

Republic of Macedonia
Ministry of Finance
QUARTERLY ECONOMIC
REPORT - Q2/2010

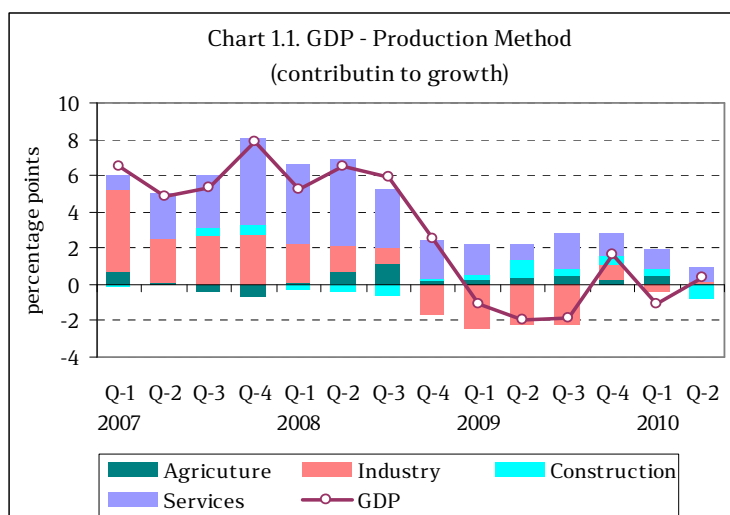
Summary

- In the second quarter of 2010, **GDP showed real growth** of 0.4% compared to the same quarter of 2009, by which average growth was -0.3% in the first half of 2010. Drop was seen in the sectors construction and catering industry, while the other sectors experienced growth, transport and communications out of which showed the most noticeable growth of 3.9%.
- **Number of employees in Q2 2010** according to the Labour Force Survey was lower by 1.4% compared to Q2 2009, amounting to 627,129 employees, however, it was above the level of Q2 2008. Improvement was also noticed in relation to Q1 2010, whereby number of employees increased by 1.8%, i.e. 11,167 new employees;
- **Inflation rate** was 1.1% (Q/Q-4) in Q2 2010 on annual basis, measured according to CPI.
- **Net salary** in Q2 2010 increased by 2.2% in nominal terms, while real growth was 1.1%.
- **Budget deficit** at the end of Q2 2010 was 1.0% of annual GDP. **Fiscal burden** in Q2 was 27.5%, reducing by 0.9 p.p. compared to Q1 2010;
- **Credits to private sector** in Q2 2010 showed upward trend, increasing by 5.8% in relation to Q2 2009 and 2.5% on quarterly basis. **Deposits** continue to experience intensive growth, realizing growth rate of 15.2% compared to Q2 2009;
- **Macedonian Stock Exchange Index** MSEI -10 in June 2010 dropped by 4.3% compared to June 2009. Total turnover realized on the Macedonian Stock Exchange in Q2 2010 decreased by 62.5% compared to the same period last year;
- **In Q2 2009, on annual level (Q/Q-4)**, significant increase of both export by 25.4% and import by 21.4% was noticed, whereby total foreign trade, expressed in euros, continued to improve, increasing significantly by 22.8%.
- **Trade openness of the Republic of Macedonia** in Q2 2010 was 94.8%, pointing out to continuation of the upward trend compared to the previous quarters.

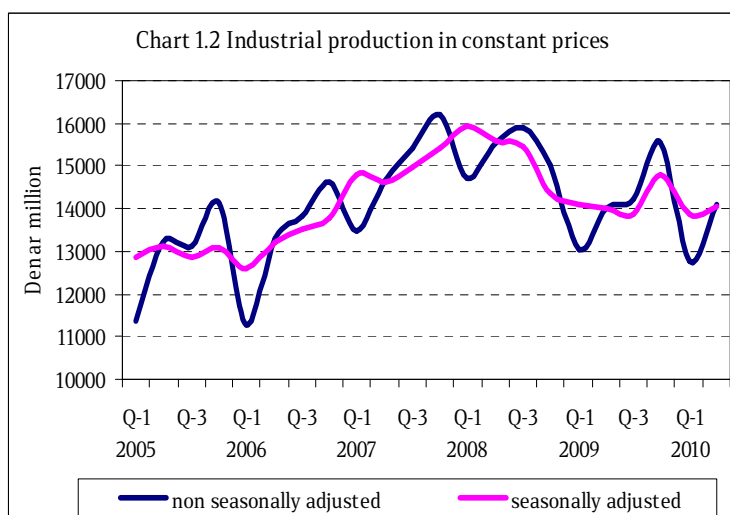
1. Macroeconomic Trends and Real Sector

In Q2 2010, Gross Domestic Product (GDP) in current prices was Denar 107,184 million. Following the drop of 1.1% in the first quarter of 2010, slight **real GDP growth** of 0.4% was seen in the second quarter, compared to the same quarter of 2009, by which average growth was -0.3% in the first half of 2010.

In Q2 2010, according to the **production method**, sectors transport and communications (3.9%), financial intermediation (3.2%), industry (0.8%), public administration (0.7%) and agriculture (0.1%) realized positive growth. Drop was seen at the following sectors: Construction (-12,1%) and hotels and restaurants (-8,7%), while activity in the trade sector did not change compared to the same quarter of the previous year.



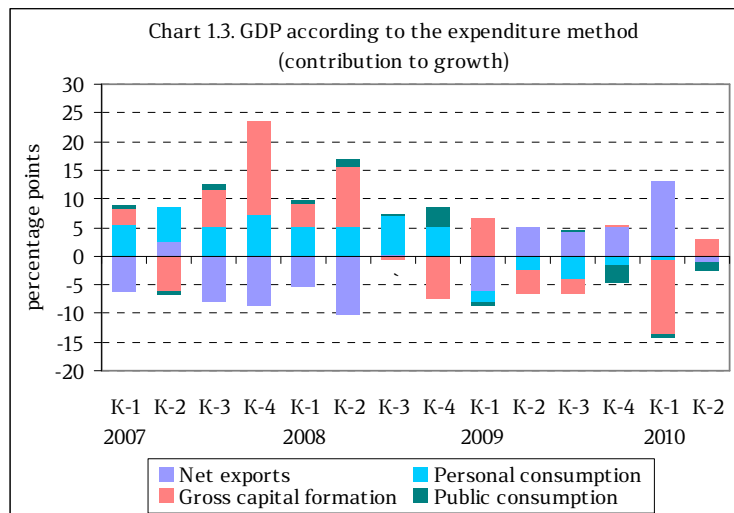
Drop of industrial production in Q2 2010 was mainly a result of the realized negative rates at: processing industry (6.4%), metal ore extraction (13.2%), production of tobacco products (14.5%), production of textile fabrics (1.7%), tanning and leather processings (5.6%), publishing (39.7%), production of chemicals and chemical products (9.1%).



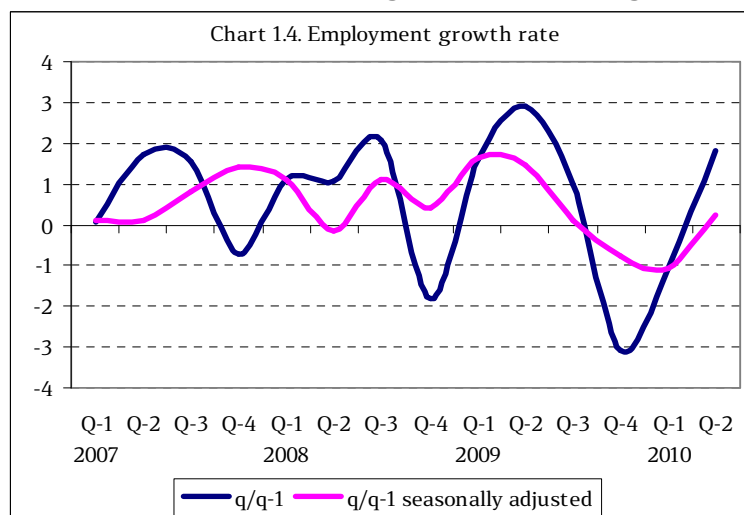
On the other hand, growth was observed at extraction of other ore and stone (40.5%), production of metal products (20.8%), production of clothing, finishing and colouring of fur (13.8%), production of cellulose and paper products (8.2%), coke production (53.8%), and recycling (56.2%).

Analyzed according to **expenditure side of GDP**, positive real growth was registered at all components, except the final public consumption, dropping by 9.3%.

Following the high drop in Q1 2010, **gross investments** in Q2 2010, showed positive trends, realizing real growth rate of 11.5% and contribution to growth of 3 percentage points. Real growth of final personal consumption in Q2 2010 was positive, amounting to 0.1%. Export of goods and services showed real growth of 16.5%, while real growth of export of goods and services was lower, amounting to 12.5%. Taking into account the higher share of import in trade, net export had negative contribution to the economic growth.



Number of unemployed persons in Q2 2010 according to the Labour Force Survey reduced by 4.3% compared to the previous quarter, which was mainly absorbed with the increase in the number of employees (1.8% growth) and to a lesser extent with the increase of inactive population (0.8% growth). Working able population increased by 0.2% in the same quarter. Such labour market trends caused for the unemployment rate to decrease by high 1.4 percentage points compared to the previous quarter, amounting to 32.1% in Q2 2010. Activity rate reduced to 56%, decreasing by 0.3 percentage points compared to the previous quarter, while employment rate increased to 38.1% from 37.5% in Q1 2010. In fact, working positions in the private sector increased on net basis in Q2 2010, compared to the previous quarter, where the number of employees increased by 1%, while in the other parts of the economy, employment increased by 3.9%. Number of employed persons, excluding the seasonal effects, slightly increased on quarterly basis, by 0.2%, following the subsequent drop in the previous two quarters.



Leading Composite Index¹ in Q2 2010 increased by 2.8 index points compared to the previous quarter. Compared to the same quarter last year, leading composite index was

¹ Prepared by the Ministry of Finance MakLead is an aggregate indicator, showing the direction 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 of producers for their production

lower by 4.2 index points. Such trends registered at the index showed that increase in the economic activity is expected to continue in the second half of the year as well, with a tendency for higher growth rates.

Leading diffusion index² in Q2 2010 registered positive trends at 62.5% of the components of the leading composite index, being higher performance compared to the previous quarter and second quarter of 2009, when it accounted for 43.8%.

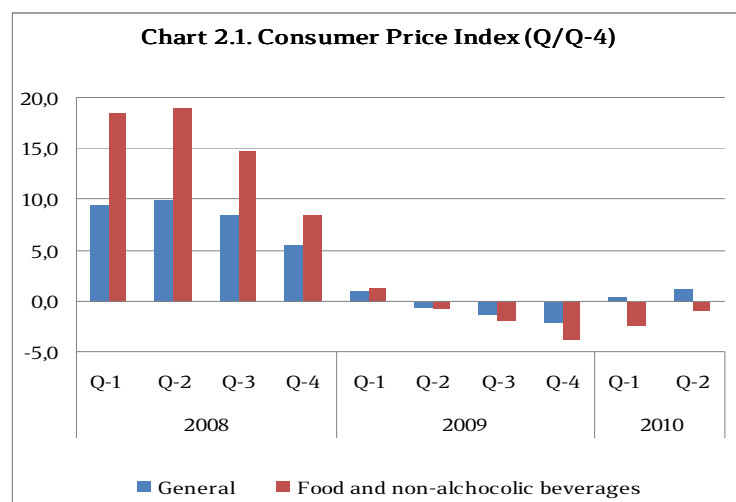
Ratio between leading and lagging index³ in Q2 2010 slightly increased to 1.46 compared to the previous quarter, when it was 1.45. This ratio shows that leading index was higher by 46% compared to the lagging index. Ratio between leading and lagging index constantly surged up to Q4 2008, when it reduced from 1.52 in Q3 2008 to 1.44. Slight fluctuations were registered in the period afterwards.

2. Prices, Costs and Productivity

Inflation rate, measured according to CPI in Q2 2010 was 1.1% compared to the same quarter last year. Highest price increase by 4.7% was seen at housing category, mainly due to the increase of prices of electricity (9.8%), as well as at the category means of transport and services by 5.2%. Prices of clothing and footwear (1%), culture and entertainment (0.8%) and tobacco and beverages (0.1%) also increased. On the other hand, downward pressures on CPI in Q2 2010 were caused by the decline of prices at food category, being lower by 0.9% compared to the same period last year. In addition, price decline was registered at the categories hygiene and health (-0.3%), hotels and restaurants (-0.1%) and other services (-7.1%).

Core inflation (which includes the effect of food and energy) in Q2 2010 stops the downward trend. In fact, it was zero in Q2 2010, i.e. it did not change compared to Q2 2009.

Retail prices in Q2 2010 increased by 2.3% compared to the same quarter of the previous year. Price increase was registered at industrial products category (4.8%),



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.

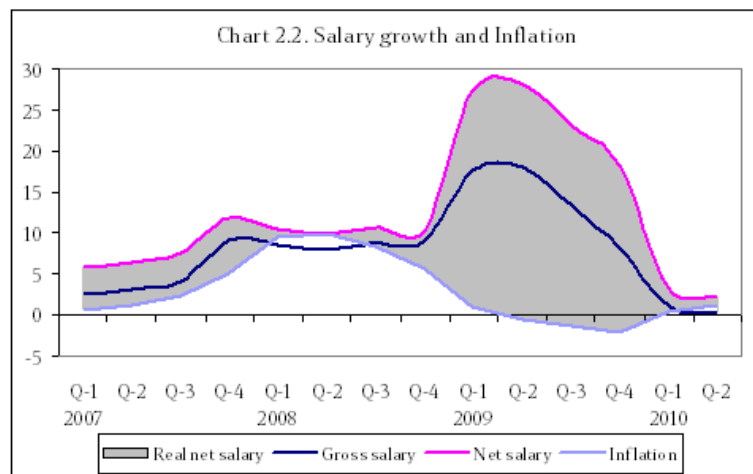
² Leading diffusion index measures the number (percentage) of components of the leading composite index, which increased in certain period.

³ Lagging index is also calculated by the Ministry of Finance. It is comprised of four indicators, following the economic cycle.

whereby the increase of industrial non-food products (7.4%) was more noticeable. On the other hand, prices reduced at the categories: agricultural products (-3.7%) and beverages (-0.3%). Value of the consumer basket of food and beverages for a four-member household, calculated on the basis of retail prices, was higher by 1.2% compared to the previous month, while it was lower by 1.3% compared to Q2 2009. Value of the consumer basket in Q2 2010 was 60.3% of the average net salary.

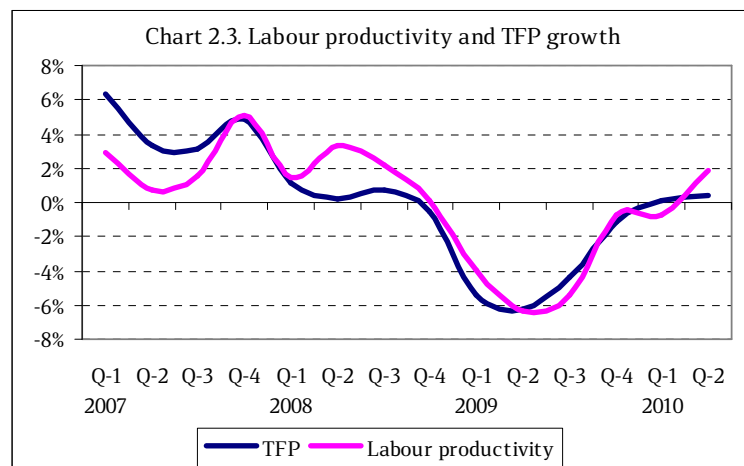
Average **net salary** in Q2 2010 was higher than the same quarter last year by 2.2% in nominal terms, while average

gross salary experienced slower nominal growth compared to net salary, by 0.3%, as a result of the reduced social contribution rates. Moderate inflation rate caused for increase of net salary to be 1.1% in real terms while for gross salary to drop by -0.8% in real terms. (shaded field in Chart 2.2).



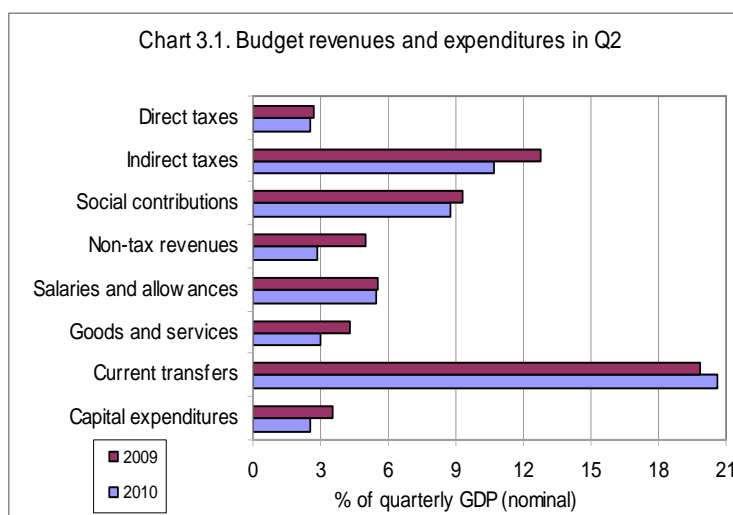
In Q2 2010, labour **productivity** increased on annual level (by 1.8%), following the trend of negative growth in the past five quarters, with a tendency for the productivity growth to continue in the period to come as well. Such result is due to the increased production in Q2 2010, as well as the reduction of the number of employees in the same period.

Total factor productivity (TFP) registered lower increase than labour productivity, i.e. 0.4%. In Q2 2010, physical capital experienced relatively high growth, of 2.1%, compared to the drop of 2.4% in the previous quarter, causing for the TFP growth to be weaker.



3. Fiscal Sector

Current data in the second quarter in 2010 showed that real GDP increased by 0.4% (drop of 1.1% was registered in Q-1 2010, while the increase rate for the whole 2009 was revised to -0.3% for the first half), confirming that the economic policies set during the crisis and the measures undertaken in 2010 helped the Macedonian economy to cope with the crisis, experiencing



least possible consequences. However, the recovery of Macedonian economy was gradual and uneven during the first and second quarter of 2010. Favourable trends of some of the macroeconomic indicators (positive trends at several sectors- industry, trade, construction and agriculture), as well as the increased performance of VAT revenues shows that growth of the economic activity will follow, thus contributing for the growth rate to be close to the projected one. Higher performance of budget revenues by 1.7% compared to Q2 2009, accompanied by relatively more moderate budget expenditures, led to **budget deficit**⁴ in the amount of Denar 1,973 million in Q2 2010 or 1.8% of realized GDP for this quarter (0.5% of projected annual GDP).

Anti-cyclical fiscal policy continued to be conducted in the second quarter of 2010 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.

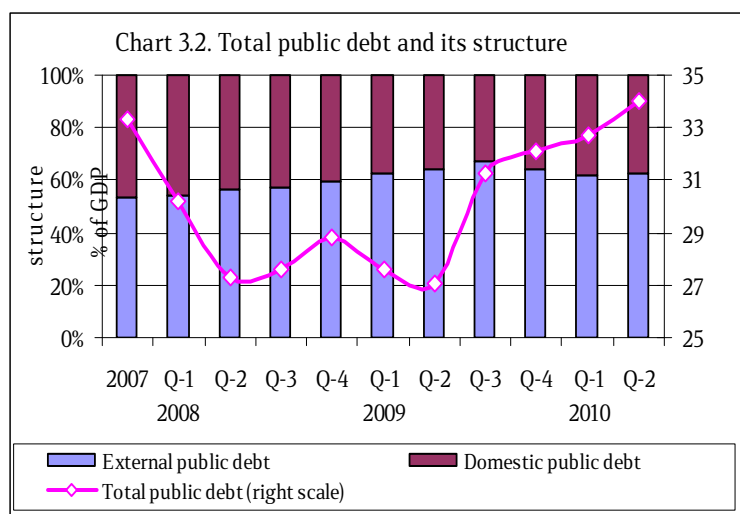
Total **budget revenues** (Government and Funds) were higher by 1.7% compared to the same quarter last year, mainly due to the higher performance of tax revenues by 14%, while social contributions were lower by 3.0%, and non-tax revenues were lower by 41%. Increase in personal consumption by 0.1% and increase of import and export of goods, resulted in higher collection at certain types of tax revenues, as well as insignificant reduction of both excises and personal tax. What is significant is that **VAT revenues**, accounted for the most or more than half (52.5%) of the total tax revenues, were higher by 24.5% in Q2 2010 compared to the same quarter last year. Regarding the structure of gross VAT revenues, there was increase in VAT collection on the basis of trading in the country in line with the increased trade sales, however, realized VAT revenues on the basis of import increased as well. Thereby, the structure of trading in the country

⁴ It covers central government budget and budgets of the Funds

points out that the sales of goods and services taxed with the general tax rate of 18% reduced by 4.6% while sales taxed with preferential tax rate of 5% increased by 6.1%, and the sales exempt from VAT significantly increase by 57.3%. Excise revenues were lower by 3.3% compared to the same quarter last year. Import increase also caused higher collection of customs duties by 34.7%. With respect to direct taxes, profit tax increased by 1.5%, taking into account that starting January 2009, only profit distributed for dividend was taxed. Revenues on the basis of personal income tax were lower by 3.7% due to the lower base, as well as the high decline of revenues on the basis of capital gain. Collection of social contributions was lower by 3.0%, whereby collection of pension insurance contributions decreased by 4.0%, as for employment contributions, it reduced by 11.1%, while as regards health insurance contributions, it insignificantly increased by 0.8%. Non-tax revenues, accounting for 9.4% of the total budget revenues in Q2 2010, were lower by 41% on annual basis.

In Q2 2010, total **budget expenditures** were lower by 3.0% compared to the same quarter of the previous year. **Current expenditures**, accounting for 92.0% of the total expenditures, decreased by 0.4% (29.4% of GDP). **Capital expenditures**, participating with 8.0% in total expenditures, were lower by 25.6% on annual basis, accounting for 2.6% of the projected GDP in this quarter. Execution of capital expenditures, as of June inclusive, accounted for 33.7% of the total projected funds in the Supplementary Budget this year. Regarding current expenditures, transfers were higher by 6.7% on annual basis, the share of category other transfers was 26.4% (including the transfers to the local government). Expenditures for goods and services decreased by 29.0%. Interest-related expenditures declined by 8.8%, whereby domestic debt interest-related expenditures dropped by 3.1% and expenditures related to interest on foreign debt declined by 19.5%.

In the coming period, budget revenues are expected to be realized with improved dynamics, since the projected growth throughout 2010 will contribute to intensification of economic activity, to be underpinned with the fourth package of anti-crisis measures. The highest revenues are expected to be realized on the basis of VAT, appropriately to the expected stabilization of the consumption and the increase of import and export. On the other hand, public investments are expected to intensify in the coming period so as to instigate the economic growth. Hence, projected deficit of 2.5% of GDP in 2010 seems feasible.



Fiscal burden, measured as participation of the budget revenues⁵ in relation to nominal GDP, was 27.5% in Q2 2010, dropping by 0.9 p.p. in relation to Q1 2010. Total budget expenditures accounted for 32% of GDP, which was by 4 p.p. lower compared to Q1 2010.

Total public debt⁶ at the end of Q2 2010 was 34% of GDP, increasing by 1.3 p.p. compared to Q1 2010. Such increase was due to the increase of both domestic public debt by 2.5% and external public debt by 4.9% in relation to Q1 2010. Thus, share of domestic public debt dropped by 37.7% (Chart 3.2). Such trends point out that additional borrowing, which is inevitable for conducting more expansive fiscal policy in conditions of slowed down economic growth, whether externally or internally, would not jeopardize the fiscal sustainability, whereby coordination with the monetary policy is indispensable. Sound fiscal policy is one of the Maastricht Criteria for convergence, having the limits set at budget deficit of 3% of GDP and general government debt of 60% of GDP.

The debt, which does not include the debt of NBRM and the public enterprises, increased to 24.1% of GDP at the end of Q2 2010, i.e. by 0.9 p.p. in relation to Q1 2010. Such phenomenon was a result of the increase of central government debt (by 4.0%) as a result of the increase of foreign borrowing. On the other hand, NBRM debt increased by 3.0%, however, share of state debt in the total public debt was 71.0% in Q2 2010, being equal to the share of the previous quarter.

4. Monetary and Financial Trends⁷

In Q2 2010, **primary money** experienced increase by 7.9% in relation to the previous quarter and an increase by 27.1% on annual level. In Q2 2010, **M1 monetary aggregate** increased by 4.5% compared to Q1 2010, in conditions of increase of ready money in circulation by 5.5% and increase of deposit money by 4.1%. M1 money supply was higher by 10.3% on annual basis. Broader monetary aggregates **M2 and M4** in Q2 2010 increased in relation to the previous quarter (4.3% and 4.6% respectively), while M2 and M4 increased by 11% and 14.8% respectively on annual basis.

Total **deposit potential**⁸ of private sector continued to intensively increase in Q2 2010, whereby quarterly increase amounted to 4.6% (compared to 2.6% in Q1 2010). Growth of deposit potential was mainly due to Denar deposits, increasing by 7% in relation to Q1 2010, while foreign currency deposits were higher by 2.4% in the analyzed period. Therefore, share of Denar deposits in the second quarter of the year increased, i.e. the level of euroization measured through the share of foreign currency deposits in the total deposit potential reduced by 52.2% (53.3% in Q1 2010). On annual level, total

⁵ It includes tax revenues, social contributions and administrative taxes and charges

⁶ According to GFS Methodology

⁷ Starting Q1 2009, analyses are made on the basis of the data harmonized with the new accounting plan for the banks, in force from January 2009

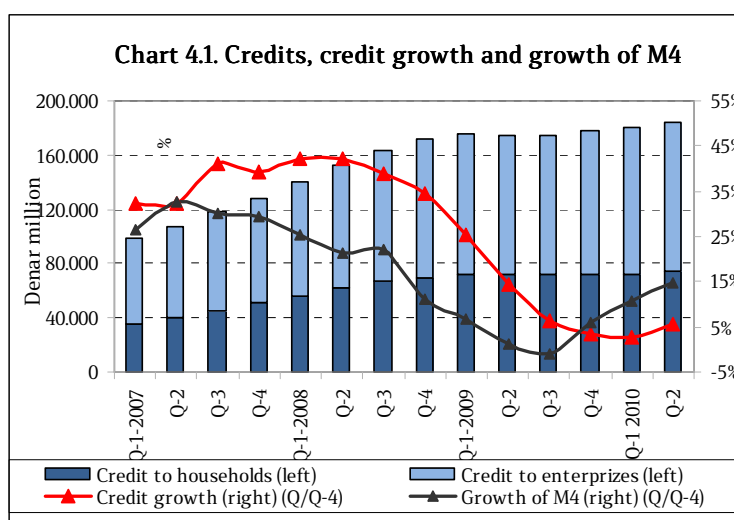
⁸ Deposits also include calculated interest

deposits increased by 15.2% in conditions of increase of Denar deposits by 15.9% and increase of foreign currency deposits by 14.6%.

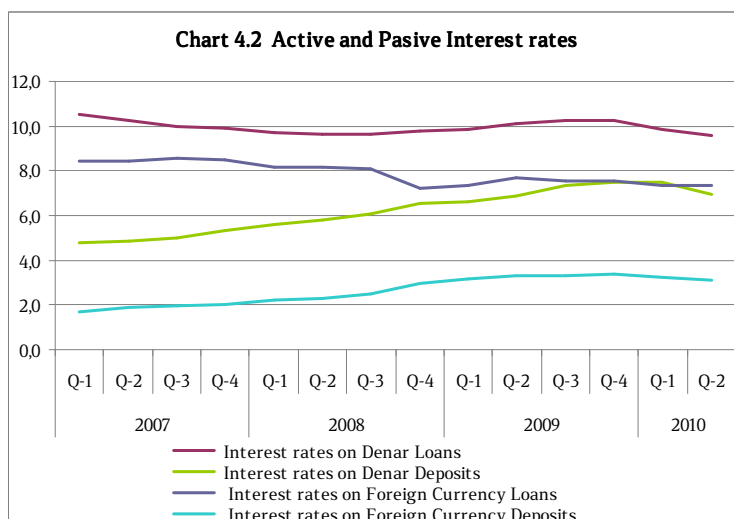
Analyzed by sectors, in Q2 2010, deposits of households and deposits of private enterprises increased on a quarterly level. In fact, deposits of private enterprises increased by 10.4% at quarterly level, being significant improvement than the last quarter, when 3.8% drop was registered. On the other hand, deposits of households slowed down their growth, increasing by 3% compared to the last quarter. On annual basis, deposits of households were higher by 19.6%, while deposits of private enterprises were higher by 7.6%, being also in line with the data on the economic activity, pointing out to certain recovery of the real sector in Q2 2010.

Credits to non-government sector extended by banks and saving houses, following the slowdown registered last period, experienced certain growth intensification in Q2 2010. In fact, on quarterly basis, they were higher by 2.5% compared to the increase by 1.4% last quarter. On annual basis, credits to private sector increased by 5.8%.

From currency point of view, in Q2 2010, Denar credits increased quarterly by 1.1% and foreign currency credits experienced more intensive growth of 7.3%, thus being dominant element as regards contribution to growth in the analyzed period (65.2% contribution). From sector point of view, credits to households increased by 2.9%, while credits to private enterprises were higher by 2.3%. Share of credits to private enterprises in total credits was 59.7%.



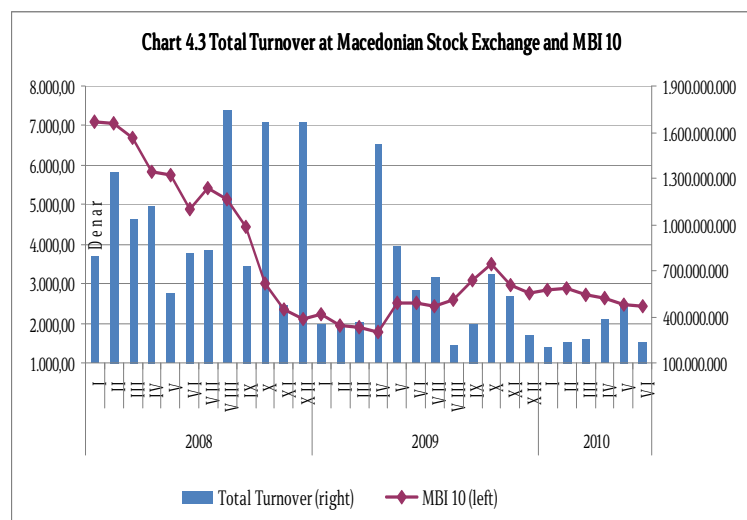
Since the beginning of 2010, NBRM, at several occasions, has reduced the reference **interest rate**, adjusting it by 350 basis points on cumulative basis. In Q2 2010 alone, interest rate on CB bills reduced by 150 basic points and thus, it reduced to 5% in June 2010, being the lowest level of this interest rate from January 2008. European Central Bank, from May 2009 onwards, has not changed the reference interest rate, remaining at the level of 1% in Q2 2010.



In the second quarter of 2010, certain loosening of the interest policy of banks can be noticed. In fact, average weighted interest rate on Denar credits reduced from the beginning of the year, amounting to 9.6% at the end of Q2 2010, being lower by 0.3 p.p. compared to the previous quarter. Comparison with June and December 2009 points out to even more significant reduction. In fact, active Denar interest rate was lower by 0.5 p.p. compared to June and by 0.7 p.p. compared to the end of 2009. Interest rate on foreign currency credits remained unchanged in relation to the end of the first quarter, remaining at the level of 7.3%. However, compared to the end of 2009, it reduced by 0.2 p.p..

Average interest rate on Denar deposits reduced by 0.5 p.p. at the end of Q2 2010, compared to the previous quarter, amounting to 7.0%. In relation to the end of Q2 2010, it was higher by 0.1 p.p.. Interest rate on foreign deposits was lower by 0.1 p.p.. (reduction by 0.2. p.p. in relation to Q2 2009) compared to the last quarter, amounting to 3.1%.

On the **capital market**, slight movement was noticed in the second quarter of the year, in relation to the previous quarter. In fact, there was growth in the total turnover of 56.5% in relation to the previous quarter, being due to both the increased traditional trading and the realized block transactions. However, compared to the same period last year, total turnover



realized on the Stock Exchange dropped by 62.5%. Macedonian Stock Exchange Index MSEI-10, as aggregate indicator of stock exchange trends, continued to drop, with a rate of 4.3% compared to June 2009, while the drop was 10.5% in relation to the end of Q1 2010.

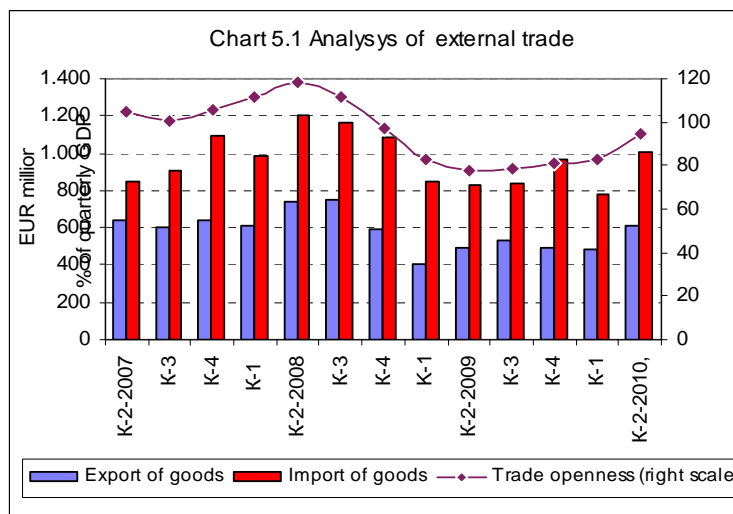
5. External Sector and Balance of Payments

According to statistical data expressed in euros (f.o.b. basis), downward trend of both the export and the import of goods, which started in the last quarter in 2008, was interrupted in the second quarter of 2010. Effects from the gradual recovery of foreign demand and the improvement of prices of metals on the world stock exchanges contributed for export of goods to experience significant positive shift, reflecting on the import demand as well. Thus, import of goods experienced high growth rate of 29.3% in this quarter, while export increased by 27.7% in relation to the first quarter this year.

Such tendency points out that foreign trade trends stabilizes, returning back to pre-crisis level.

Analyzed on annual basis (Q/Q-4), within significant increase of export by 25.4% and simultaneous increase of import by 21.4%, total foreign trade, expressed in euros, continued to improve, increasing significantly by 22.8%, mainly due to the low comparative basis in the second quarter last year.

Increase in export of goods was a result of the increased foreign demand and improved prices of metals. **Analyzed by SITC sectors** (Standard International Trade Classification), **positive trends** in the export in the



second quarter were registered at the following: products classified according to the material 42% (iron and steel), chemical products by twice, raw materials except fuel by 87% (metal ore and metal scrap), mineral oils and lubricants by 38.3% (oil and oil products), food products by 4.5%, while as a result of the reduced export of tobacco and tobacco processed goods, negative shifts were observed in the beverages and tobacco sector by 18%, compared to the same quarter of 2009.

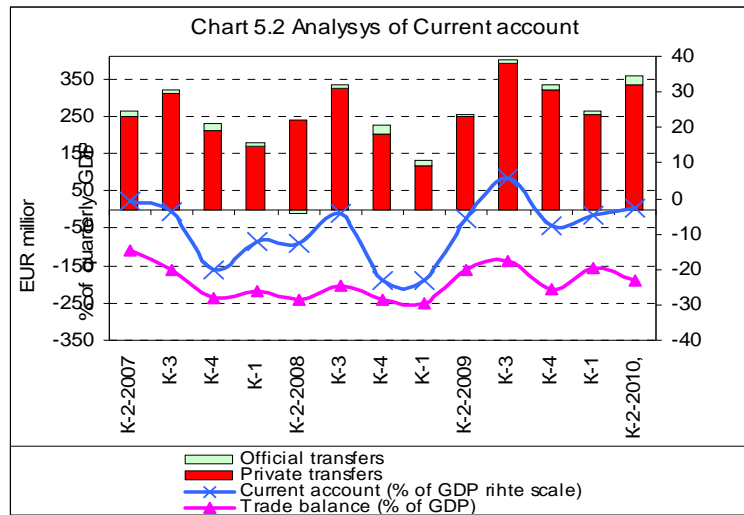
As regards the import of goods, all groups of products under SITC registered positive growth rate in Q2 2010. Thereby, highest growth of import was registered at the following categories: products classified according to the material 26% or EUR 58.8 million (iron and steel, non-ferrous metals, items from non-metal minerals and textile yarns), mineral oils and lubricants 52.7% or EUR 58.4 million (oil and oil products) chemical products 24.4% or EUR 25 million (pitch and raw chemicals), raw materials by 66% or EUR 24 million (metal ore and metal scrap), machines and transport equipment 6% or EUR 12 million, etc. Increase in the import of inputs used by export-oriented sectors, i.e. the part of the so-called import component of the export was favourable circumstance, having positive effects on the recovery and the stabilization of their overall production.

Trade openness of the Republic of Macedonia in Q2 2010 was 94.8%, continuing the upward trend in relation to the previous quarters, and reducing the rate of openness to the level realized in the fourth quarter of 2008. This was mainly due to the significant annual increase in the overall volume of the foreign trade (22.8%) in relation to the same quarter of the previous year.

Trading volume with the EU in Q2 2010 accounted for 55.9% of the total trade of the Republic of Macedonia, and in relation to Q2 2009, it increased by 2.4 p.p.. Export from and import to the European Union registered strong growth of 25.2% and 21.3% respectively, compared to the same period in 2009. In addition to Germany, most

significant trading partners to the Republic of Macedonia remain to be Serbia, Greece, Italy and Bulgaria, whereby the trading volume in Q2 2009 with these countries accounted for 36.8% of the total trade. In Q2 2010, 58.7% of the Macedonian export was realized on the markets in Germany, Kosovo, Bulgaria, Serbia and Greece.

As a result of parallel rapid increase in export and import of goods, in Q2 2010, **trade balance** deficit (EUR -391.8 million) deepened compared to the previous quarter, accounting for -22.9% of quarterly GDP. Upward trend of **net current transfers**, which commenced in the second quarter of 2009, following the interruption in Q1 2010, again increased in Q2 2010, whereby they amounted to EUR 258.9



million, and they were reduced to almost the same level compared to Q4 2009, and compared to the previous quarter (Q1 2010), they increased by 34% or EUR 89 million, due to the higher private transfers, which are dominant and driving component of current transfers.

Following the narrowing of the **current account deficit** in the first quarter of 2010, it reduced by 41% (EUR 31 million) in Q2 2010 as well, compared to the previous quarter, amounting to -2.5% of quarterly GDP. Such reduction of the current account deficit was mainly due to the increased inflows of private transfers in relation to the previous quarter.

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