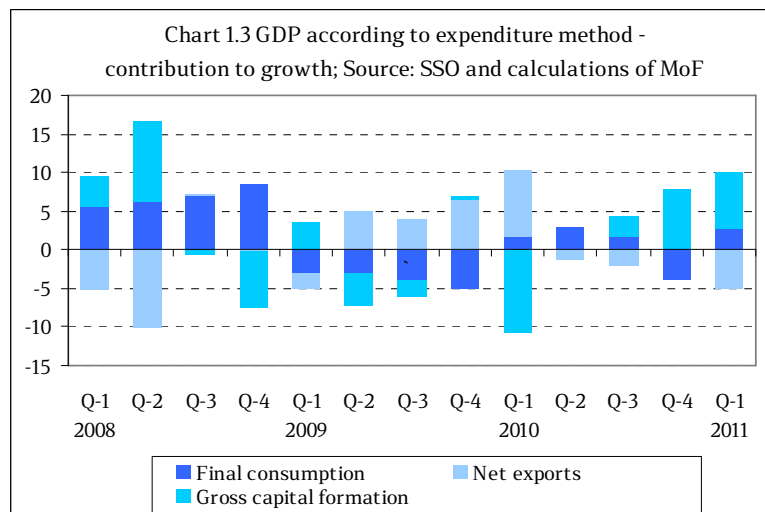
¹ Calculated on the basis of monthly releases of Industrial Production Index

tobacco products (1.4%), production of clothing (35.2%), production of wood and wood products (33.6%), printing and production of recorded media (8.6%), production of coke and refined oil products (43%), production of basic pharmaceutical products and pharmaceutical preparations (11%), production of furniture (12.1%), production of other non-metal products (13.1%), production of metals (34.1%), production of fabricated metal products (30.8%), production of electrical equipment (193.7%), production of production of machines and devices, not mentioned elsewhere (7%), production of motor vehicles (5.6%), production of other transportation equipment (263%) and production of rubber products (18.2%).

On the other hand, drop was recorded at electricity supply (3%), production of chemicals (8.5%), production of paper (19.5%), production of leather (40,1%), production of textile (19%), production of beverages (3.8%), production of food products (13.5%), repair and installation of machines and equipment (75%) and other production industry (43.5%).

In Q1 2001, industry productivity surged by 12.4%, compared to the decline of 5.4% in Q1 2010 and of 8.5% in Q4 2010.

GDP growth, analyzed according to **GDP expenditure side**, was featured with positive contribution by domestic demand, while net import demand had negative contribution to the growth. Domestic demand was driven by gross investments, which continue to experience accelerated growth, reaching 60.1% in Q1



2011. Gross investments, as percentage of GDP, accounted for 29.5%, showing an increase by 12.6 p.p. compared to the same quarter in 2010.

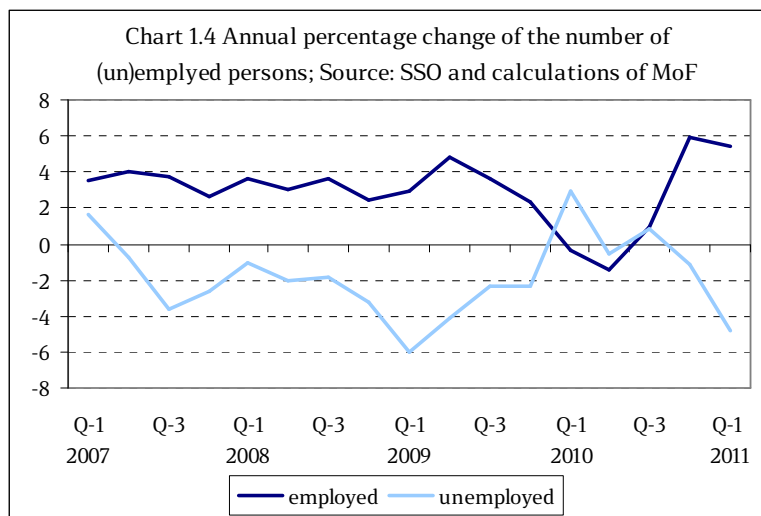
What was indicative for the growth of gross investments in Q1 2011 was the high growth in the field of construction, increase of production of capital goods by 64.6%, while import of investment goods dropped by 12.7% in nominal terms.

Personal consumption in Q1 2011 increased by 3.9%, following the 5.5% decline in the previous quarter. Increase in the personal consumption is in line with the trends in the trade and VAT collection, growth of domestic production of consumer goods and moderate import of consumer goods. Public consumption dropped by 3.2%, reflecting the reduction of budget expenditures for goods and services in Q1 2011 by 5.7%.

High growth of export of goods and services continued at the beginning of 2011, showing real growth rate of 34.8%, while import of goods and services accelerated at the same time, showing real growth of 36.5% on Q1. Developments in the external sector

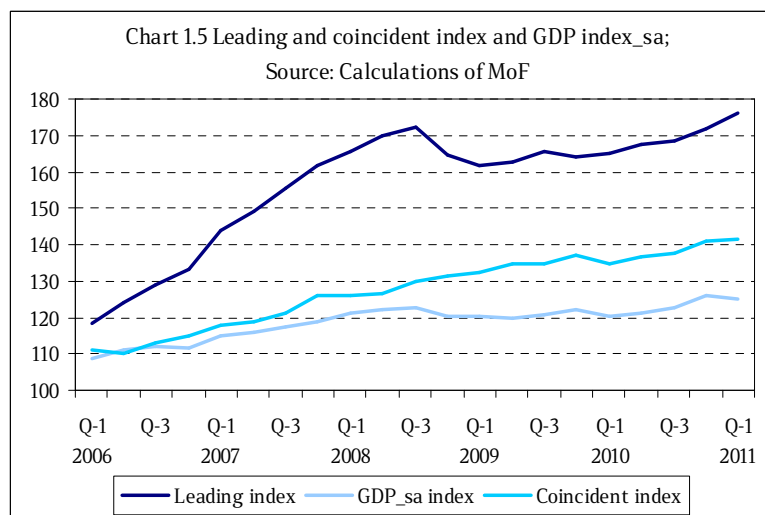
resulted with a negative contribution to GDP growth, however, supporting the industrial activity in the country.

According to the Labour Force Survey, trend of high increase in the **number of employees** continued in Q1 2011 as well, registering 5.5% growth rate on annual basis, compared to the 5.9% increase in the previous quarter. Such trend was accompanied with decline in the number of unemployed persons by 4.8% on annual basis. Growth of employment also absorbed certain reduction at the inactive population (1.4% drop) and certain increase at the working-able population (0.5% increase).



Such trends on the labour market caused for the activity rate in Q1 2011 to increase by 0.8 percentage points, compared to the same quarter in 2010, accounting for 57.1%. Employment rate increased to 39.3%, increasing by 1.8 p.p., compared to the same quarter in 2010, while unemployment rate dropped to 31.2% from 33.5% in Q1 2010. In fact, on net basis, increase in the number of employed persons in Q1 2011 was a result of the increase of working posts in the private sector, where number of employees increased by 10.0% on annual basis, while employment in the other parts of the economy decreased by 6.7%.

Leading Composite Index² in Q1 2011 increased by 4.5 index points, compared to the previous quarter. Compared to the same quarter in 2010, leading composite index was higher by 10.8 index points. Such trends registered at the index showed that positive growth of economic activity is expected to continue at least in the next two



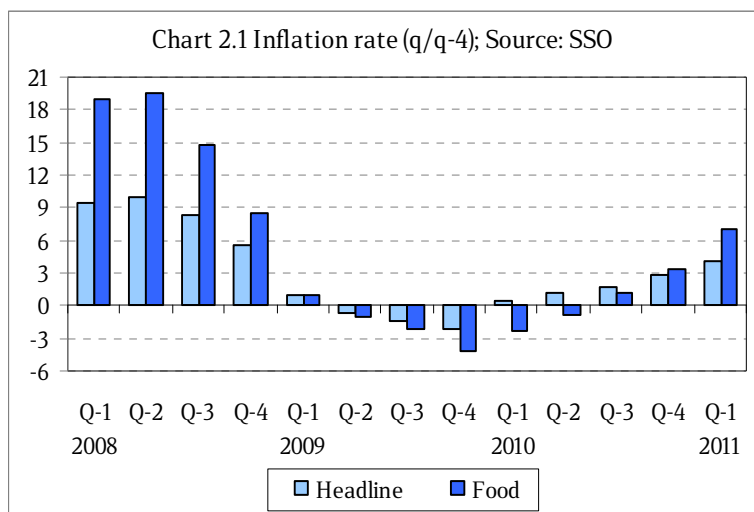
² Prepared by the Ministry of Finance MakLead is an aggregate indicator, showing the trend of business cycle in advance. Index is comprised of eight leading indicators of the economic cycle: 1/average salary in processing industry; 2/average number of persons - beneficiaries of pecuniary allowance; 3/assessment by producers for their production stock for new orders; 4/index of agreed construction works; 5/MSEI-10 stock exchange index; 6/money supply - M2; 7/interest differential and 8/total import reduced for the import of personal consumption.

quarters in the current year.

Leading diffusion index³ in Q1 2011 registered positive trends at 68.8% of the components of the leading composite index, showing higher performance by 12.5 p.p. compared to the previous quarter and the same quarter in 2010.

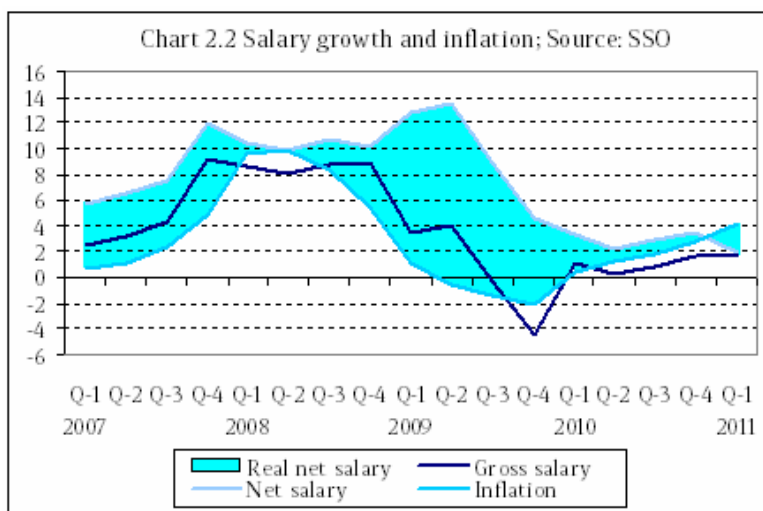
2. Prices, costs and productivity

Inflation rate, measured according to the CPI index, amounted to 4.1% in Q1 2011 compared to the same quarter in 2010 (2.9% in Q4 2010). Highest price increase was recorded at food category – 7.1%, followed by price increase in the means of transport and services category – 4.8%, mainly being driven by the increase of prices of liquid fuels and oils – 18.1%. Housing category experienced growth of 3%, mainly as a result of increase of prices of flats (6% increase) and prices of heating and lighting (3.3% increase). Price increase was also registered at hygiene and health (1.4%), hotels and restaurants (1.4%), clothing and footwear (1%) and tobacco and beverages (1%). On the other hand, reduction of prices was observed at the category culture and entertainment (-0.8%) and other services (-5.6%).



Core inflation (excluding the effect of food and energy) in the first quarter in 2011 was kept at relatively low level of 0.9%, compared to the previous quarter, when it amounted to 0.7%.

Retail prices in Q1 2011 increased by 4% compared to the same quarter in 2010. Prices of industrial non-food products (contribution of 2.1%) contributed the most to the increase of the retail price index, which surged by 5.3% - mainly driven by increase in retail prices of liquid oils and lubricants. Retail prices of industrial

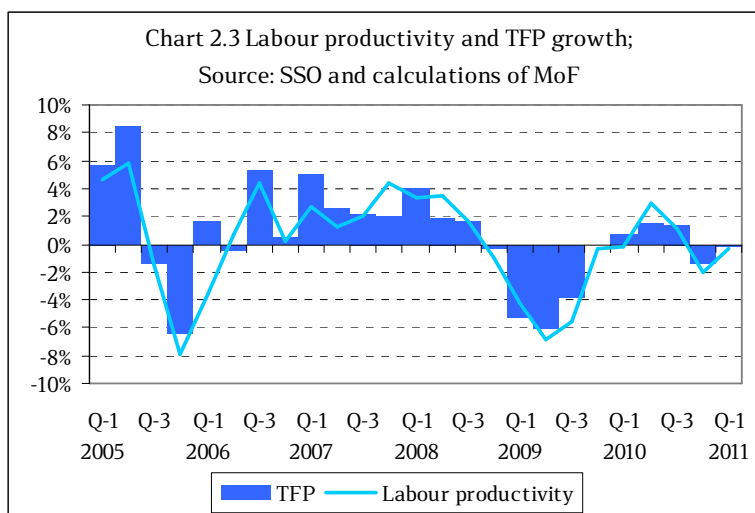


³ Leading diffusion index measures the number (percentage) of components of the leading composite index which increased in a certain period.

food products increase by 6.1%, contributing with 0.9 p.p.. Agricultural products category experienced growth of 8.2%, while prices of services increased by 1.3%.

Average **net salary** in Q1 2011 amounted to Denar 20,681, being higher by 1.9% in nominal terms, compared to same quarter in 2010. Net salary declined by 2.1% in real terms (shaded field in Chart 2.1). Analyzed by sectors, highest increase of net salary was registered in the services sector – 3%, followed by the increased of salaries in the industry – 2.2%, while salaries in the agriculture sector dropped by 1.1%. Average **gross salary** experienced nominal growth of 1.7%, and it declined by 2.3% in real terms.

High growth of economic activity in Q1 2011 was followed by even higher increase in the number of employees, which resulted in a slight decline of **labour productivity** of 0.3%. In parallel to the high increase in the number of employees, physical capital also experienced high increase of around 5% in Q1 2010, reflecting the high growth of investments in real terms in

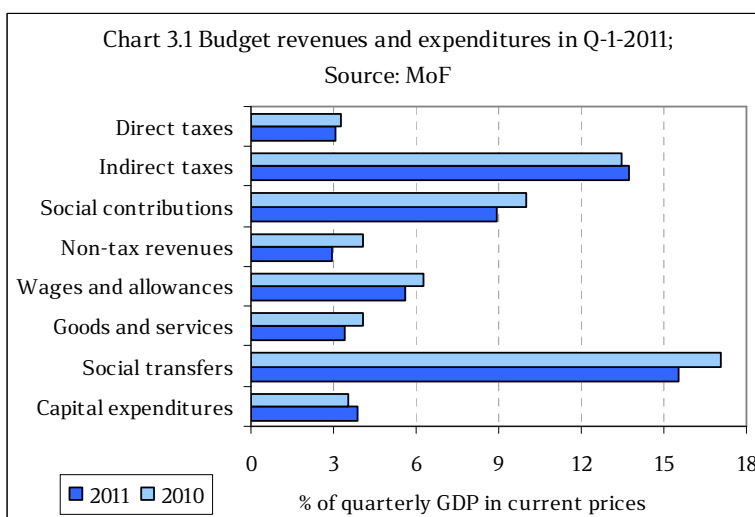


the same quarter. Such trends of growth factors caused for **total factor productivity (TFP)** to drop by 0.2% in Q1 2011, compared to the 1.4% decline in the previous quarter. Chart 2.3 shows TFP and labour productivity trends.

3. Fiscal Sector

Higher performance of **budget revenues** was observed in Q1 2011, compared to Q1 2010, accompanied by relatively higher budget expenditures. Budget deficit accounted for Denar 3,713 million in Q1 2011, being 3.6% of GDP realized in this quarter.

Counter-cyclical fiscal policy continued to be implemented in the first quarter in 2011, aimed at mitigating the consequences from the global economic crisis on our economy and maintaining macroeconomic stability. Thereby, fiscal sustainability of public finance was not



jeopardized.

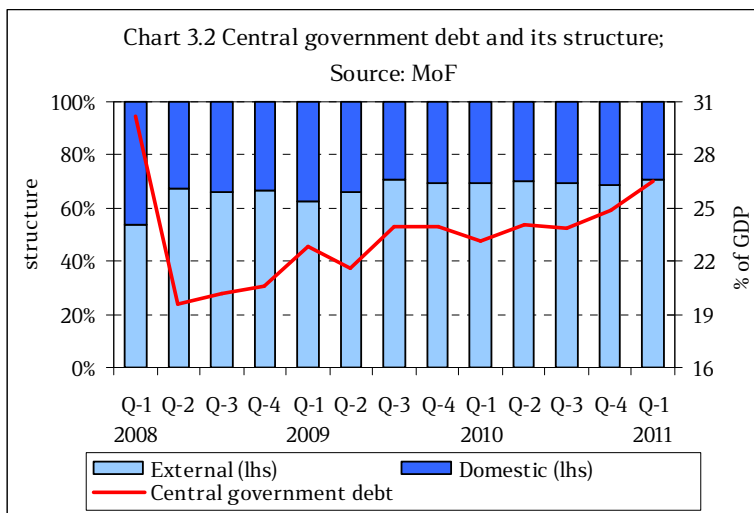
Total budget revenues were higher by 6.5% compared to the same quarter in 2010, mainly due to the higher performance of tax revenues by 12.4%, while social contributions were lower by 0.3%, and non-tax revenues were higher by 19.0%. Thereby, higher collection was recorded at profit tax and personal income tax, and record high collection was registered at VAT. VAT revenues, accounting for 54.1% of the total tax revenues, surged by 19.9% in Q1 2011, compared to the same quarter in 2010. Structure of sales in the country shows that sales of goods and services, taxed with the general tax rate of 18% surged by 12.3%, while sales taxed with preferential tax rate of 5% increased by 9.9%. 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 9.0%, compared to the same quarter in 2010, while collection of customs duties reduced by 15.1%. As for direct taxes, profit tax revenues increased by 4.7% (one should take into account that starting January 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 is registered, participating with significant percentage in the structure of this tax). Revenues on the basis of personal income tax were higher by 6.2%. Collection of social contributions was higher by 0.3%, whereby collection of pension insurance contributions increased by 0.4%, collection of health insurance contributions also surged by 0.6%, while revenues on the basis of employment contributions declined by 3.0%. Non-tax revenues, accounting for 9.5% of total budget revenues, were lower by 19.0% in Q1 2011, compared to the same period in 2010.

Capital revenues in Q1 2011 increased by twice on annual basis, mainly on the basis of lease of construction land, as well as sale of flats. Revenues on the basis of donations were higher by 15.5%.

Total **budget expenditure** in Q1 2011 were higher by 4.5%, compared to the same quarter in 2011. Current expenditures, accounting for 88.6% of the total expenditures, increased by 2.5% on annual basis. Capital expenditures, participating with 11.4% in the total expenditures, were higher by 23.8%, compared to Q1 2011. Execution of capital expenditures in Q1 2011 improved unlike the previous years, amounting to 17.1% of total projected funds for 2011. As for current expenditures, expenditures for goods and services decreased by 5.6%, while expenditures related to salaries and allowances remained stable, i.e. they increased by less than 0.1%. However, transfers were higher by 4.0% on annual basis, while “other transfers” category accounted for 25.2% (including transfers to local government) in the total transfers. Transfers to the Pension and Disability Insurance Fund, accounting for 27.1% in total expenditures, were higher by 3.1% compared to the same quarter in 2011. Interest-related expenditures increased by 55.4%, whereby domestic debt interest-related expenditures increased by 98.0%, and expenditures related to interest on foreign debt surged by 23.7%.

Fiscal burden, measured as participation of budget revenues⁴ in relation to nominal GDP, was 27.2% in Q1 2011, increasing by 1.7 p.p. in relation to Q4 2010. Total budget expenditures accounted for 34.3% of GDP, which was by 2.3 p.p. higher compared to Q4 2010.

Total **central government debt** at the end of Q1 2011 accounted for 26.5% of GDP, increasing by 1.7 p.p. compared to Q4 2010. Share of central government external debt in the total central government debt increased by 2.4% in Q1 2011 compared to Q4 2010, while share of central government domestic debt in the total central government debt dropped by 2.4%.



of central government domestic decreased to 29.0% 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

In Q1 2011, **primary money**⁵ dropped by 3.4% compared to the previous quarter, in conditions of decline of both ready money in circulation and total liquidity of banks by 7.1% and 0.8%, respectively. Annually, primary money were higher by 7.6% (compared to the increase by 6.6% in the previous quarter). **Monetary aggregate M1** declined by 5.8% compared to Q4 2010, while it was higher by 7.5% on annual basis. Broader monetary aggregates **M2 and M4** in Q1 2011 increased in relation to the previous quarter by 0.1% and 0.9% respectively, while they increased by 7.7% and 11.4% on annual basis respectively.

Total **deposit potential**⁶ of the private sector on annual basis grew by 12.4% (compared to 13.7% in the previous quarter). As for quarterly dynamics, deposits experienced slowed down increase by 1.4% in relation to the previous quarter when they increased by 4.7%.

⁴ It included tax revenues, social contributions and administrative fees and duties and road toll

⁵Primary money is calculated as a sum of 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).

⁶Deposits also include calculated interest.

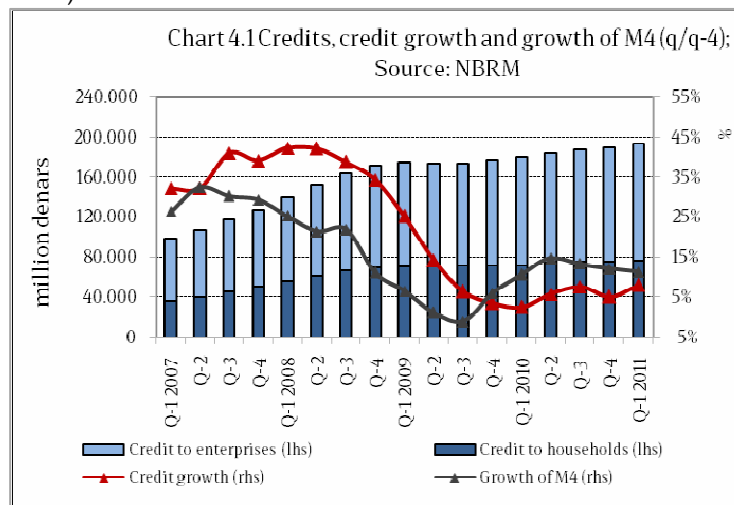
From sectoral point of view, quarterly increase of deposits was to a great extent a result of the increase of deposits of households, surging by 2% compared to Q4 2010 (96.6% contribution). At the same time, deposits of private enterprises grew by 0.6% on quarterly basis. On annual basis, deposits of households were higher by 14%, while deposits of private enterprises experienced high growth rate of 11.3%.

From currency point of view, foreign currency deposits surged by 1.9%, providing dominant contribution to the quarterly growth of deposits (contributing with 67.8%). Therefore, level of euroization, measured through the share of foreign currency deposits in the total deposit potential, increased by 51.3% (51% in Q4 2010) or measured through the share of foreign currency deposits of households in their total deposits, the level of euroization increased from 59.1% in Q4 2010 to 59,3% in Q1 2011.

According to maturity, short-term deposits, accounting for 67.3% of the total deposits in Q1 2011, increased by 2.4%, compared to the previous quarter, while deposit money declined by 6.4%. Long-term deposits were higher by 6.3%. On annual basis, deposit money increased by 11.2%, while short-term and long-term deposits surged by 7.6% and 39.1% respectively.

Credits to non-government sector in Q1 2011 increased by 2.3%, compared to the previous quarter. Analyzed on annual basis, growth of credits accelerated to 8% at the end of the first quarter (7.1% in Q4 2010).

From sectoral point of view, credits to private enterprises (contribution of 75.3%) contributed the most to credit growth on quarterly basis, increasing by 2.9% compared to the previous quarter. Credits to households increased by 1.5% on quarterly basis. On annual basis, growth of credits to private enterprises accelerated to 9.1%, while credits to households increased by 6.6%.

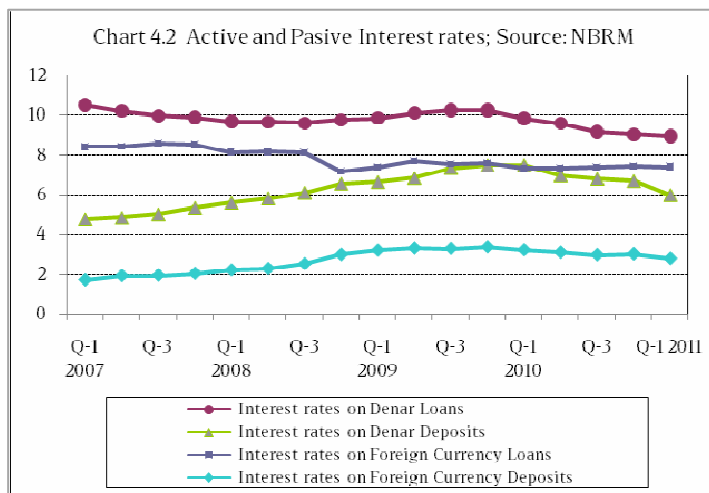


From currency point of view, Denar credits surged by 1.8%, compared to Q4 2010, and on annual basis they increased by 3.2%. Foreign currency credits in Q1 2011 were higher by 3.9% in relation to the previous quarter, while they experienced high increase of 24.6% on annual basis.

According to maturity, short-term credits increased by 0.6% in relation to the end of Q4 2010, while long-term credits increased by 2.9%. On annual basis, short-term credits were lower by 1.7%, while long-term ones were higher by 13.8%.

In the first quarter in 2011, NBRM kept the reference **interest rate** unchanged at the level of 4%. European Central Bank, from May 2009 onwards, has not changed the reference interest rate, and it was kept at the level of 1% at the end of Q1 2011.

In the first quarter in 2011, interest rates of banks were reduced. Thus, interest rate on newly approved Denar credits was 8.1%, showing 0.5 p.p. decline on quarterly basis, while interest rate on total Denar credits declined by 0.1%, amounting to 8.9%. Interest

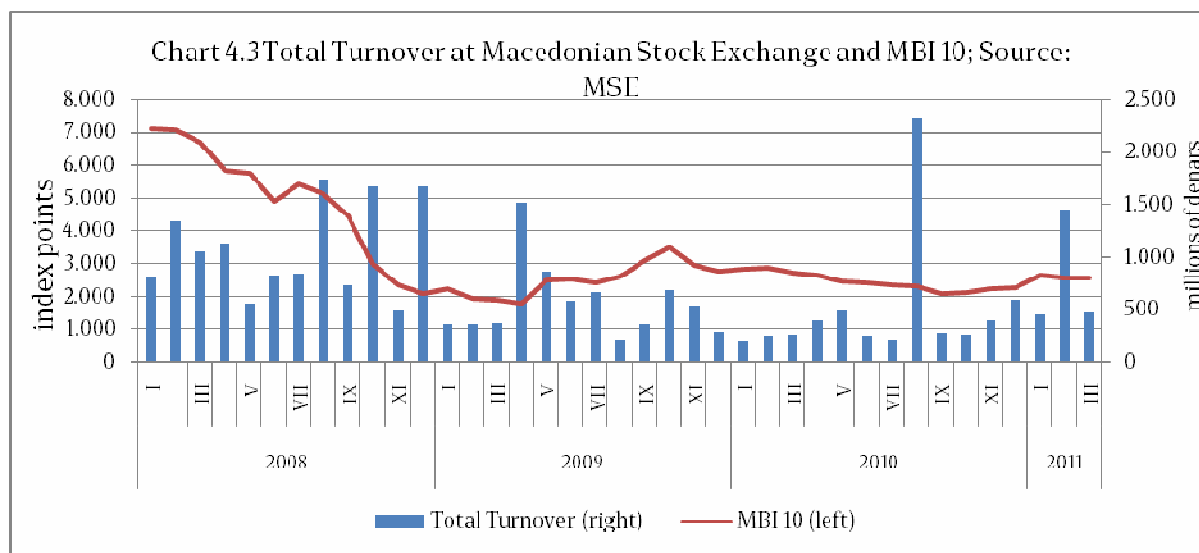


rate on newly approved foreign currency credits was 6.8%, showing 0.5 p.p. decline on quarterly basis, while interest rate on total foreign currency credits remained unchanged at the level of 7.4%.

Average interest rate on new Denar deposits amounted to 3.1% in Q1 2011, and it dropped by 1.1 p.p. compared to the previous quarter, while interest rate on

total Denar deposits was 6%, declining by 0.7% compared to the previous quarter. Interest rate on new foreign currency deposits amounted to 1%, being lower by 0.3 p.p. in relation to the previous quarter, while interest rate on total foreign currency deposits declined by 0.2 p.p., being 2.8%.

As regards **capital market**, total turnover increased in the first quarter in 2011, mainly as a result of the block transactions. Traditional trading turnover surged by 37% in relation to the same period last year, while it dropped by 16.7% on quarterly basis. Macedonian Stock Exchange Index MSEI-10, as aggregate indicator of stock exchange trends, increased by 12.8% compared to December 2010, while compared to March 2010, it dropped by 5.1%.

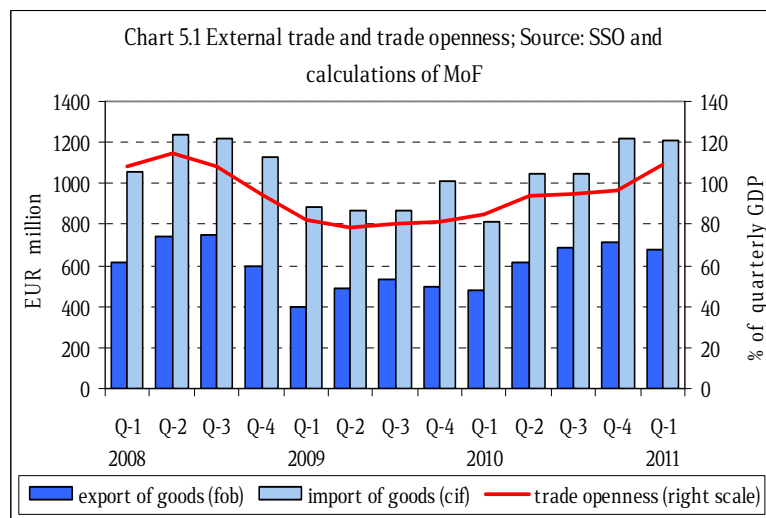


5. External Sector and Balance of Payments

Total foreign trade in the first quarter in 2011 experienced high growth of 47.4% compared to the same period in 2010, being the highest growth rate since 2003

onwards. Such growth was explained with the low comparison base in the same quarter in 2010 and the simultaneous increase of both export and import of goods at the same time.

In Q1 2011, **export of goods** (EUR 682.3 million) increased by 44.4% in relation to the same quarter in 2010, being the highest growth rate in the last four years (highest growth rate of 48.4% was registered in Q1 2007). Analyzed by SITC (Standard International Trade Classification) sectors, positive export trends were observed at:



- chemical products, i.e. chemical materials and metal products – by EUR 97 million, contributing to growth with 20 p.p. (such trends were due to the high growth of export of “catalysts with precious metals or precious metal compounds by “Johnson Matthey””);
- products classified by material – by 39% (iron and steel by EUR 51 million or contributing to growth with 10.7 p.p.) and other.

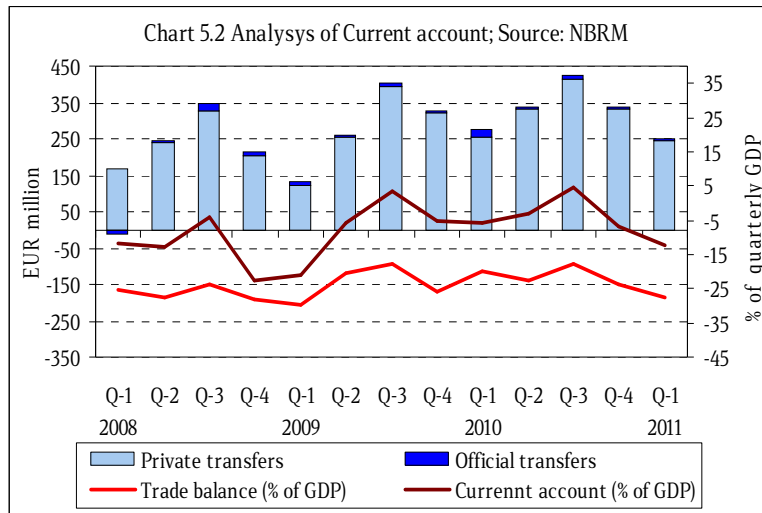
Import of goods (EUR 1,181.5 million) increased by 49.2% (EUR 398.7 million) in Q1 2011 in relation to Q1 2010, being the highest growth in absolute terms compared to all quarters in the previous 8 years. Analyzed by SITC sectors, in Q1 2011, highest increase of import, in addition to non-ferrous metals the import of which increased by EUR 100 million, contributing to growth with 12.3 p.p., was also registered at mineral fuels and lubricants (oil and oil products - by EUR 54 million, electricity - by EUR 25 million), raw chemicals - by EUR 70 million (as a result of increased import by the companies in Bunargik Free Economic Zone - “Johnson Matthey”), contributing to growth with 6 p.p. and products for colouring and tanning - by EUR 23 million, contributing to growth with 2.3 p.p., etc. Import growth at these categories of goods, which are intermediary inputs in the production process, points out to strengthening of production activity in the next quarters. Still, recent figures should be considered with caution, since they do not exclude the effects of the low comparison basis in the first quarter last year.

Trade openness of the Republic of Macedonia in Q1 2011 was 109.5%, showing upward trend in relation to the previous quarters in 2009 and 2010, i.e. it was almost equal to the level reached in the quarters in 2008. Higher trade openness in Q1 2011, compared to the previous quarter, was a result of a significant surge in the export and the high increase, in absolute terms, of the import, as well as the lower GDP in this quarter.

In Q1 2011, in conditions of significant increase of trade with the European Union (EU 27), in relation to Q1 2010, by 50%, share of trade with EU in the total foreign trade increased by 2.6 percentage points, accounting for 58.3%, whereby export of goods

participated with 63.2% and import of goods accounted for 55.8%. As a result of the structural changes in trade with abroad, in the first four months in 2011, 32% of the trade deficit of the country was a result of the trade deficit with Great Britain, followed by Russia, Greece, China, Serbia, Turkey, etc. Trade surplus was realized with Germany, Kosovo, Albania, etc.

BOP current account deficit in Q1 2011 amounted to EUR 204.4 million, or 12.3% of GDP. In relation to the same quarter in 2010, deficit was higher by EUR 122.6 million (or by 7 p.p. of GDP). In conditions of better positive balance of services and lower deficit at the sub-balance of income, main factor for the annual deficit expansion in Q1 2011 was the increased negative trade balance.



Trade balance (-27.8% of GDP) in Q1 2011 declined compared to the previous quarters in 2010 and 2009, returning to the level of Q1 2008 (-27.8% of GDP). Annual increase of import in Q1 2011 exceeded the increase of the export which registered faster annual recovery rate in 2010 quarters. Such trends in both export and import caused for the level of trade deficit in relation to GDP to increase by 7.9 p.p. compared to Q1 2010.

Net current transfers in Q1 2011 slightly grew (2.1%) compared to Q1 2010, mostly due to the higher official transfers. Private transfers, although registering a slight decline of 3.9%, continued to have dominant share (92%) in the current transfers.

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