



REPUBLIC OF MACEDONIA

MINISTRY OF FINANCE

# QUARTERLY ECONOMIC REPORT

Q – 2 – 2009





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# ● QUARTERLY ECONOMIC REPORT

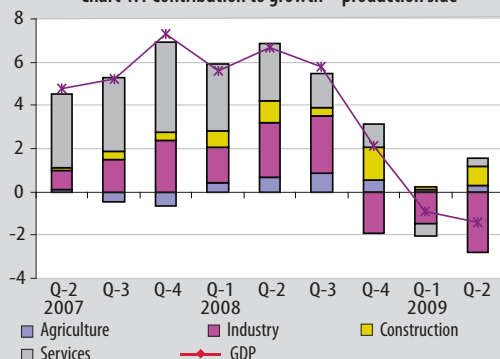
## Q-2-2009

### SUMMARY

- **Real GDP growth** in Q2 2009 was –1.4%, showing continuation of the negative growth in Q1 2009, when growth was –0.9 p.p. Compared to Q1 2009, GDP grew by 5.9%. **Industrial production** dropped significantly by 13% compared to Q2 2008, while in relation to the previous quarter, it increased slightly by 1.4%.
- **Employment growth** accounted for 4.8% compared to Q2 2008, while **unemployment rate** (31.9%) dropped by 1.9 p.p. in relation to Q2 2008.
- **Leading composite index** was higher by 4.5 index points in relation to previous quarter, and such MakLead trends suggest approaching the end of economic activity drop, i.e. positive trends are expected in the last quarter.
- **Inflation rate** was – 0.6% ( Q / Q-4 ), compared to 1% in the previous quarter. Value of the consumer basket of food and beverages for a four-member household, calculated on the basis of retail prices, declined by 1.8% compared to the previous quarter, and compared to Q2 2008, it surged by 1.5%, accounting for 62.5% of average net salary in Q2 2009.
- **Net salary** increased by 28.2% in nominal terms, mainly due to methodological changes, and by 29% in real terms.
- **Budget deficit** at the end of Q2 was 0.9% of projected GDP in 2009, being within planned framework. **Fiscal burden** in Q2, measured as participation of budget revenues in relation to nominal GDP, was 27.2%, dropping by 2 p.p. in relation to Q2 2008. **Total public debt** accounted for 27% of GDP at the end of Q2, which was by 0.6 p.p. lower compared to March 2009.
- **Credits to private sector** significantly slowed down by 14.3% in relation to Q2 2008, whereby compared to Q1 2009, credit growth dropped by even 11 p.p. Credits to private sector, compared to nominal GDP realized in Q2 2009, accounted for 44%, showing 0.2 p.p. slowdown in relation to the previous quarter.
- At the end of Q2 2009, **Macedonian stock exchange index MSEI-10**, as aggregate indicator of stock exchange trends, increased by 32.9% in relation to Q1 2009, while the drop in relation to Q2 2008 was slowed down, amounting to 48.2%.
- **Export of goods** decreased by 33.4%, while **import of goods** showed lower decrease of 30.4% in relation to the same quarter in 2008. Compared to the previous quarter in 2009, export increased by 22.5%, while import dropped by 2.5%.
- As a result of the decline in foreign trade in Q2 2009, **trade deficit** (EUR –443.1 million) experienced no significant developments compared to the previous quarter, being –27.4% of quarterly GDP.

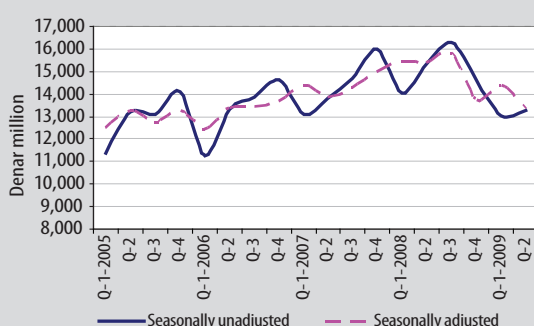
## 1. MACROECONOMIC TRENDS AND REAL SECTOR

Chart 1.1 Contribution to growth – production side



In Q2 2009, GDP in current prices was Denar 100,503 million. In terms of per capita<sup>1</sup>, it was Denar 49,058 and, compared to the previous quarter, there was a nominal increase by around Denar 5,187. In Q2 2009, as a result of the effects of the global economic crisis on the Macedonian economy, **real GDP growth** was negative, amounting to -1.4% with regard to the same quarter in 2008, showing continuation of the negative growth from the first quarter in 2009, when it was -0.9 p.p. (Chart 1.1). Seasonally adjusted, GDP grew by 0.62% in Q2 2009, thus Macedonia technically exited recession.

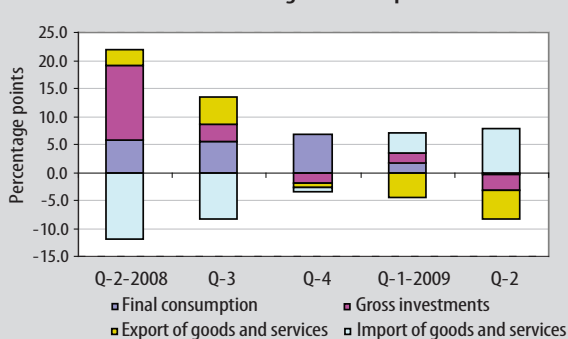
Chart 1.2 Industrial Production



In Q2, negative growth was seen in the following sectors: industry (-13.6%), transport and communication (-5.6%), hotels and restaurants (-9.1%), retail and wholesale (-0.5%), in relation to Q2 2008. On the other hand, financial intermediation, construction, agriculture and public administration were sectors showing positive growth, at the same time preventing GDP from experiencing deeper decline.

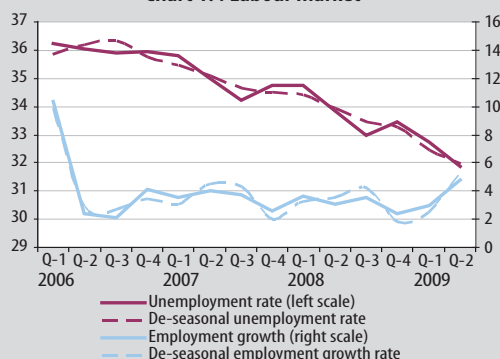
**Industrial production** dropped on annual basis by 13% in Q2 2009, adding to the decline registered in Q1 2009 (-10.8%). Most of the industrial sector registered activity slowdown, however, analyzed by branches having the largest share in the index, drop of industrial production in Q2 was mainly due to the realized negative growth rates at the production of base metals (52.2%), production of furniture (-34.7%), consumer durables (-32%) and production of clothing (30.5%). In general, industry in Q2 2009 negatively contributed to growth by 2.8 p.p., being continuation of the negative trend in the first quarter (-1.5%) and the main reason for GDP decline.

Chart 1.3 Contribution to growth – expenditure side



Observing **GDP from the expenditure side**, in Q2 2009, final consumption realized negative growth rate of -0.6% in real terms and gross investments realized negative growth rate -25.2%, while export and import dropped by -26.9% and by -28.5% respectively. Nominal share of final consumption in growth was -0.3 p.p., compared to positive share of 1.7 p.p. in the previous quarter; share of gross investments was negative (-3% p.p.), showing weaker performance in relation to Q1 2009, when it was positive (1.8%), while share of trade balance, unlike in the previous quarter, was positive (2.7%) and it improved in relation to Q1 2009, when it was -2.8 p.p.

Chart 1.4 Labour market



1. Evaluation of the population on 31 December 2008 according to SSO

In Q2 2009, **employment growth** accounted for 4.8% compared to the same quarter in 2008, and employment rate increased to 38.8% (by 1.6 p.p.). Number of unemployed persons decreased by 4.1%, most of which was absorbed by employment growth. Thereby, increase in working-able population led to surge in labour force, most of which were newcomers on the labour market, resulting in increase of activity rate to 57% (by 0.8 p.p.). Such developments led to decline of **unemployment rate** by 1.9 p.p. (to 31.9%). In fact, private sector created working positions on net basis, where number of employee increased by 6.9%, while in the other parts of the economy, employment experience slight decline by 0.8%. If seasonal effects are excluded, unemployment rate registered no significant changes. De-seasoned unemployment rate was 31.9% in Q2 2009, pointing out that unemployment in Macedonia is more structural rather than frictional.

**Leading composite index**, MakLead, surged by 4.5 index points in Q2 2009 on quarterly basis, following the high decline by 10 index points in the previous quarter. Compared to the same quarter last year, leading composite index was lower by 7.4 index points. Such trends registered at MakLead index suggested approaching the end of economic activity drop, i.e. positive trends are expected in the last quarter of the current year. In Q2 2009, **leading diffusion index** registered positive trends at 68.8% of the components of the composite index, being twice higher compared to the previous quarter, and same performance as in Q3 2008.

**Ratio between leading and lagging index** in Q2 2009 increased to 1.51, showing that leading index was higher by 51% compared to the lagging index. Ratio between leading and lagging constantly surged up to Q4 2008, when this indicator started to drop, being stopped in this quarter.

Chart 1.5 Leading and Coincident Index of GDP (de-seasonal)

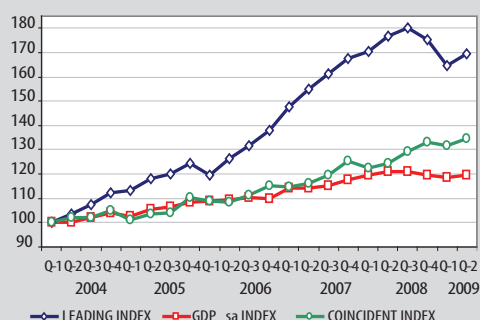
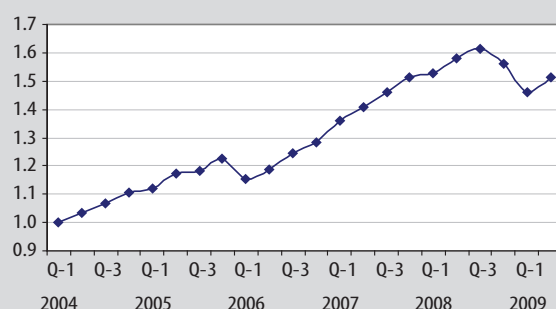


Chart 1.6 Ratio between the Leading and the Lagging Index



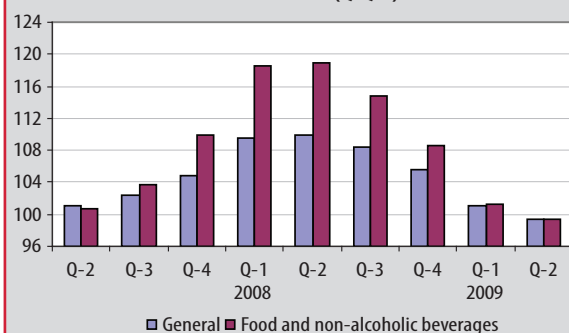
## 2. PRICES, COSTS AND PRODUCTIVITY

In Q2 2009, **inflation rate**, measured according to CPI, was -0.6% (Q/Q-4) compared to 1% in the previous quarter. Highest price decline by 10.9% was registered in the Means of Transport and Services category, mostly due to the decline of price of liquid fuels and oils by 27.2%. Food costs in Q2 2009 declined by around 1%, contributing with 66.7% to the total decline of consumer prices. Price drop was seen in the Culture and Entertainment category (by 2.3%), as a result of the lower education prices, as well as in the Clothing and Footwear category by 0.9%. Costs for administrative services also dropped by 10.6%. On the other hand, relatively high increase of prices on annual basis was seen at the Housing category by 6.7% and the Tobacco and Beverages category by 4.2%.

Slight increase of prices was observed at the Hotels and Restaurants category (3.1%) and Hygiene

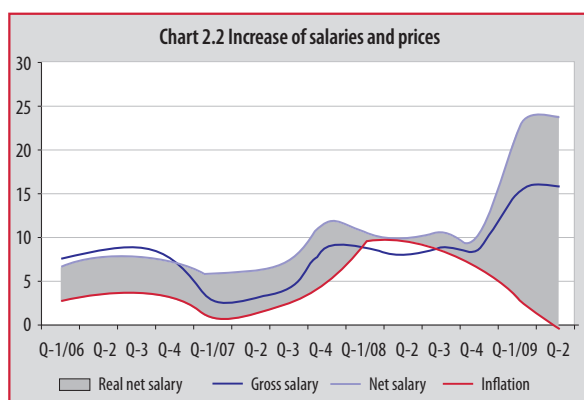
and Health category (2.7%). **Core inflation** (which includes the effect of food and energy) also experienced downward trend in Q2 2009, amounting to only 0.1%, compared to 1.5% in the previous quarter. Core inflation is expected to continue the downward trend by the end of the

Chart 2.1 CPI (Q/Q-4)



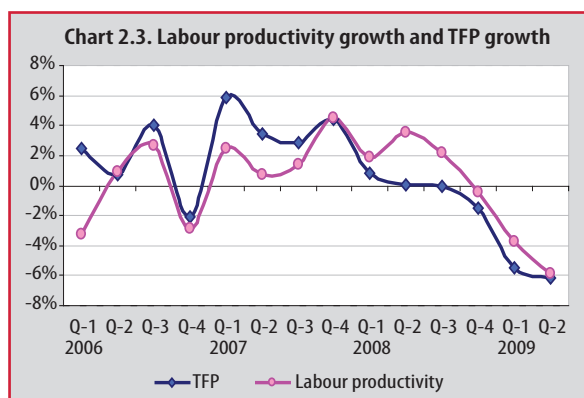
year, whereby upward trend of price of oil and expected increase of prices of primary food products on global stock markets will transfer, to a certain degree, to the general price level in Macedonia, to be more intensified next year, taking into account their pressure and transmission to the core inflation, and the general price level.

In Q2 2009, **retail prices** decreased by 1.5% compared to the same quarter previous year.



Highest price increase was registered at the Beverages category (7.3%), while prices dropped the most at the agricultural products (4.1%) and industrial-non-alimentary products (4%). Value of consumer basket of food and beverages for a four-member household, calculated on the basis of retail prices, declined by 1.8% compared to the previous quarter, and compared to Q2 2008, it surged by 1.5%, accounting for 62.5% of average net salary in Q2 2009.

Average **net salary** in Q2 2009, compared to same quarter previous year, was higher by 28.2%. Such increase was largely due to methodological changes, i.e. starting January 2009, net salary includes food and travel allowances. **Average gross salary** experienced slower growth compared to net salary, by 17.9%, as a result of the reduced rates of social contributions and the two-fold increase of personal tax exemption. Slight decline of general price level caused for real growth of net and gross salary not to differentiate a lot from the nominal growth, amounting to 29% and 18.6% respectively (see shaded field in Chart 2.2).



In Q2 2009, downward trend of **productivity**, which commenced in the last quarter in 2008 (see Chart 2.3) continued, taking into account that slowdown and decline of economic activity was accompanied by employment growth. Decline of productivity in Q2 2009 accounted for 5.9%. Total factor productivity (TFP) registered higher decline than labour productivity, i.e. -6.1% in Q2 2009 (see Chart 2.3). TFP decline was due both to increase in investments, in particular physical capital, and growth of human capital, realizing real growth rate of 4.8%.

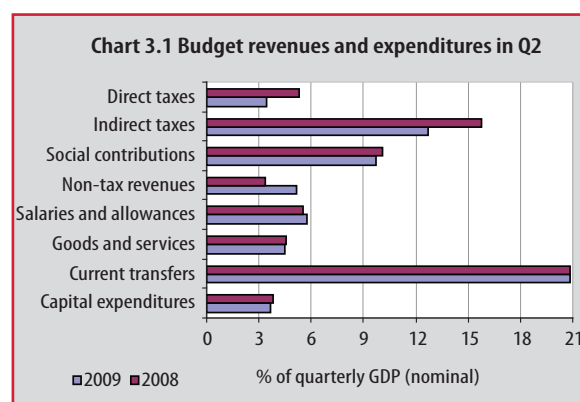


### 3. FISCAL SECTOR

Decline in the economic activity in the Republic of Macedonia was reflected in the fiscal sphere. Lower performance of budget revenues (89.9% performance) in Q2 2009, accompanied by relatively higher budget expenditure, led to **central government budget deficit**<sup>2</sup> in the amount of Denar 3.6 billion or 0.9% of the projected GDP. Still, expansive fiscal policy did not jeopardize the fiscal sustainability of the country, taking into account that public debt is at relatively low and stable level. Total general government budget revenues (Government and Funds) remained almost the same (lower by only 0.2%) compared to the same quarter last year, mainly due to the higher performance of contributions by 7.3%, while tax revenues were lower by 14.5%. Slowdown in personal consumption and import decline, followed by tax reforms undertaken to mitigate the consequences from the economic crisis, resulted in lower collection at all types of tax revenues. **VAT revenues**, accounting for almost half (48.7%) of total tax revenues, were lower by 14.5% in Q2 2009 compared to the same quarter 2008. Regarding the structure of gross VAT revenues, there was slight increase in VAT collection on the basis of turnover in the country in line with the increased trade sales, while realized VAT revenues on the basis of import dropped by 33.3%. Performance of projected revenues on the basis of VAT in Q2 2009 accounted for 90.1%. Excise revenues were higher by 8.1% compared to the same quarter last year, showing overperformance by 3.9%. Import decline led to lower collection of customs duties (by 21.4%). With respect to direct taxes, significant decline of 70.4% was expectedly registered at profit tax, taking into account that starting January 2009, only profit distributed for dividend was taxed. Personal income tax revenues were higher by 3.0% despite the lower base and the high decline of revenues on the basis of capital gain. Collection of social contributions was higher by 7.3%, and collection of all types of social contributions increased. In Q2 2009, non-tax revenues, accounting for 19.9% of total budget revenues, were higher by 70.5% on annual basis.

Total **budget expenditures** in Q2 2009 were higher by 10.7% compared to the same quarter previous year. **Current expenditures**, accounting for 89.6% of total expenditures, increased by 11.2% (31.5% of GDP). **Capital expenditures**, participating with 10.4% in total expenditures, were higher by 6.5% on annual basis, accounting for 3.7% of projected GDP in this quarter. Execution of capital expenditures, as of

June inclusive, accounted for 26.4% of the projected ones for this year. Regarding capital expenditures, transfers were higher by 10.3% on annual basis, whereby the category Other Transfers (24.0% growth), including transfers to local government, contributed the most to this increase. Expenditures for goods and services increased by 9.9%, while expenditures related to salaries and allowances were higher by 16.3%. Interest-related expenditures surged by 6.2%, whereby domestic debt interest-related expenditures increased by 17.4%.



In the coming period, budget revenues are expected to be realized with slower dynamics than in the previous period, as a result of decline of economic activity and measures to overcome such trends. In fact, decline in import, profit and productivity will reflect on tax revenues as well. 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 2.8% of GDP in 2009 seems feasible.

**Fiscal burden**, measured as participation of budget revenues<sup>3</sup> in relation to nominal GDP, was 27.2% in Q2 2009, dropping by 2.0% p.p. in relation to Q2 2008. Total budget expenditures accounted for 35.2% of GDP, which was by 35.2% p.p. lower compared to Q2 2008.

**Total public debt**<sup>4</sup> at the end of Q2 2009 was 27.0% of GDP, being a decline by 0.6 p.p. compared to Q1 2009. Such decline was due to the high decline of domestic public debt (by 4.7%), while external public debt decreased by only 0.4% in relation to Q1 2009. Thus, share of domestic public debt dropped by 1 p.p. to 36.2% (Chart 3.2). Such

2. Includes central government budget and Funds' budgets

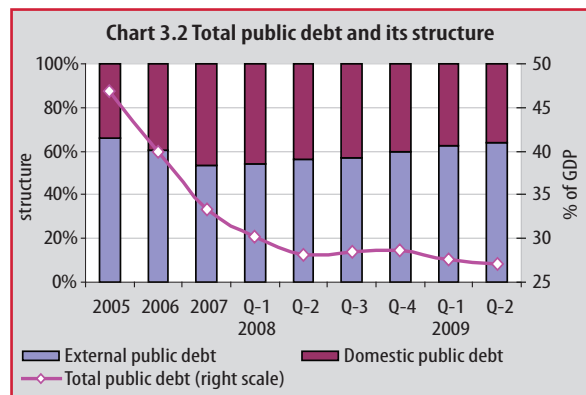
3. Includes tax revenues, social contributions and part of non-tax revenues

4. According to GFS Methodology



trends point out that additional borrowing, which is inevitable for conducting more expansive fiscal policy in conditions of slowed down economic

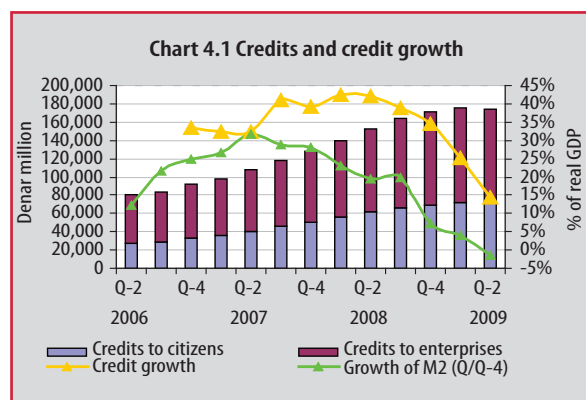
growth, whether externally or internally, would not jeopardize fiscal sustainability. Sound fiscal policy is one of the Maastricht Criteria, having the limits set at budget deficit of 3% of GDP and general government debt of 60% of GDP.



**General government debt**, which does not include debt of NBRM and debt of public enterprises, decreased to 21.6% at the end of Q2 2009, i.e. it dropped by 1.2 p.p. in relation to Q1 2009. Such phenomenon was result of the decrease of central government debt (by 14%) due to decrease of stock of continuous government securities (by 24.5%), i.e. slowdown of dynamics of their issuance. On the other hand, NBRM debt increased by 40.5%. Accordingly, share of general government debt in total public debt dropped by 2.9 p.p. (to 80%).

#### 4. MONETARY-FINANCIAL TRENDS<sup>5</sup>

At the end of Q2 2009, **primary money** dropped by 1.7% in relation to the previous quarter, experiencing a decline by 4.7% on annual level. In Q2 2009, **M1 monetary aggregate** increased by 1.8% compared to Q1 2009, while on annual basis, a decline was registered by 3.6%, mainly as a result of the drop of ready money in circulation by 12.1%. In Q2, broader monetary aggregates **M2 and M4** slightly increased in relation to the previous quarter (0.5% and 0.8% respectively), while M2 registered decline by 1.3% on annual basis, and M4 experienced slowdown from 6.6% in Q1 to 1.2% in Q2 2009.



**Credits to private sector** in Q2 2009 experienced significantly lower growth by only 14.3% in relation to Q2 2009, (compared to 34.4% in Q4 2008 and 25.3% in Q1 2009). Significant tightening of credit requirements was seen in the second quarter in 2009 as a result of perception by the banks of increased risk and worsened expectations for the overall economic activity in the country. Strong growth slowdown was registered at credits to enterprises by 10.7 p.p. (from 23.6% in Q1 2009 to 12.9% in Q2 2009). Trend

regarding credits to households was similar to the trend in corporate crediting, the growth of which continued to significantly slow down by 11.4 p.p. (16.3% in Q2 2009 compared to 27.6% in Q1 2009). Credits to private sector, compared to nominal GDP,<sup>6</sup> amounted to 44% in Q2 2009, showing 0.2% p.p. slowdown in relation to the previous quarter.

**Total deposit potential<sup>7</sup>** of private sector increased by 2.1% in Q2 2009, showing significantly slowed down growth dynamics (compared to 7.7% in the previous quarter and growth of 23.8% in Q2 2008). In Q2 2009, deposits of households increased by 10.7% in relation to Q2 2008, being a decline by 1.9 p.p. in relation to growth in Q1 2009. Deposits of enterprises experienced continued and stronger decline. In fact, they dropped by 22.2% in relation to Q2 2008.

**Interest on central bank bills** in Q2 2009 increased by 2 p.p. compared to 9% when applying fix interest rate tender. For comparison purposes, in the second quarter 2009, European Central Bank revised downward the reference interest rate twice and it amounted to 1.0% at the end of the quarter, being a cumulative decline by 0.5 p.p. compared to Q1 2009. NBRM adopted additional measures aimed at preserving exchange rate stability, as well as price and financial stability in the economy. In fact, NBRM adopted new Decision on Reserve Requirement

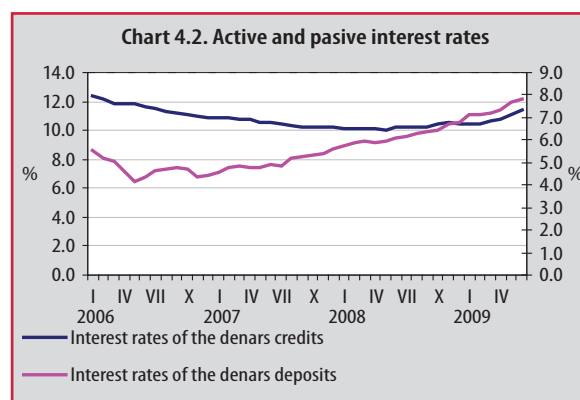
5. Starting Q1 2009, analyses are made on the basis of the data harmonized with the new accounting plan for the banks, in force from January 2009
6. Estimation
7. Deposits include calculated interest

pursuant to which reserve requirement rate for banks' foreign exchange liabilities increased from 10% to 13%, reserve requirement rate for banks' Denar-denominated liabilities with forex clause increased from 10% to 20% and it provided for the banks to fully use the funds from reserve requirement set aside in Denars for their daily liquidity needs.

**Average weighted interest rate** on Denar credits amounted to 10.1% at the end of Q2 2009, registering an increase of 0.5 p.p. annually, and an increase of 0.3 p.p. compared to the previous quarter. Interest rates on deposits continuously grew, thus at the end of Q2 2009, interest on credit balance on Denar deposits increased by 1 p.p. in relation to Q2 2008 and amounted to 6.8%, which was by 0.2 p.p. higher compared to Q1 2009.

In parallel to deepening of global financial crisis effects, intensified influence was seen of monetary policy on banks' interest rate policy in crediting households and enterprises. Even 80% of the banks said that NBRM monetary policy significantly affected their interest rate policy regarding crediting enterprises<sup>8</sup>.

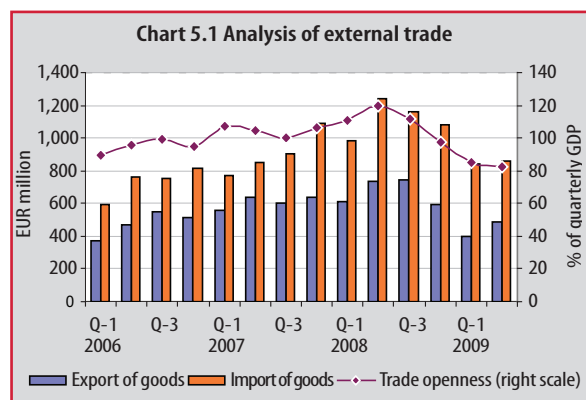
**Macedonian stock exchange index** MSEI-10, as aggregate indicator of stock exchange trends, stopped the declining trend at the end of Q2 2009, showing 32.9% growth compared to Q1 2009, and slowed down decline by 48.2% in relation to Q2 2008 (compared to 71.6% drop seen in Q1 2009). Total turnover realized on the Macedonian Stock Exchange also showed increase by 18.3% in relation to Q2 2008 and high 175% compared to the previous quarter.



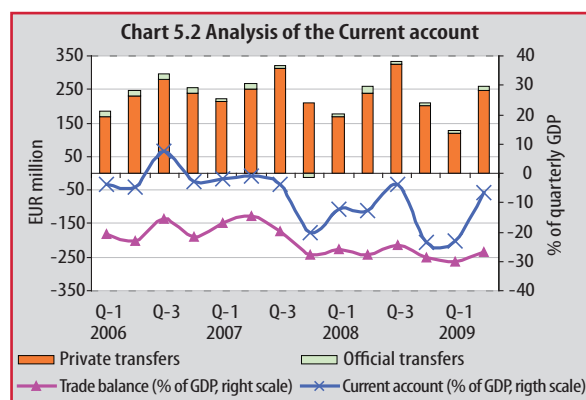
8. NBRM, Credit Activity Survey, July 2009

## 5. EXTERNAL SECTOR AND BALANCE OF PAYMENTS

Downward trend of both the export and the import of goods, which started in the last quarter in 2008, also continued in Q2 2009. Thereby, both export and import of goods registered high negative rate in this quarter.



Export of goods, expressed in euros, dropped by 33.4% compared to the same quarter 2008, while import of goods, also expressed in euros, declined by 30.4% in the same quarter in relation to Q2 2008. As for import of goods, negative growth rate was realized at most groups of products according to SMTK in Q2 2009. Thereby, highest decline was recorded at the categories Mineral Oils and Lubricants (-54.9%), Raw Materials (-38.5%), Animal and Plant Oil (-36.8%) and products classified according to the material (-41.7%). During the analyzed period, only Beverages and Tobacco category experienced positive growth (22.8%). Disadvantage was the decline of import



of inputs used by export-oriented sectors, i.e. part of the so called import component of the export, having negative effects on the recovery of their overall production.

Trade openness of the Republic of Macedonia was 82.5% in Q2 2009, continuing the downward trend in relation to the previous quarters, and reducing the rate of openness to the levels before 2007. This was mainly due to the decline in the overall volume of the external trade by 31.6% in relation to the same quarter previous year.

In Q2 2009, trading volume with the EU accounted for 54% of the total trade of Macedonia, and in relation to Q1 2009, it increased by 1 p.p. Serbia remained to be the second major trading partner to Macedonia, whereby the trading volume in Q2 2009 accounted for 11.1% of the total trade and it was kept at dropped at almost the same level in relation to the previous quarter. In Q2 2009, 62.4% of Macedonian export was realized on the markets in Serbia, Germany, Greece, Kosovo and Bulgaria.

As a result of parallel rapid decline of export and import of goods, in Q2 2009, trade deficit (EUR -443.1 million) experienced no significant developments compared to the previous quarter, being -27.4% of quarterly GDP. Upward trend of net current transfers, which commenced in Q2 2008, was interrupted in Q4 2008 and they dropped in Q1 2009. In Q2 2009, net current transfers amounted to EUR 260.5 million, and they were at almost the same level compared to Q2 2008. Compared to the previous quarter, net current transfers increased by almost 100%, due to the increased private transfers, which are dominant and driving component of current transfers (95%). Following the historically largest deepening of current account deficit in the last quarter in 2008, in Q1 2009, it registered almost insignificant drop, while compared to Q2 2009, it decreased by 68% in relation to the previous quarter, amounting to -6.5% of quarterly GDP. Such decrease of current account deficit was due to higher net current transfers and reduced trade deficit in relation to the previous quarter.



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