Republic of Macedonia
Ministry of Finance

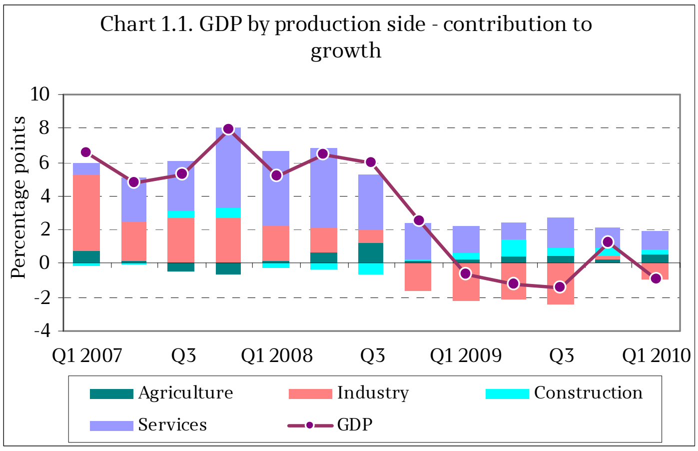
QUARTERLY ECONOMIC REPORT – Q1/2010

Summary

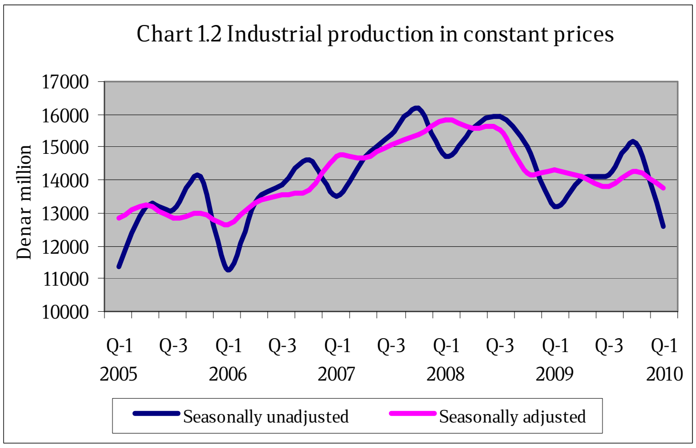
- In Q1 2010, GDP dropped by 0.9% in real terms in relation to the same quarter in 2009. Production decline was evidenced in industry, traffic and catering, while the remaining sectors grew, whereby construction showed most significant increase of 7.7%;
- Compared to the same quarter last year, number of employed persons declined by 0.4%. Employment rate in Q1 2010 was 37.5%, while unemployed accounted for 33.5% of the labour force.
- In Q1 2010, inflation rate, measured according to CPI, was 0.4% (Q/Q-4).
- In Q1 2010, net salary grew by 3.3% in nominal terms and by 2.8% in real terms.
- Budget deficit at the end of Q1 2010 was 1.0% of the annual GDP. Fiscal burden in Q1 accounted for 28.3%, showing 0.3 p.p. drop compared to Q4 2009.
- Credits to private sector continued to increase, however with slowed down dynamics. In fact, they increased by only 2.5% in relation to Q1 2009. On the other hand, deposits continued their intensive growth of 11.4%.
- Macedonian Stock Exchange Index MSEI-10 increased by 38.6% compared to Q1 2009. At the same time, total turnover on the Macedonian Stock Exchange experienced 36.4% decline.
- Annually, in conditions of significant increase of export by 20.4% and simultaneous decline of import by 8%, total foreign trade, expressed in euros, experienced increase by 1.1% for the first time in a year.
- Trade openness of the Republic of Macedonia was 82.8% in Q1 2010, continuing the upward trend in relation to the previous quarters.

1. Macroeconomic Trends and Real Sector

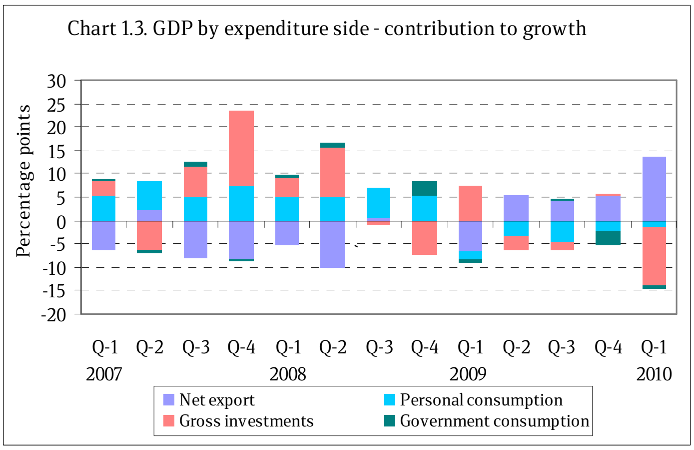
In Q1 2010, gross domestic product (GDP) in current prices was Denar 93,524 million or Denar 21,904 per capita[1]. In Q1, **real GDP growth** was negative, amounting to 0.9% compared to the same quarter in 2009. Despite the positive GDP growth (1.2%) in the previous quarter, pointing out to recovery of the Macedonian economy, performance in the first quarter in 2010 showed that there were still risks as a result of the global economic crisis.



In Q1 2010, according to the **production method**, negative growth was seen in the following sectors: transport and communication (-1.2%), hotels and restaurants (-13.3%) and industry (-4.6%), which led to genitive GDP growth. On the other hand, sectors like financial mediation (3.7%), construction (7.7%), agriculture (5.0%), retail and wholesale (1.1%) and public administration (4.0%), showed positive growth (Chart 1.1).



Decline of the industrial production in Q1 2010 was due to the realized negative growth rates at the following: processing industry (14.6%), ore and stone extraction (5.8%), production of electrical machines and devices (55.5%), production of metal products in metal processing stage (55.6%), production of coke, oil derivatives and nuclear fuel (49.1%), production of furniture (18.7%), production of machines and devices (3.5%).



On the other hand, growth was

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

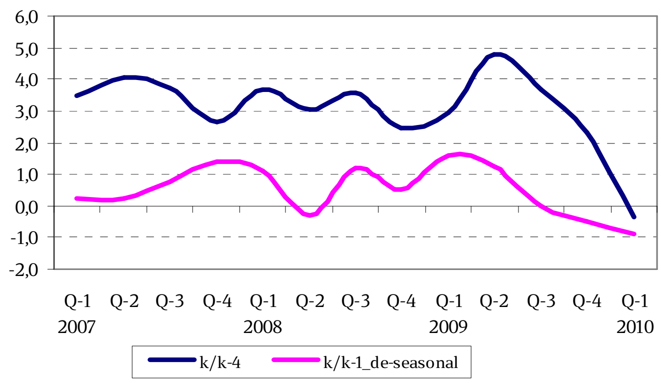
observed at production of base metals (48.1%), production of other means of transport (7.2%), recycling (227,9%) and electricity supply (19%).

Observing GDP from the expenditure side, in Q1 2009, final consumption realized drop of 1.6% in real terms, import dropped by 14.6%, export declined by 12.4%, while gross investments decreased by 46.6%.

Compared to the same quarter last year, number of employed persons declined by 0.4% in Q1 2010, and employment rate accounted for 37.5%.

Relatively high increase of the working-able population of 0.6% led to surge in both labour force and inactive population. Thereby, most of the increased working-able population moved directly to unemployment. During the analysed period, such developments led to increase in the number of unemployed by 2.9%, while unemployment rate increased by 0.7 p.p. (to 33.5%). In fact, working positions in the private sector reduced on net basis, where the number of employees dropped by 1.4%, while in the other parts of the economy, employment increased by 2.4%. Number of employed persons, excluding the seasonal effects, showed downward trend starting Q3 2009 (Q/Q-1), whereby the decline on Q1 2010 was the highest, amounting to 0.9%. This was due to the cyclical trends in the economy, taking into account that labour market indicators are lagging behind the cycle.

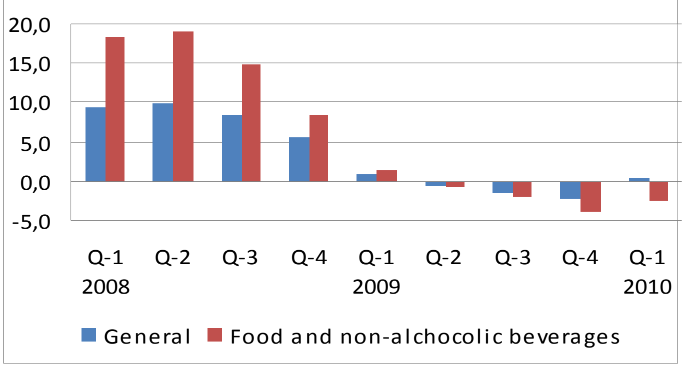
Chart 1.4. Employment growth rate



2. Prices, Costs and Productivity

In Q1 2010, inflation rate, measured according to CPI, was amounted to 0.4% compared to the same quarter in 2009. Highest price increase by 4.9% was registered in the Housing category, mostly due to the increase of heating and lighting prices by 8.7%. Prices of means of transport and services were higher by 4.0% compared to Q1 2009, and prices in the categories hygiene and health and tobacco and beverages surged by 1.2% respectively. On the other hand, prices declined in the food category (-2.4%), clothing and footwear category (-0.4%), hotels and restaurants (-0.4%), culture and entertainment category (-0.1%) and

Chart 2.1. CPI (Q/Q-4)

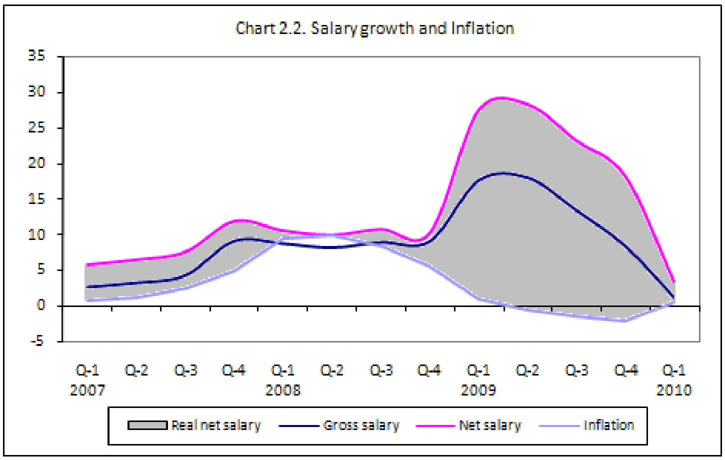


in the category – other services (-2.3%).

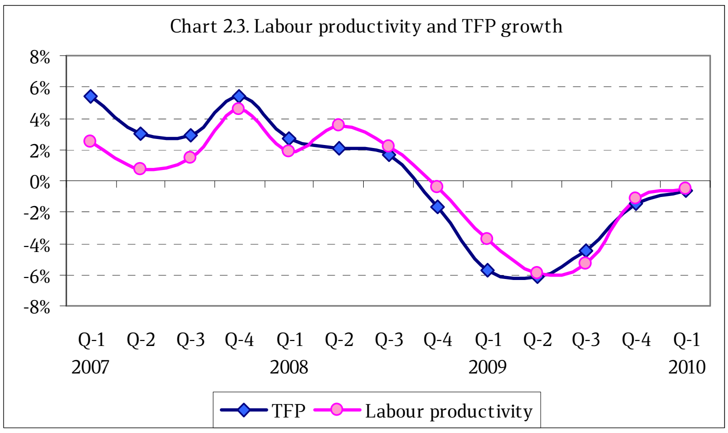
Core inflation (which includes the effect of food and energy) also experienced a declining trend. In fact, it was negative in Q 1 2010 and amounted to -0.2% compared to -0.7% in the previous quarter.

In Q4 2009, retail prices increased by 1.9% compared to the same quarter in 2009. Price increase was registered at the industrial products category (4.1%), whereby more significant price increase was registered at the category of industrial non-alimentary products (6.6%). Prices of beverages and tobacco surged by 1.7% and by 0.6%respectively. On the other hand, as for agricultural products category, prices declined by even 6%, whereby prices of fresh eggs and fresh fruit experienced the highest decline of 13.0% and 10.9% respectively. Value of the consumer basket of food and beverages for a four-member household, calculated on the basis of retail prices, was higher by 3.6% compared to the previous quarter, while in relation to Q1 2009, it was lower by 4.2%. Value of consumer basket in Q1 2010 accounted for 60.4% of average net salary.

Average net salary in Q1 2010 was higher by 3.3% in nominal terms compared to the same quarter in 2009, while average gross salary experienced slower nominal growth by 1.1%, compared to net salary, as a result of the reduced rates of social contributions. Moderate inflation rate caused for increase of net and gross salaries to be lower in real terms, amounting to 2.8% and 0.6% respectively (shaded field in Chart 2.2).

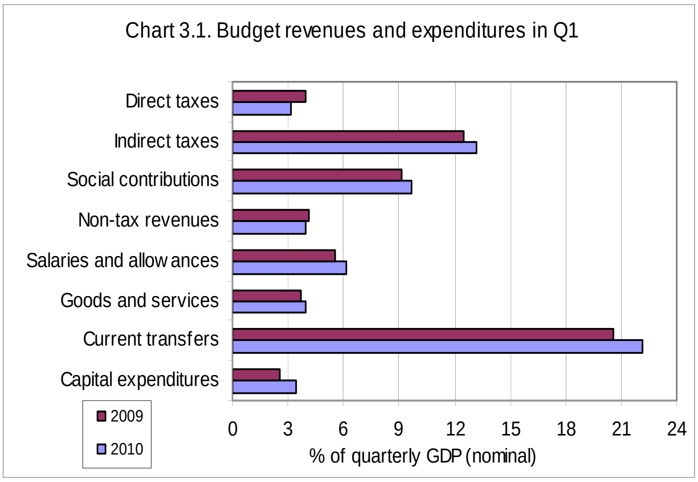


In Q1 2010, downward trend of productivity, which commenced in the last quarter in 2008 (see Chart 2.3). Labour productivity dropped by 0.5% in Q1 2010 compared to the same period last year, however, gradual improvement was also observed. Productivity decline was a result of the decline in the economic activity in Q1 2010, although it was accompanied by employment decline. Total factor productivity (TFP) registered slightly higher decline than labour productivity, i.e. – 0.6% (see Chart 2.3). TFP decline was mainly due to the relatively lower decline of physical capital and human capital.



3. Fiscal Sector

Gradual recovery of the economy and positive growth rate are expected in 2010, as a post-crisis year. Data in the first quarter in 2010 showed that real GDP dropped by -0.9% (growth of 1.2% was registered in Q4 2009, while the decline rate for the whole 2009 was revised to -0.5%), confirming that the economic policies set during the crisis and the four packages of anti-crisis measures adopted by the Government and implemented in 2009 helped the Macedonian economy cope with the crisis, suffering least possible consequences.



Lower performance of budget revenues (91.8% performance) in Q1 2010, accompanied by relatively higher budget expenditure, led to budget deficit[2] in the amount of Denar 4,099 million or 4.4% of GDP in Q1 (1% of total annual GDP). Counter-cyclical fiscal policy continued to be implemented in the first quarter in 2010, aimed at mitigating the consequences from the global economic crisis on our economy and maintaining macroeconomic stability. Thereby, it can be concluded that fiscal sustainability of the country was not jeopardized, neither was the monetary stability as a result of issue of treasury bills.

Total budget revenues (Government and Funds) were lower by 5.7% compared to the same quarter in 2009, mainly due to the lower performance of tax revenues by 7.6%, social contributions by 1.2%, while non-tax revenues were lower by 12%. Slowdown in personal consumption and import decline, followed by tax reforms undertaken to mitigate the consequences from the economic crisis, resulted in slightly lower collection at all types of tax revenues, which, inter alia, was a reason for supplementary budget. It is important that VAT revenues, accounting for more than half (51.2%) of total tax revenues, were higher by 0.4% in Q1 2010 compared to the same quarter in 2009. Regarding the structure of gross VAT revenues, there was an insignificant decline in VAT collection on the basis of trading in the country in line with the declined trade sales, while realized VAT revenues on the basis of import surged by 1.8%. Performance of revenues on the basis of VAT in Q1 2010, compared to the projections, accounted for 105.2%. Excise revenues were higher by 0.5% compared to the same quarter in 2009. Import decline, reduction and abolishment of customs tariffs for raw materials and machines for certain products, as well as reduction of customs tariffs in line with the undertaken international obligations provided in Free Trade Agreements, led to lower collection of customs duties (by 16.9%).

2 It covers central government budget and budgets of the Funds

With respect to direct taxes, significant decline of 56.0% 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 4.0% despite the lower base and the high decline of revenues on the basis of capital gain was registered. As regards the structure of these revenues, the majority was usually realized from payroll tax – 72.0%, followed by tax on income realized on the basis of contractual agreements - 8.2%, tax on income from capital – 3.6%, tax on income from capital gains – 3.6%, income realized on the basis of property and property rights - 3,8%, while share of income on other basis in the structure was relatively lower. Collection of social contributions was lower by 1.2%, whereby collection of all types of social contributions declined, the highest being registered at the health insurance contributions by 8.1% and employment contribution by 8.9%.
In Q1 2010, non-tax revenues, accounting for 12.4% of the total budget revenues, were lower by 12% on annual basis.

Total budget expenditures in Q1 2010 were higher by 1.2% compared to the same quarter last year. Current expenditures, accounting for 90.4% of total expenditures, dropped by 0.8% (32.5% of GDP). Capital expenditures, participating with 9.6% in total expenditures, were higher by 24.5% on annual basis, accounting for 3.5% of GDP in this quarter. Execution of capital expenditures, as of March inclusive, accounted for 14.1% of the total projected ones for this year. Regarding capital expenditures, transfers were lower by 0.5% on annual basis, whereby the category Other Transfers accounted for 23.2% (including transfers to local government). Expenditures for goods and services declined by 0.9%, while expenditures related to salaries and allowances were higher by 3.3%. Interest-related expenditures declined by 55.7%, whereby domestic debt interest-related expenditures dropped by 28.8% and expenditures related to interest on foreign debt declined by 65.9%.

In the coming period, budget revenues are expected to be realized with improved dynamics compared to the previous period, in parallel with the projected growth throughout 2010, to be underpinned with the new fourth package of anti-crisis measures. On the other hand, realization of public investments is expected to intensify so as to instigate the economic growth. Hence, projected deficit of 2.8% of GDP in 2010 seems feasible.

Fiscal burden, measured as participation of the budget revenues[3] in relation to nominal GDP, was 28.3% in Q1 2010, dropping by 0.3 p.p. in relation to Q4 2009. Total budget expenditures accounted for 35.9% of GDP, which was by 1.7 p.p. higher compared to Q4 2009.

At the end of Q1 2010, total debt[4] accounted for 32.7% of GDP, which was by 0.6 p.p. higher compared to Q4 2009. Such increase was due to the increase of domestic public debt by 14.3%, while external public debt increased by 1.4% in relation to Q4 2009. Thus, share of domestic public debt increased by 38.3% (Chart 3.2). Such trends point out that

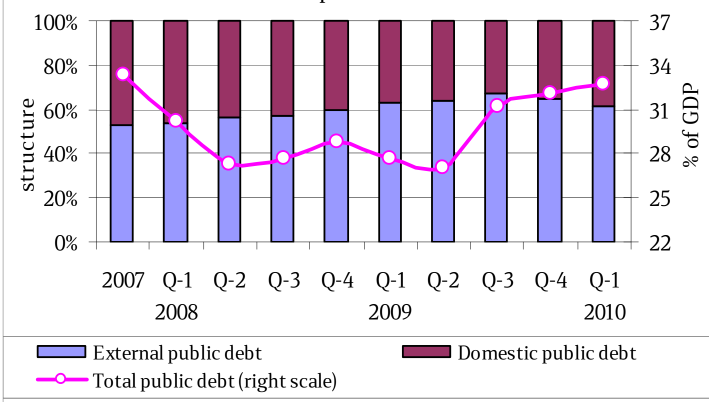
3 Includes tax revenues, social contributions and administrative taxes and charges

4 According to GFS Methodology

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, whereby coordination with the monetary policy is necessary. Sound fiscal policy is one of the Maastricht Criteria, having the limits set at budget deficit of 3% of GDP and debt of 60% of GDP.

The debt, which does not include the debt of NBRM and of the public enterprises, increased to 25.2% of GDP at the end of Q1 2010, i.e. it increased by 0.9 p.p. in relation to Q4 2009. Such trends were a result of the increase of central government debt (by 0.3%) due to the increase of external borrowing. On the other hand, NBRM debt experienced an increase of 35.0%, leading to decline of the share of state debt in the total public debt by 4.0 p.p. (the share in Q1 was 71.0%).

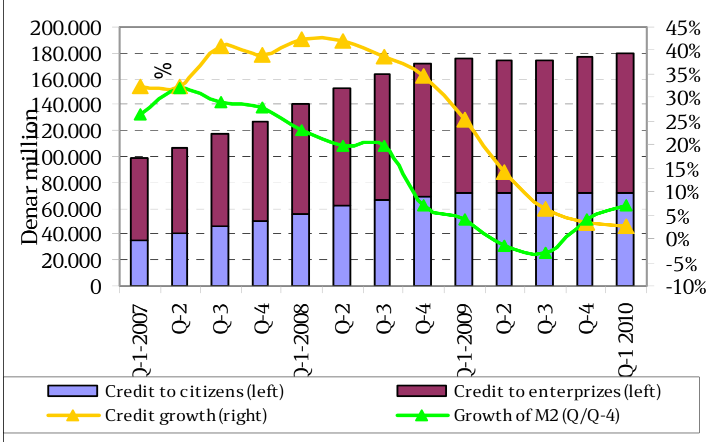
Chart 3.2. Total public debt and its structure



4. Monetary-Financial Trends[5]

At the end of Q1 2010, primary money dropped by 4.3% in relation to Q4 2009, and it surged by 19.8% on annual level. In Q1 2010, M1 monetary aggregate declined by 3.7% compared to Q4 2009, mainly as a result of the drop of ready money in circulation by 8.7%, as well as the decline of deposit money by 1.5%. M1 money supply was higher by 7.4% on annual basis. In Q1 2010, broader monetary aggregates M2 and M4 moderately increased in relation to Q4 2009 (0.6% and 1.7% respectively), while M2 and M4 registered an increase by 7% and 10.7% respectively on annual basis.

Chart 4.1. Credits and credit growth



Credits to private sector continued increasing, however with lower dynamics. Thus, in Q1 2010, they registered slower growth of 2.5% in relation to Q1 2009 (compared to 14.3%, 6.4% and 3.5% respectively in Q2, Q3 and Q4 2009). Sector analysis points out to

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

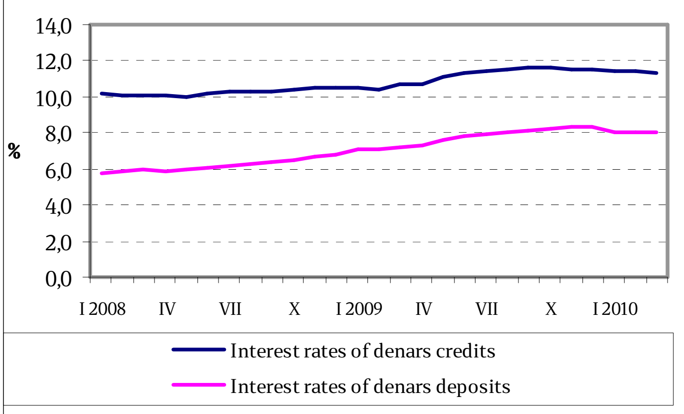
moderate intensification of growth of credits to enterprises in Q1 2010 to 4.1% in relation to Q1 2009 (2.3% on quarterly basis), while growth of credits to households slowed down further, being just 0.6%. Credits to private sector, compared to nominal GDP[6] accounted for 42.0% in Q1 2010, showing 1.1 p.p. slowdown in relation to Q4 2009.

In Q1 2010, total deposit potential[7] of the private sector continued its intensified growth, whereby it surged by 11.4% on an annual level (compared to 7.1% in Q4 2009). In relation to the Q4 2009, total deposits were higher by 2.6%. Thereby, growth of deposit potential on quarterly basis was mainly due to Denar deposits registering 3.2% increase in relation to Q4 2009, as well as to foreign currency deposits which grew by 2%. Analysed by sectors, in Q1 2010, deposits of households increased by 19.9% in relation to Q1 2009, while deposits of enterprises experienced lower decline by 5.5% (16.4% in Q4 2009). In relation to Q4 2009, deposits of households were higher by 5%, while deposits of enterprises declined by 3.8%.

As a result of decreased pressures on the foreign exchange market, as well as better expectations of NBRM, interest on central bank bills in Q1 2010 experienced multiple drop, by 2 p.p. on cumulative basis, i.e. from 8.5% to 6.5%. In Q2 2009 (since May), European Central Bank made no changes in the reference interest rate, keeping it at the level of 1% at the end of Q1 2010.

At the end of Q1 2010, average weighted interest rate on Denar credits was 9.8%, i.e. it dropped by 0.4 p.p. in relation to Q4 2009. Interest rate on foreign currency credits was 7.3%, being a decline of 0.3 p.p. compared to Q4 2009 and a decline of 0.1 p.p. in relation to the same quarter in 2009. Despite the quarterly increase in the past several quarters, at the end of Q1 2010, average weighted interest rate on Denar deposits remained unchanged compared to the previous month (7.5%), while in relation to Q1 2009, it was higher by 0.9 p.p. Interest rate on foreign currency deposits decreased by 0.2 p.p. compared to Q4 2009, being at the level of 3.2%.

Chart 4.2. Active and pasive interest rates



Macedonian stock exchange index MSEI-10, as aggregate indicator of stock exchange trends, decreased by 8.6% in relation to Q4 2009. In relation to Q1 2009, MSEI-10 experienced high growth of 38.6%. Total trading on Macedonian Stock Exchange declined by 52.5% on quarterly basis in Q1 2010, and in relation to Q1 2009, it declined by 34.1%.

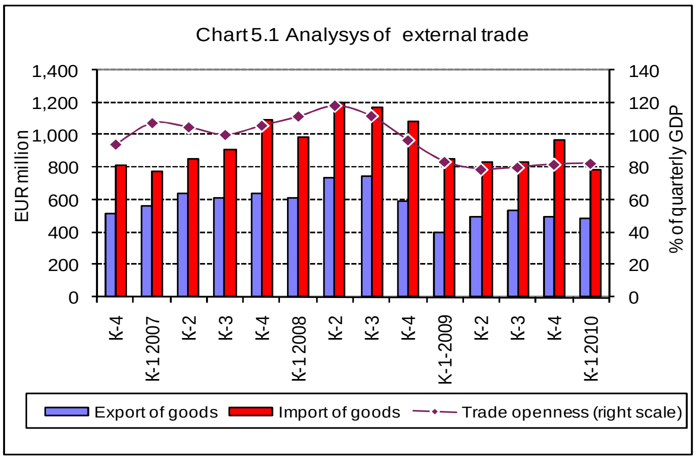
[6] Estimation
[7] Deposits include calculated interest

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 2009, also continued in Q1 2010. Effects from the decline of the import continued to reflect more intensively on the import demand, whereby import of goods experienced higher negative rate of 19% in Q1 2010, and export dropped by 2% in relation to the last quarter in 2009. Such tendency points out that foreign trade risks in the first quarter were still not eliminated.

Analysed on annual basis, in conditions of significant increase of export by 20.4% and simultaneous decline of import by 8%, total foreign trade, expressed in euros, experienced increase by 1.1% for the first time in a year, mainly due to the low comparative basis. **Analysed by SITC sectors (Standard International Trade Classification)**, in Q1 2010, positive trends in the export were registered at the following: food products (24.8%), beverages and tobacco (55.4%, as a result of the increase in the export of tobacco and tobacco processed goods), two-fold increase of export of raw materials, except fuel (metal ore and metal scrap), mineral oils and lubricants (34.5%, oil and oil products), chemical products (55.6%) and products classified by material (17.7%, iron and steel), while due to reduced export of clothing and industrial and electrical machines, negative shifts were observed in the following sectors: machines and transport devices and other finished goods.

As regards the import of goods, almost all groups of products under SITC registered negative growth rate in Q1 2010. Thereby, highest decline was registered at the following categories: machines and transport devices (-27.7% or EUR 64 million), mineral oils and lubricants (-18.5% or EUR 30.6 million), raw materials (-38.5%), animal and plant oil (-36.8%) and products classified by material (-41.7%). During the analysed period, more significant positive shift by 22.7% or EUR 20 million was registered at the chemical products category. 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 82.8% in Q1 2010, continuing the upward trend in relation to the previous quarters, and reducing the rate of openness to the level realized in the first quarter in 2009. This was mainly due to the minimum annual growth of the overall volume of the foreign trade (1.1%) in relation to the same quarter in 2009.

In Q1 2010, trading volume with the EU accounted for 55.9% of the total trade of Macedonia, and in relation to Q1 2009, it dropped by 2.9 p.p. Export to the European Union registered strong increase of 22%%, while import experienced slower decline of 4% compared to the same period in 2009. In addition to Germany, most significant trading partners to the Republic of Macedonia remain to be Greece and Serbia, whereby the trading volume in Q1 2010 accounted for 16% of the total trade. In Q1 2010, 60% of Macedonian export was realized on the markets in Germany, Kosovo, Bulgaria, Greece and Italy.

As a result of parallel rapid decline of export and import of goods, in Q1 2010, trade deficit (EUR -296.4 million) experienced significant positive performance compared to Q4 2009, accounting for -19.5% of quarterly GDP. Upward trend of net current transfers, which commenced in Q2 2009, was interrupted in Q1 2010. They amounted to EUR 258.9 million, and they were at almost the same level compared to Q2 2009. Compared to Q4 2009 (Q4 2009), net current transfers declined by 24.5% or by EUR 84 million, due to the lower private transfers, which are dominant and driving component of current transfers (95%). Following the deepening of current account deficit in the last quarter in 2009, in Q1 2010, it registered significant drop of 47% , (EUR 66 million) compared to Q4 2009, amounting to -4.8% of quarterly GDP. Such decrease of current account deficit was mostly due to the reduced trade deficit in relation to Q4 2009.

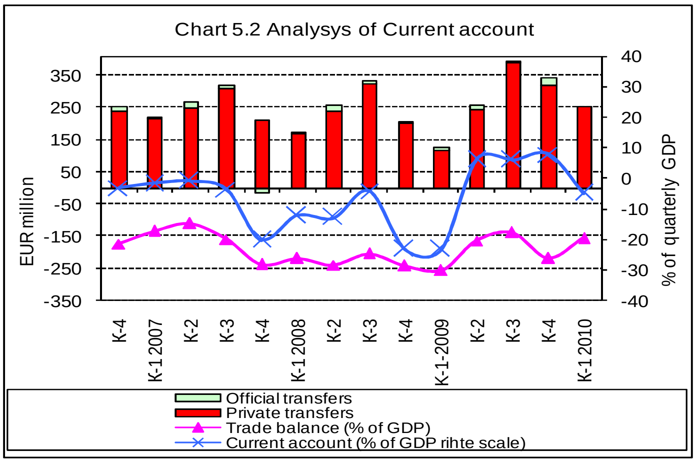


Chart 5.2 Analysys of Current account

Report is prepared by:

Ministry of Finance

Macroeconomic Policy Department

www.finance.gov.mk

Persons in charge:

Anita Popovska MA

Aneta Acevska

Negati Kurtisi

Koprinka Sapunova

Sami Asani

Supervised by:

Snezana Delevska

Skopje, July 2010