

## QUARTERLY ECONOMIC REPORT

Q-4-2008

### SUMMARY

- **Real GDP growth** in Q4 2008 was 2.1%, being by 5.2 p.p. lower than the growth realized in Q4 2007. **Industrial production** significantly declined by 7.6%.
- **Employment growth** accounted for 2.4% compared to Q4 2007, while **unemployment rate** (33.5%) dropped by 1.3 p.p. in relation to Q4 2007.
- **Inflation rate** was 5.5% (Q/Q-4), compared to 8.4% in the previous quarter.
- **Net salary** grew by 10.2% in nominal terms, and by 4.4% in real terms.
- **Budget deficit** at the end of Q4 was 1% of the projected GDP in 2008. **Fiscal burden** in Q4, measured as participation of the budget revenues in relation to nominal GDP, was 29.4%, dropping by 0.3 p.p. in relation to Q4 2007. **Total public debt** accounted for 28.2% of GDP at the end of Q4, which was by 5.1 p.p. lower compared to December 2007.
- **Credits to the private sector** grew by 38.4% in relation to Q4 2007, showing decline of the credit growth. Growth of credits to the private sector, compared to nominal GDP realized in Q4 2008, was 40.9%, showing 1.6 p.p. slowdown in relation to the previous quarter.
- At the end of Q4 2008, **Macedonian stock exchange index** MSEI-10, as aggregate indicator of stock exchange trends, dropped by 54% in relation to Q3 2008, while the drop in relation to Q4 2007 was even more significant, amounting to 74%.
- **Export of goods** declined by 7%, while **import of goods** dropped by 1.1%.
- **Trade balance** reached -28.6% of GDP, being the worst deterioration at quarterly level so far, while **BOP account deficit experienced** the historically highest deepening and reached 23.4% of GDP, thus being the main source of risk to the macroeconomic stability in the coming period.
- Index of **real Denar effective exchange rate** stopped the downward trend from Q2, registering appreciation in Q4.

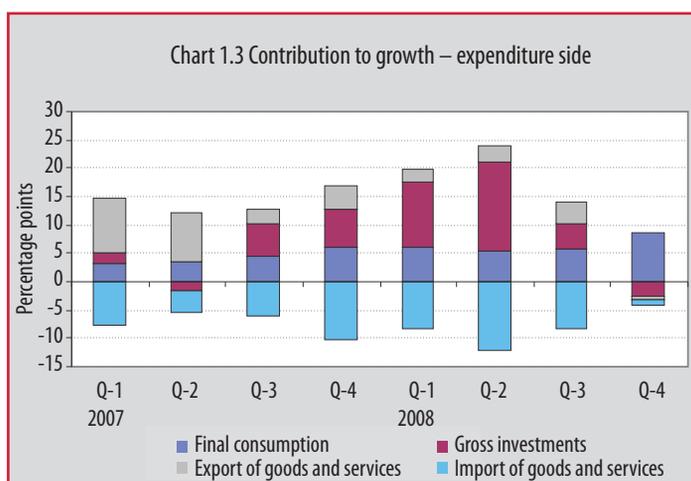
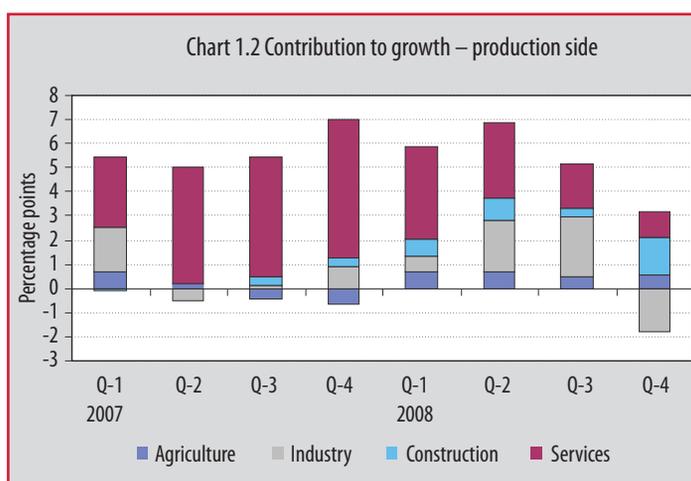
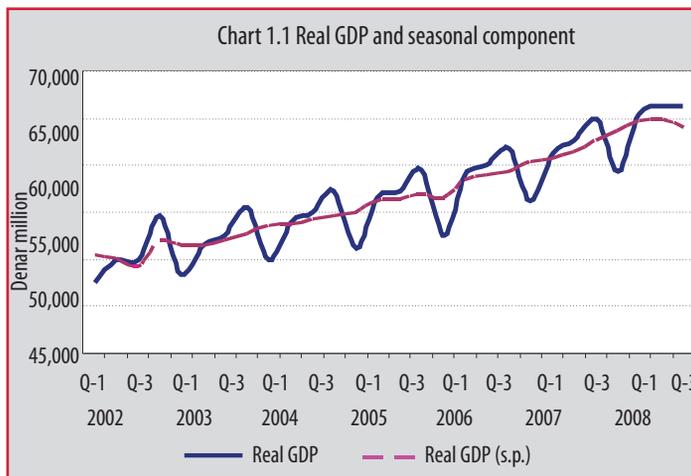
## 1. MACROECONOMIC TRENDS AND REAL SECTOR

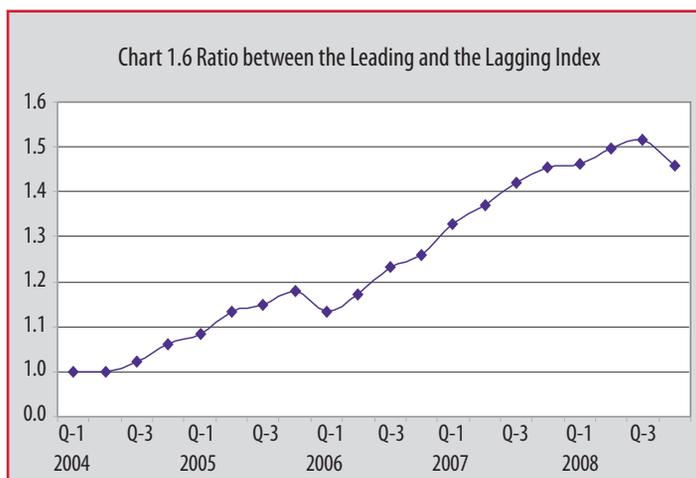
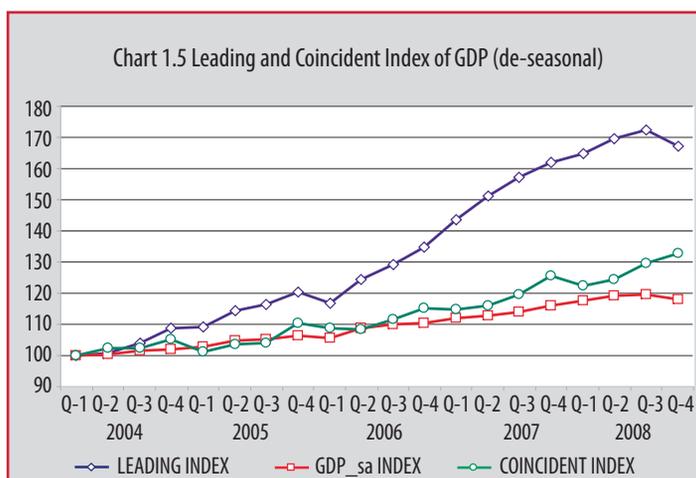
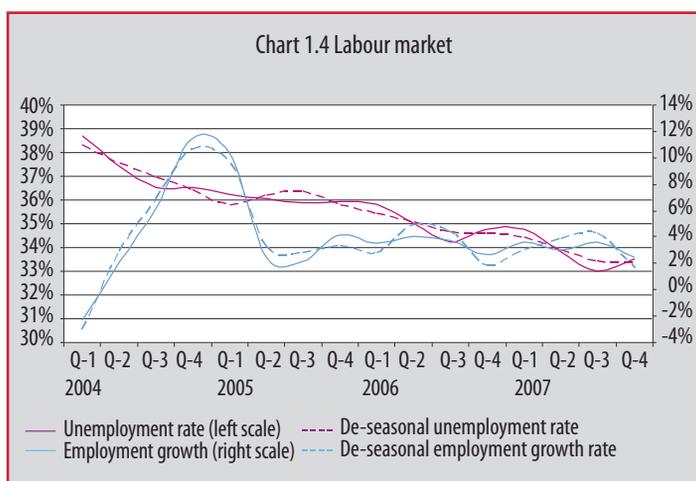
In Q4, GDP in current prices was Denar 105,017 million. In terms of per capita, it was Denar 51,237 and, compared to the same quarter in 2007, there was a nominal increase by around Denar 2,555. In Q4 2007, real GDP growth was 2.1% with regard to the same quarter in 2007, showing significant growth decline compared to the previous three quarters in 2008, mainly due to the effects from the global economic crisis (Chart 1.1). Seasonally adjusted, real GDP grew by 2.3% in Q4 2008 in relation to Q4 2007, and declined by 1.4% compared to Q3 2008. Growth in Q4 was slowed down in almost all sectors of the economy, except in civil engineering and hotels and restaurants, which were driving force of realized GDP in this period, experiencing growth by 23% and 9.4%, respectively. As a whole, services experienced growth slowdown compared to the previous quarters (2.1% in Q4) (Chart 1.2).

Industrial production dropped on annual basis by 7.6% in Q4 2008, being significant decline compared to the previous quarters (13% in Q3 2008, 12.4% in Q2 2008 and 6.5% in Q1 2008).

Observing GDP from the expenditure side, in Q4 2008, final consumption grew in nominal terms by 20%, import grew by 2.3%, while gross investments and export dropped grew by 28.8% and by 3.7% respectively. Nominal share of final consumption in growth was 8.5%, being by 2.6 p.p. more compared to the previous quarter; share of gross investments was -2.7%, significantly declining compared to the previous quarters (15.6% in Q2 and 4.6% in Q3), while share of trade balance was negative, -1.6%, however significantly improved in relation to Q3, when it was -5.1%.

In Q4 2008, employment growth accounted for 2.4% compared to Q4 2007, decreasing by 1.2 p.p. in relation to the growth realized in the previous quarter. Unemployment was fully absorbed by the employment growth, and certain portion of the new employments was a result of the inclusion





and the lagging index was constantly increasing throughout the whole observation period. More intensive increase at this indicator was evident starting in 2006, which can be taken as turning point in the economy, taking into account that the average value of the indicator in the period before was around one.

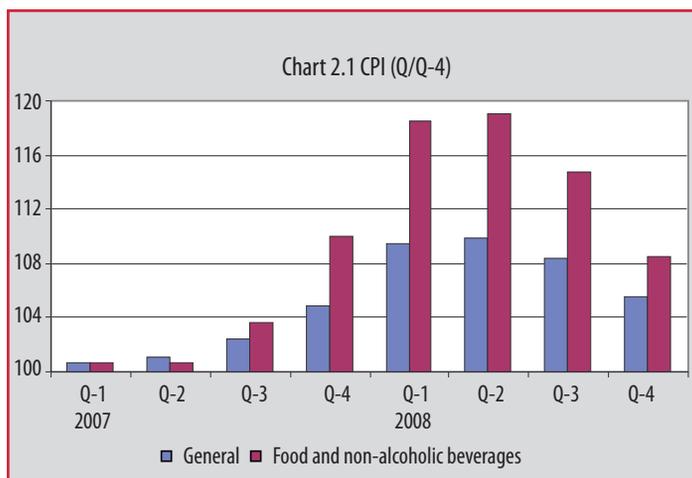
of the non-active population in the labour force. This led to 3.2% drop of the unemployment rate, mostly in the course of 2008, and it accounted for 33.5%, being by 1.3 p.p. lower than the one in Q4 2007. If seasonal effects are excluded, unemployment rate registered no changes in relation to the previous quarter, i.e. it was more of a structural rather than fractional character.

Leading composite index, MakLead, declined by 5.4 index points in Q4 2008 in relation to the previous quarter, and grew by 5.1 index points in relation to the same quarter in 2007. MakLead declined on monthly basis after Q1 2006, followed by continuous increased onwards, while GDP experienced the highest growth rates in the next years. MakLead index showed slowed down growth even in the previous quarter, declining in Q4. Such trends registered at MakLead index suggested slower economic activity in the coming year, and it might be the turning point in the economy, evident in the relation between the leading and the lagging index. In Q4 2008, leading diffusion index registered positive trends at 38% of the components of the composite index, unlike the previous quarter, as well as the same quarter in 2007, when this indicator was 69%.

Ratio between leading and lagging index in Q4 2008 dropped to 1.46, i.e. it returned to the level in Q1 2008 and Q4 2007, when this ratio was stagnant. The ratio showed that leading index was by 46% higher than the lagging index. Ratio between the leading

## 2. PRICES, COSTS AND PRODUCTIVITY

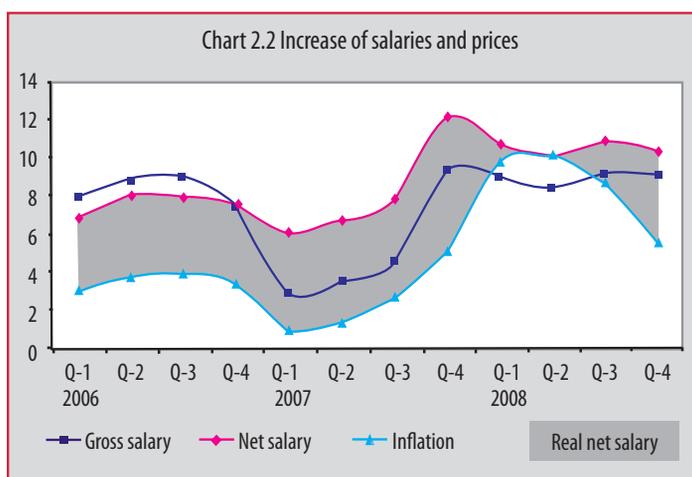
In Q4 2008, inflation rate, measured according to CPI, was 5.5% (Q/Q-4) compared to 8.4% in the previous quarter. Growth rate of food costs continued the downward trend (8.6% in Q4 2008), accounting for 3.3 p.p. in the total increase of consumer prices. High increase of prices on annual basis was registered at the housing category (10.3%), caused by the increase of the heating prices. Price increased at the category hotels and restaurants by 8.9%, and at tobacco and beverages category by 4.3%. Prices declined by 2.5% in the traffic sector, as a result of the high drop of the price of oil on the global stock markets (by 51.7% compared to the previous quarter) and the measures for the Government to mitigate the oil shock that spread throughout the world in 2008. Mild increase of prices was registered at the categories education, culture and entertainment (0.9%) and clothing and footwear (0.3%). Decline of oil prices and prices of wheat on the global stock markets in this period and their maintenance at sustainable level in 2009 will lead to slight growth of consumer prices in the country. In fact, in this case core inflation (which excludes the effect of food and energy) has a declining trend as a result of the above-mentioned, whereby it might be expected for 2009 to end with deflation. Core inflation was 2.3% in Q4 2008 compared to 2.4% in the previous quarter.

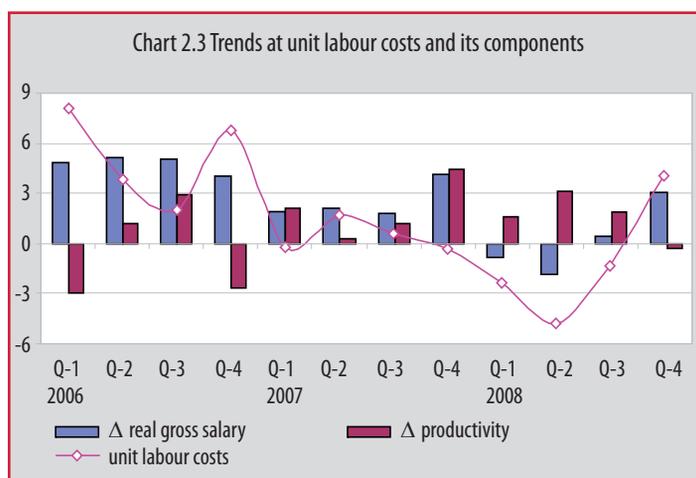


Retail prices in Q4 2008 were higher by 4.3% compared to the same quarter in 2007, whereby growth was the highest at the beverages category (9.1%). In fact, increase of prices in the categories food products and industrial-alimentary products was significantly slowed down, accounting for 7.6% and 7.9% respectively. Value of the consumer basket of food and beverages for a four-member household, calculated on the basis of retail prices, increased by 9.9% compared to Q3 2007, accounting for 72.3% of the average net salary in Q4 2008.

Upward trend of gross salaries continued in Q4 2008 as well, increasing by 9% in nominal terms compared to Q4 2007. At the same time, net salary grew by 10.2%. Slower growth of gross salaries in relation to net salaries was due to the reduction of the personal income tax from 12% to 10% at the beginning of 2008. Downward trend of inflation caused for real net salary to be higher by 4.4% (see shaded field in Chart 2.2).

Unit labour costs (ULC), measured as ratio between real gross salary and productivity, grew by 3.8% in Q4 2008 on quarterly basis for the first time in 2008. Such phenomenon was a result of the fact that real growth of gross salaries (by 3.5%) was followed by decline productivity by 0.3%, due to the slower increase of the output.





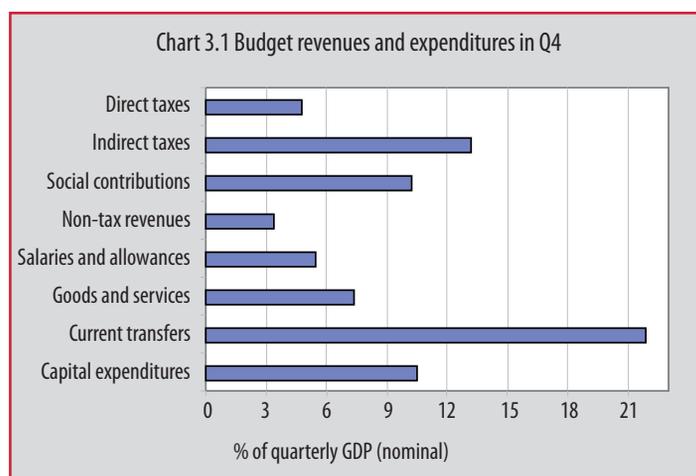
In fact, high decline of the industrial production in Q4, and accordingly of the productivity (by 11.7%), caused for ULC to increase the most in the industry sector, having in mind that average real gross salary in the industry increased by 1.6%. Primary sector and services sector experienced slight increase of ULC by 0.9% and 0.5% respectively. In fact, primary sector registered higher increase of the real gross salary compared to the services sector (4% compared to 2.2%) and productivity (3.1% compared to 1.8%).

### 3. FISCAL SECTOR

Fiscal developments in Q4 2008 point out to expansive policy. Unlike the previous quarters, general government budget balance experienced 3.6% deficit in Q4 compared to the projected GDP in 2008. Higher expenditures in the last quarter should not be seen as a surprise, having in mind the usual larger spending as the end of the year approaches. In Q4 2008, additional impetus to budget spending was the high capital expenditures, the performance of which in the previous three quarters was 35% of the total projected ones in 2008.

In Q4 2008, total expenditures were higher by 19% compared to the same quarter previous year. Current expenditures, accounting for 77.3% of the total expenditures, increased by 16.4%. Expenditures for goods and services surged the most, by 32.8%, within the current expenditures, transfers increased by 15.5%, interest-related expenditures by 8% (interest on foreign debt accounted the most), while expenditures related to salaries and allowances surged by 4.1%. Capital expenditures in Q4 2008 were by 28.7% higher, thus projected capital expenditures in 2008 accounted for 78.1%, being 5% of the projected GDP in 2008.

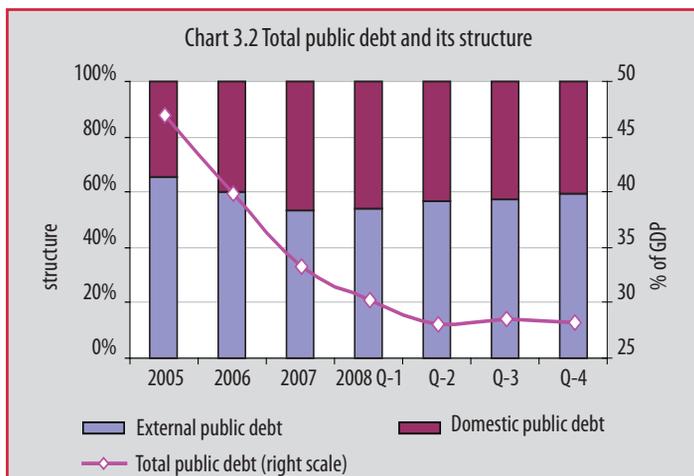
Total budget revenues were higher by 5.6% compared to the same quarter 2007. Tax revenues in Q4 were lower by 0.6%, collection of social contributions increased by 14.3%, while non-tax revenues surged by 18.3% compared to the same quarter previous year. Lower tax revenues were a result



of the weaker collection of VAT by 3%, accounting for 45% of the total tax revenues, reduction of the collection of customs duties by 15.7% (due to both decline of export and lower customs rates), while excise revenues were higher by 7.6%, within the indirect taxes. With respect to direct taxes, personal income tax revenues were lower by 11.5%, while profit tax revenues significantly surged by 43.5%.

High budget deficit in Q4 2008 caused for the surplus accumulated in the previous three quarters to become

deficit at the end of 2008, accounting for 1% of the projected GDP, being by only 0.5 lower than the projected one. Budget revenues are expected to decline in the coming period, as a result of both the decline of the economic activity and the measures to overcome such trends. In fact, slower growth of the economic activity will lead to decline of the import, profit and consumption, which will reflect on the tax revenues. On the other hand, economic growth is expected to be instigated through higher public investments. Hence, projected deficit of 2.8% of GDP in 2009 seems feasible.



Fiscal burden, measured as participation of the budget revenues in relation to nominal GDP, was 29.4% in Q4 2008, dropping by 0.3% p.p. in relation to Q4 2007. Total budget expenditures accounted for 46.4% of GDP, which was by 5.4 p.p. higher compared to Q4 2007.

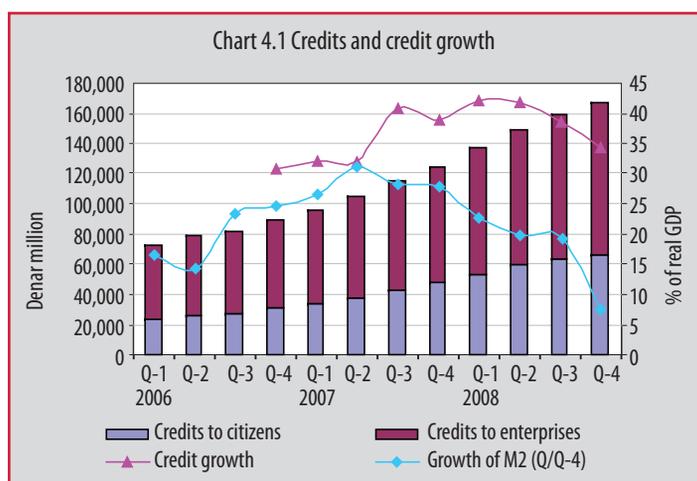
Total public debt was 28,2% of GDP in Q4 2008, which, in relation to December 2007, was a decline by 5.1 percentage points. Such decline was due to the high decline of the domestic public debt (by 16.2%), while external public debt was higher by 8.4% on annual basis. Hence, share of domestic public debt dropped by 40.4% (Chart 3.2).

General government debt, which does not include the debt of NBRM and the public enterprises, decreased to 20.9% at the end of Q4 2008, i.e. it dropped by 3.8 p.p. in relation to December 2007. This speaks in favour of the sound fiscal policy, which is one of the Maastricht criteria (limit of general government debt to GDP ratio must not exceed 60). Accordingly, room is created for more expansive fiscal policy, as well as for financing the budget deficit from domestic sources, whereby, in coordination with the monetary policy, macroeconomic stability would not be deteriorated.

#### 4. MONETARY-FINANCIAL TRENDS

At the end of Q4 2008, primary money increased by 4.3% in relation to the previous quarter, and they increased by 11.9% on annual level, above all as a result of the increased liquidity of the commercial banks. In Q4 2008, M1 monetary aggregate increased by 9.7% compared to Q3 2008, while on annual basis, the increase was 14.1%, mainly as a result of the high increase of deposit money by 24%. In Q4, broader monetary aggregates M2 and M4 dropped in relation to the previous quarter (-2.3% and -0.5% respectively), due to deposit decline by 6.6% in the same quarter, while growth of M2 registered certain slowdown on annual basis (7.4% in Q4 2008 and 19.5% in Q3 2008).

- Credits to the private sector in Q4 2008 registered slower growth of 34.5% in relation to Q4 2007, however compared to Q3, credit growth dropped by even 4 p.p. as a result of the implementation of
- the restrictive measures of the monetary policy previously undertaken by NBRM. Growth slowdown, although slight, was registered at credits to enterprises by 0.5 p.p. (from 33% in Q3 to 32.5% in Q4), leading to the conclusion that banks continued applying the policy enforced by NBRM, initially
- aimed at calming down the inflationary trends in the first half of the year, while in the second half
- of the year, it was aimed at preventing the spillover of the global financial crisis to the Macedonian



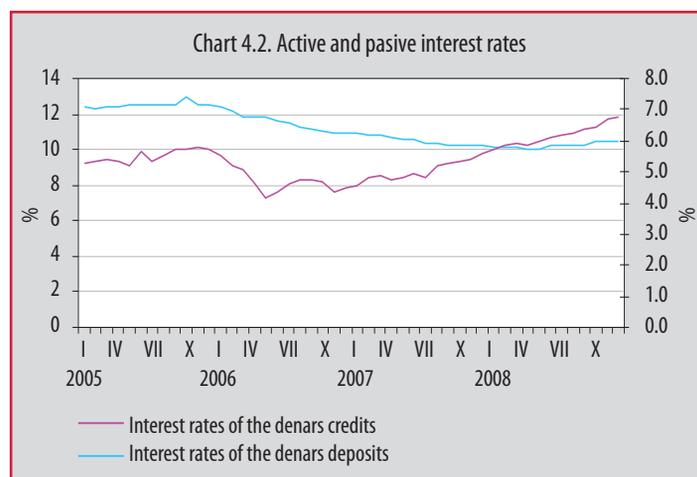
banking system. On the other hand, growth of household credits continued to significantly slow down by 10 p.p. (37.6% in Q4 in relation to 47.6% in Q3). Growth of credits to the private sector, compared to nominal GDP realized in Q4 2008, was 40.9%, showing 1.6 p.p. slowdown in relation to the previous quarter.

Total deposit potential of the private sector registered an upward trend, however growth path experienced strong slowdown (10.4% in Q4 2008 in relation to 22.1% in the previous

quarter). In Q4 2008, deposits of citizens increased by 11.7% in relation to Q4 2007, and they were lower by 8 p.p. in relation to Q3 2008. Deposits of enterprises surged by 5.9% in relation to Q4 2007, whereby growth significantly slowed down in relation to Q3 2008 (growth dropped by 18.8 p.p.).

Interest on central bank bills in Q4 was kept on the same level as in Q3 2008, i.e. at 7%. For comparison purposes, reference interest rate in the Euro zone dropped several times, cumulatively by 2.25 p.p. compared to July 2008, and starting 21 January 2009, it was 2%, with a downward tendency. Despite the fact that the main reason for the relatively high interest rate on central bank bills – inflation increase, as a risk, was put under control by the middle of the year, global economic crisis, which spread to the Macedonian economy in the last quarter as well, imposed new risk of deepening the external imbalance. Hence, no effects on the monetary policy are expected in the coming period, on the contrary, as a result of the pressures on the stability of the exchange rate, its further tightening might be expected. Having in mind the specific features of the Macedonian economy, NBRM conducts the monetary policy in opposite direction of the one of the leading central banks, such as CEB, FED and the Bank of England, which radically reduced the interest rates as a response to the global financial crisis.

Average weighted interest rate on Denar credits amounted to 9.8% at the end of Q4 2008, registering a drop of 0.1 p.p. annually, and an increase of 0.2 p.p. compared to the previous quarter. Interest rates on deposits continuously grew, thus at the end of Q4 2008, interest on credit balance on Denar deposits increased by 1.2 p.p. in relation to Q4 2007 and amounted to 6.5%, which was by 0.4 p.p. higher compared to Q3 2008. No reduction of banking interest rates is expected in the coming period,



mainly due to the current monetary policy of increased reference interest rate and other restrictive measures, as well as due to the financial crisis in the USA which has already spilled over to the European financial institutions that are business partners to the Macedonian banks.

At the end of Q4 2008, Macedonian stock exchange index MSEI-10, as aggregate indicator of stock exchange trends, dropped by 54% in relation to Q3 2008, while the drop in relation to Q4 2007 was even more significant,

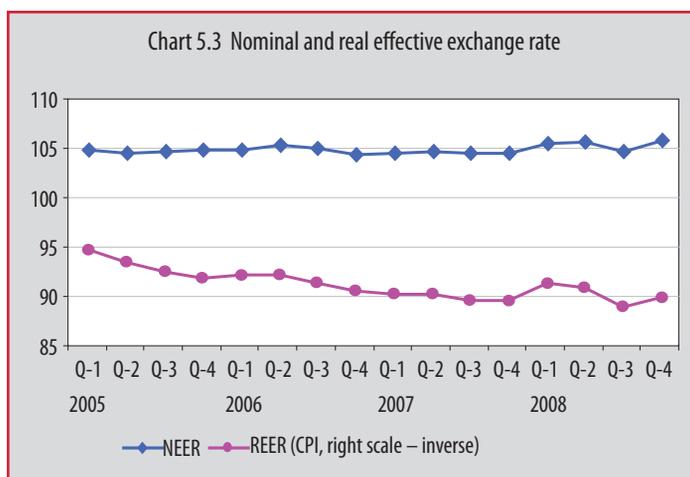
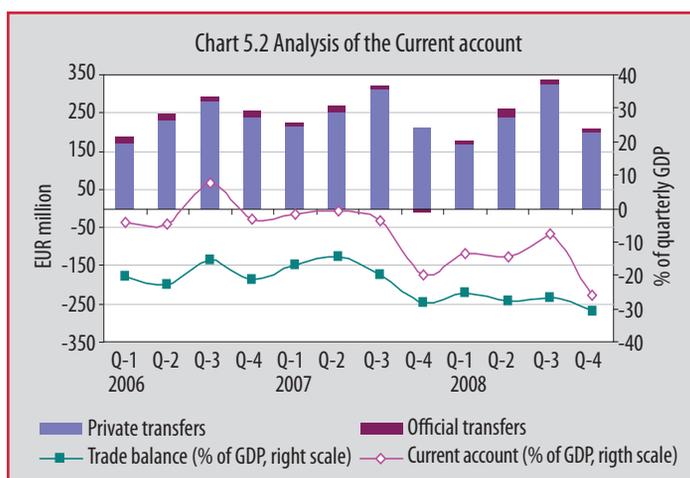
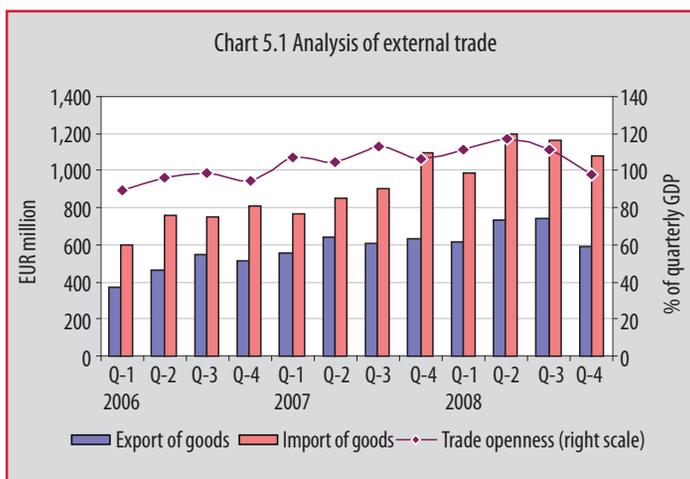
amounting to 74%. Further decline of stock exchange activity in Q4 2008 was mainly due to the global economic developments and weakening of the capital market worldwide as a result of the global financial crisis.

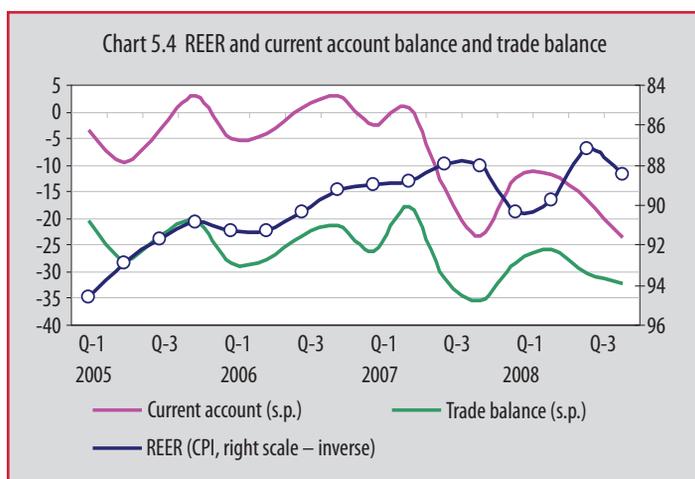
## 5. EXTERNAL SECTOR AND BALANCE OF PAYMENTS

For the first time since 2004, export and import of goods dropped in Q4 2008. Thereby, export of goods, expressed in euros, declined by 7% in relation to the same quarter in 2007, unlike the first three quarters, when growth rates were high. On the other hand, in Q4 2008, import of goods, expressed in euros, and compared to the export, experienced weaker decline by 1.1% in relation to Q4 2007. Highest growth of import was recorded at the categories beverages and tobacco (37.1%), machines and transportation devices (18.9%) and chemical products (9.6%). On the other hand, categories raw materials and mineral oil and lubricants experienced the highest decline, in terms of import, by 42.7% and 32.8% respectively. Decline in the import of intermediary inputs points out to the possible slowdown of the production activity in the next quarters.

Trade openness of the Republic of Macedonia was 97.7% in Q4 2008, significantly declining in relation to the previous quarters, and the last such low levels of trade openness were registered in 2006. This was due to the overall decline in both the import and the export, as well as to the growth, although slight, of GDP in Q4 2008.

In Q4 2008, trading volume with the EU accounted for 53.4% of the total trade of Macedonia, and in relation to Q3, it increased by 1.1 p.p. Second most significant trading partner to the Republic of Macedonia is Serbia, whereby the trading volume in Q4 2008 accounted for 14.3% of the total trade and it increased by 1.4 p.p. in relation to Q3.





As a result of the higher decline of the export in relation to the import, trade balance in Q4 2008 reached 28.6% of GDP, registering the highest deterioration on quarterly basis so far. At the same time, net current transfers, unlike in the first two quarters when they registered decline, in Q4 continued the increase registered in Q3, and it surged by 5.1% in relation to Q4 2007. Private transfers (96%) continued to dominate in their structure. Despite the increase of current transfers, due to the worsened trade balance, withdrawal of foreign

portfolio investors and the insufficient volume of FDIs, BOP current account balance registered the historically highest deepening in Q4 and reached -23.4% of GDP, thus being the main source of risk to the macroeconomic stability in the coming period.

Nominal Denar/EUR exchange rate remains as intermediary target of the monetary policy. In Q4 2008, nominal Denar effective exchange rate appreciated compared to the previous quarters. Real Denar effective exchange rate index, calculated on the basis of CPI index, increased, after the depreciation in the second and the third quarter in 2008. On the other hand, REER, calculated on the basis of price index of producers of industrial products, registered slight depreciation, pointing out to certain improvement in the export competitiveness of the Macedonian economy. (Chart 5.4).

