Republic of Macedonia
Ministry of Finance

QUARTERLY ECONOMIC REPORT
Q-1-2012

Summary

- In Q1 2012, real GDP decreased by 1.4% on annual basis. Such decline was partly due to the high comparative basis , i.e. the high economic growth of 6.3% registered in the same quarter in the previous year, partly due to the decreased external demand resulting in high drop of industrial production, as well as the bad weather conditions, predominating within certain period of time in the respective quarter;
- Unemployment rate in Q1 2012 amounted to 31.6%, while employment rate accounted for 38.6%.
- Inflation rate in Q1 2012 experienced slowed down growth of 2.6% compared to the same quarter in 2011, measured according to CPI;
- Average gross salary in Q1 2012 amounted to Denar 30,634, increasing by 0.8% in nominal terms, while it declined by 2.6% in real terms.
- Total budget revenues were higher by 1.2% in Q1 2012 and total budget expenditures surged by 3.4% compared to the same quarter in 2011;
- Quarterly growth of total deposit potential of banks in Q1 2012 amounted to 1.7%, while credit activity of banks to non-government sector experienced growth rate of 1.8% on quarterly basis;
- Macedonian Stock Exchange Index MSEI -10 increased by 2.6% compared to December 2011;
- In Q1 2012, on annual basis (Q/Q-4), contraction of export by 2.7% and import by 7.3% was registered, whereby total foreign trade, expressed in euros, dropped by 5.5%;
- Trade openness of the Republic of Macedonia in Q1 2012 was 105.4%, experiencing downward trend compared to the same quarter in the previous year by 7.2 p.p..

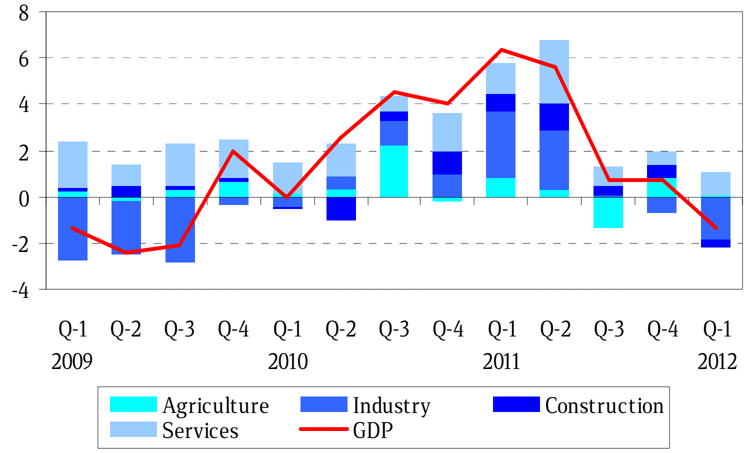
1. Macroeconomic Trends and Real Sector

In Q1 2012, real GDP dropped by 1.4% on annual basis. Such decline was partly due to the high comparative basis , i.e. the high economic growth of 6.3% registered in the same quarter in the previous year, partly due to the decreased external demand resulting in high drop of industrial production, as well as the bad weather conditions, predominating within certain period of time in the respective quarter.

Nominal GDP growth in Q1 2012 accounted for 0.9% compared to the same quarter last year, implying that GDP deflator amounted to 2.3%.

Real GDP growth in Q1 2012 compared to the previous quarter accounted for -20.2%, being to a great extent due to the negative seasonal effects. Accordingly, seasonally adjusted quarterly GDP growth in Q1 amounted to -1.1%.

Chart 1.1 GDP by production approach - contribution to growth; Source: SSO and calculations of MoF



Analyzed according to the GDP production side, highest growth in Q1 2012 was seen in the sector restaurants and hotels - 5.8%. Sector financial services realized positive growth rate second quarter in a row, accounting for 3% in Q1 2012. Sector public administration continued its moderate positive growth in Q1 2012 as well, experiencing 2.3% growth rate. Agriculture sector increased by 1%, while trade sector experienced slight growth of 0.3%. Transport, storage and communications sector experienced negative but minimum growth of 0.1%, arising from the industrial activity drop.

Industry sector experienced a decline by 9.6%, following the drop of 4.1% in the previous quarter, coinciding with significantly slowed down activity of EU economy in the past two quarter, within which some of the countries registered economic activity drop.

Construction sector following the high growth rates in the previous quarters, decreased by 9.8% in Q1 2012, corresponding to the drop of value of carried out construction works. This was mainly a result of the bad weather conditions, predominating in this period, as well as the high comparative basis, given that high growth of around 22% was realized in the previous year.

Reduction of industrial production[1] rate in Q1 2012 was mainly due to the decrease of the production of coke and refined oil materials (49.1%), production of electrical equipment (47.5%), production of motor vehicles (27.3%), mining and quarrying (24.8%), production of furniture (22.9%), production of other non-metal minerals (22.6%),

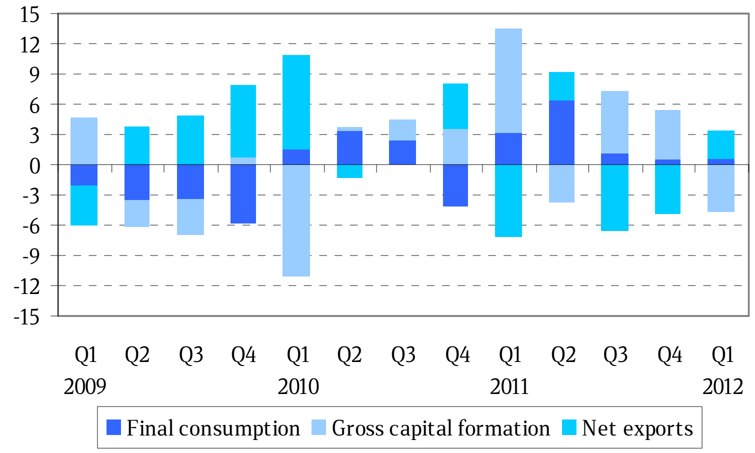
[1] Calculated on the basis of monthly releases of Industrial Production Index.

production of clothing (19.6%), supply of electricity (17.6%), production of chemicals and chemical products (14.6%), mining and quarrying (10.4%) and production of basic pharmaceutical products (1.6%). From the point of view of the structure of industrial production index, 66.9% of the branches experienced drop.

On the other hand, growth was observed at the following: production of fabricated metal products (50.1%), production of leather – (39.3%) , production of rubber products (26.9%), production of machines and devices – n.e.c (21.9%), production of tobacco (16.8%), production of textile (13.7%), mining of metal ore (5.2%), production of food products (5.2%) and production of beverages (4.6%).

Analyzed according to the expenditure side, fiscal consumption in Q1 2012 increased by 0.5%, being due to the increase of personal consumption by 0.7%. Public consumption had neutral contribution to the increase of final consumption, unlike the negative contribution of public consumption in the previous two quarters.

Chart 1.2 GDP by expenditure approach - contribution to growth; Source: SSO and calculations of MoF

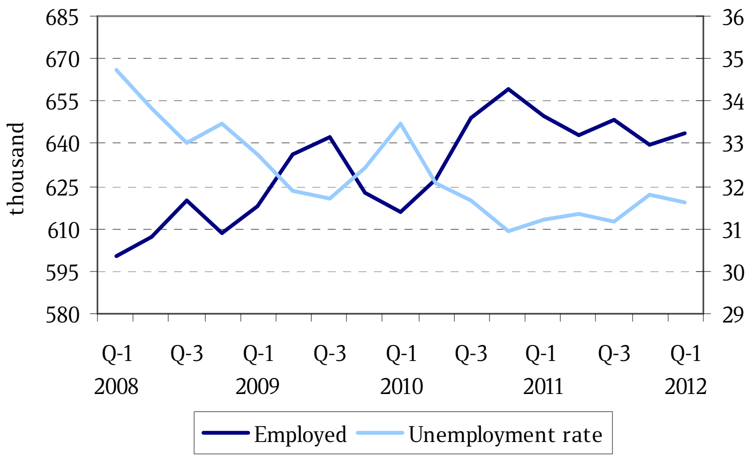


Increase of public consumption is in line with the trends in trade, being underpinned by the high increase of private transfers (in the first two months of the year) and the acceleration of the increase of crediting to households.

Gross investments in Q1 2012 dropped by around 19% being to a great extent a result of the high comparative basis, i.e. the huge growth (65.6%) of gross investments in the same quarter in the previous year. Drop of gross investments coincides with the drop of activity in the construction, drop of production of capital goods and similar.

Decreased external demand also resulted in drop of foreign trade, whereby export of goods and services decreased by 1.6% and consequently, the import declined by 2.8% on real basis.

Chart 1.3 Number of employed and unemployment rate; Source: SSO

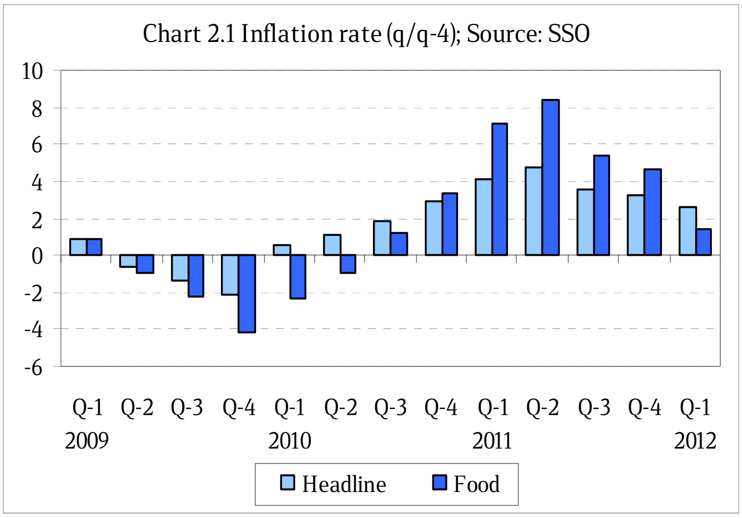


According to the Labour Force Survey, number of employed persons in Q1 2012 increased by 0.7%

compared to the previous quarter, while compared to the same quarter in the previous year, number of employees decreased by 0.9%. Accordingly, number of unemployed persons in Q1 2012 was lower by 0.2% compared to the previous quarter, while compared to the same quarter in the previous year, number of unemployed persons was higher by 0.9%. Hence, active population in Q1 2012 increased by 0.4% on quarterly basis, i.e. it was lower by 0.3% on annual basis.

Employment rate in Q1 2012 accounted for 38.6%, being slight increase compared to the previous quarter, when it accounted for 38.5%. Unemployment rate in Q1 2012 amounted to 31.6%, being lower by 0.2 p.p. compared to the previous quarter, being higher by 0.4 p.p. compared to the same quarter in the previous year. Active population in Q1 2012 accounted for 56.4% of total working-able population.

2. Prices, Costs and Productivity



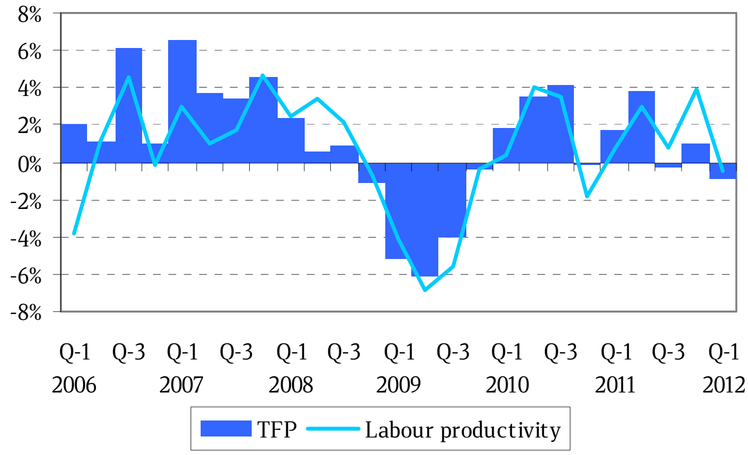
Inflation rate, measured according to CPI, was 2.6% in Q1 2012 compared to the same quarter in 2011, being slowed down increase compared to the previous quarter (3.2%). Highest price increase was registered in the in the housing category – 6.8%, being mostly due to the increase of heating prices by 10.3% and the electricity prices by 11.6%. Increase of prices in the food category significantly slowed down, from 4.7% in Q4 2011 to 1.4% in Q1 2012. Means of transport and services category grew by 3.6%, being to a great extent a result of the increased prices of liquid fuels and oils, while prices in restaurants and hotels category were higher by 3%. Growth was seen in the categories hygiene and health – 1.8%, clothing and footwear - 1.6%, administrative and financial services – 1%, culture and entertainment – 0.7%. Prices in category tobacco and beverages remained unchanged.

Core inflation (which excludes the effect of food and energy) was 1.3% in Q1 2012, being higher by 0.3 p.p. compared to the core inflation in the previous quarter.

Retail prices in Q1 2012 increased by 3.2% compared to the same quarter in 2011. Prices of industrial products, which surged by 4.4%, contributed the most with 2.4p.p. to the total increase of the retail prices. Within this category, highest price increase was recorded at non-food products – 6%. Prices of food products surged by 2.4%. Retail price of beverages increased by 0.4%. Retail prices in agricultural products category experienced slight decrease by 0.1%.

Average net salary in Q1 2012 amounted to Denar 20,897, being higher by 1% in nominal terms, compared to same quarter in 2011. On real basis, net salary dropped by 1.4% (shaded field in Chart 2.2). Average gross salary amounted to Denar 30,634, increasing by 0.8% in nominal terms, while it dropped by 2.6% in real terms.

Chart 2.2 Labour productivity and TFP growth; Source: SSO and calculations of MoF



Economic activity drop in Q1 2012 was also accompanied by the drop of the number of employed persons. However, drop of employment was more moderate than the decrease of economic activity, resulting in decline of the labour productivity by 0.4%, followed by the increase by 3.9% in the previous quarter. In fact, in Q1 2012, physical capital experienced minimum increase by 0.1%. Such tendencies of growth factors caused for total factor productivity (TFP) to decrease by 0.8% in Q1 2012, followed by the increase by 1% in the previous quarter. Chart 2.2 shows TFP and labour productivity trends.

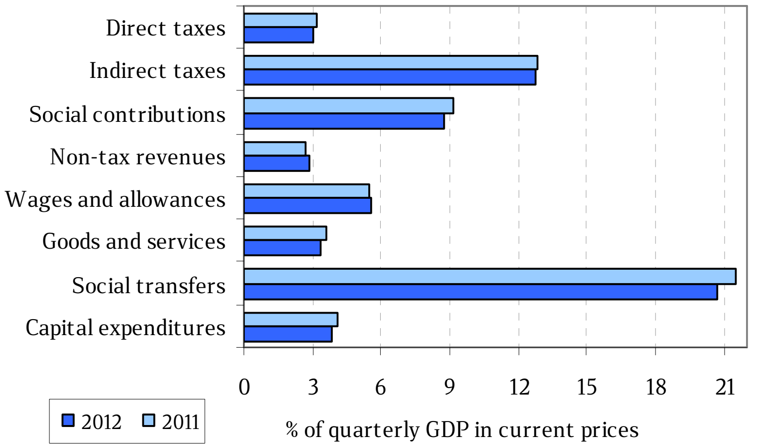
3. Fiscal Sector

Higher performance of budget revenues was observed in Q1 2012, compared to same quarter in 2011, accompanied by relatively higher budget expenditures. Budget deficit was in the amount of Denar 4,528 million in Q1 2012, being 4.4% of GDP realized in this quarter (central budget deficit amounted to Denar 3,475 million, i.e. 3.3% of GDP, surging by 1.2 p.p. compared to the previous quarter).

Counter-cyclical fiscal policy continued to be implemented in the first quarter in 2012, aimed at mitigating the consequences from the global economic crisis on Macedonian economy and maintaining macroeconomic stability. Thereby, fiscal sustainability of public finance was not jeopardized.

Total budget revenues were higher by 1.2% compared to the same quarter in 2011, being mostly due to the higher performance of contributions by 3.4%, while tax revenues realized more moderate growth, i.e. they increased by 1.2% and at the same time, non-tax revenues were lower by 7.0%. Thereby, insignificantly lower collection of both VAT and excises was seen, while collection of personal income tax and profit tax realized moderate growth, i.e. higher increase of revenues than customs duties by 15.2%. VAT revenues dominated, accounting for 53.8% of the total tax revenues, being lower by 0.4% in Q1 2012 compared to the same quarter of 2011, i.e. they were lower by 13.7% than the performance in the previous quarter. Regarding the structure of gross VAT revenues, there was an increase in VAT collection on the basis of import, while VAT on the basis of sales in the country dropped by 4.3% in line with the trade sales, and dynamics of VAT refund was also intensified by 4.0%. Excise revenues were lower by 0.7% compared to the same quarter in 2011. As for direct taxes, profit tax increased from 4.8% to 23.5 p.p. compared to the previous quarter (one should take into account that starting April 2010, revenues on the basis of tax paid for dividend and other distribution of profit are recorded, participating with significant percentage in the structure of this tax). Revenues on the basis of personal income tax were higher by 2.5% compared to the previous year. Observed from the point of view of structural share of GDP, direct taxes reduced their share in GDP by 0.2 p.p. on annual basis, while indirect taxes surged by 0.1 p.p..

Chart 3.1 Budget revenues and expenditures in Q-1-2012; Source: MoF



Collection of social contributions was higher by 3.4%, whereby higher collection was recorded at all contributions, i.e. pension insurance contributions - 3.0%, health insurance contributions - 4.1% and employment contributions - 3.6%. Non-tax revenues, accounting for 2.7% of total quarterly GDP, were lower by 7.0% compared to the same period in 2011.

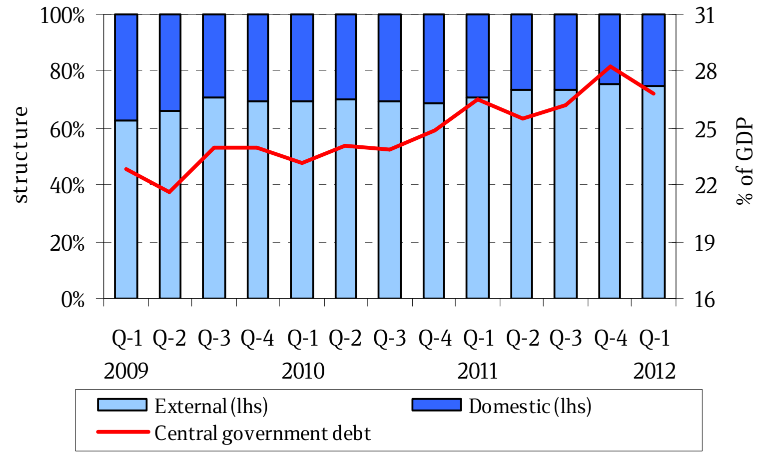
Capital revenues in Q1 2012 were higher by 40.2% on annual basis (these revenues include revenues on the basis of lease of construction land, as well as sale of flats and revenues on the basis of dividends). Revenues on the basis of grants were higher by 21.2%, compared to Q1 2012.

Total **budget expenditures** in Q1 2012 were higher by 3.4%, compared to the same quarter in 2011. Current expenditures, accounting for 88.4% of the total expenditures, increased by 3.1% on annual basis. Capital expenditures participating with 11.6% in the total expenditures were higher by 5.0% compared to Q1 2011, whereby their performance in Q1 2012 was with better dynamics than in the previous years. As for current expenditures, expenditures for goods and services increased by 7.0%, while expenditures related to salaries and allowances experienced relatively moderate drop, i.e. they decreased by 1.3% compared to the same quarter last year. Funds for transfers, participating with 61.0% in the total expenditures, were higher by 3.0% on annual basis, while the share of the category „Other Transfers" in the total transfers accounted for 22.3% (including transfers to local government - block and earmarked grants, as well as other subsidies and transfers). Transfers to the Pension and Disability Insurance Fund, accounting for 27.8% in total expenditures, were higher by 6.1% compared to the same quarter in 2011, i.e. they were lower by 0.7% compared to Q4 2011. Interest-related expenditures increased by 48.0%, whereby domestic debt interest-related expenditures surged by 23.5%, and expenditures related to interest on foreign debt surged by 77.8%.

Fiscal burden, measured as participation of budget revenues [2] in relation to nominal GDP, was 27.3% in Q1 2012, increasing by 0.7 p.p. in relation to Q4 2011. Total budget expenditures accounted for 34.9% of GDP, which was by 4.7 p.p. higher compared to Q4 2011.

Total central government debt at the end of Q1 2012 accounted for 26.8% of GDP, decreasing by 1.4 p.p. compared to Q4 2011. Share of central government external debt in the total central government debt decreased by 0.8% compared to Q4 2011, while share of central government domestic debt in the total central government debt surged by the same amount. Hence, share of central government domestic debt increased to 25.1% of the total central government debt. Such trends point out that additional borrowing, which is inevitable for conducting more expansive fiscal policy, whether externally or internally, would not jeopardize fiscal sustainability, whereby coordination with monetary policy is needed. Sound fiscal policy is one of the Maastricht Criteria for convergence, having the limits set at budget deficit of 3% of GDP and government debt of 60% of GDP.

Chart 3.2 Central government debt and its structure; Source: MoF



4. Monetary and Financial Trends

In the first quarter of 2012, monetary policy remained the same. NBRM retained the reference interest rate at 4% in conditions of favourable macroeconomic climate and weakened inflationary pressures as a result of the slow down of the increase of food prices.

Primary money[3] in Q1 2012 dropped by 9%, in conditions of decline of both ready money in circulation and total liquidity of banks by 7.3% and 10.3%, respectively.

During the first quarter of 2012, there was slowdown of the quarterly increase of money supply and total deposit potential of banks. Narrowest money supply M1 experienced quarterly drop of 3.2% compared to Q4 2011, as a result of the drop of ready money in

[2] It included tax revenues, social contributions and administrative fees and duties and road toll

[3] It includes ready money in circulation (including cash in hand of banks), denar and foreign currency reserve requirement and the surplus of liquid assets over the reserve requirement (in denars)

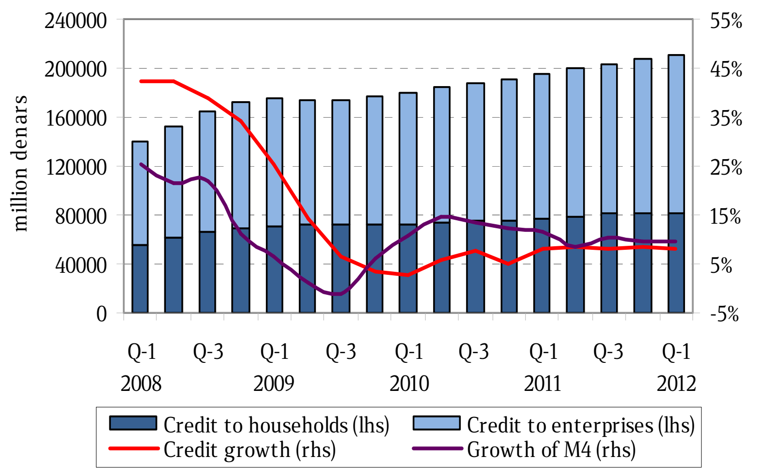
circulation and deposit money by 7.5% and 1.2% respectively. Broader monetary aggregates M2 and M4 experienced slowed down increase by 0.2% and 1% respectively in Q1 2012, compared to the previous quarter as a result of the decrease of foreign currency deposits.

Increase of total deposit potential[4] of banks slowed down in the first quarter of the year, being a result of the drop of foreign currency deposits. Thus, on quarterly basis, total deposits surged by 1.7% compared to 3.4% in Q4 2011. New saving was in domestic currency as a whole, within drop of foreign currency deposits. In fact, Denar deposits increased by 4.7% on quarterly basis, while foreign currency deposits reduced by 1.5% due to the decrease of foreign currency savings of enterprises and households.

From the point of view of sectors, deposits of households increased by 2%, while deposits of enterprises increased by only 0.7%. New saving by households was fully in domestic currency, having positive contribution to the further decrease of the level of euroization by 47.2% (from 48.7% in Q4 2011) measured through the share of foreign currency deposits in total deposit potential.

According to maturity, short-term deposits increased by 1.6% in Q1 2012 compared to the previous quarter, while growth of long-term deposits accelerated to 5.3% (5% in Q4 2011).

Chart 4.1 Credits, credit growth and growth of M4 (q/q-4);
Source: NBRM



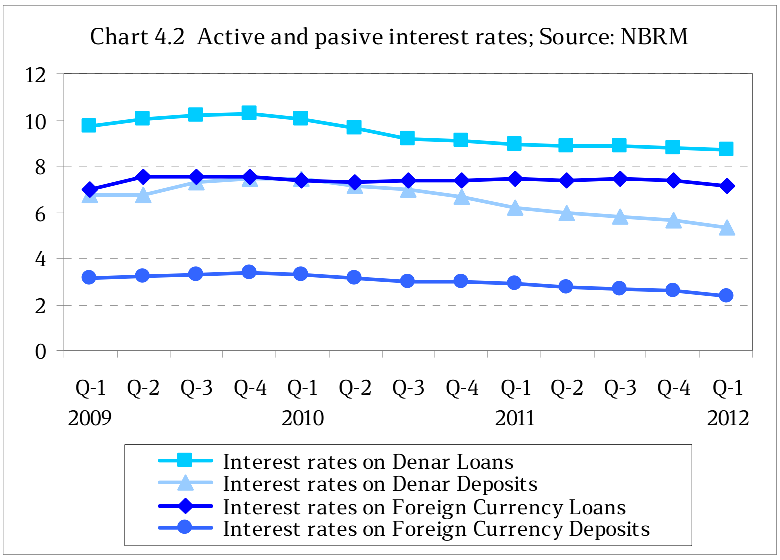
Credit activity of banks to non-government sector, in Q1 2012 experienced growth rate of 1.8% on quarterly basis, in conditions of increased crediting to corporate sector and households sector. Increased crediting to private enterprises by 2.5% (contributing with 80.5%) had dominant contribution to growth of credit activity, while growth of credits to households slowed down to 0.8% compared to Q4 2011.

From currency point of view, foreign currency credits showed slowed down growth of 1% on quarterly basis (compared to the growth of 3.4% in Q4 2011). Denar credits surged by 2.2% on quarterly basis in Q1 2012.

From maturity point of view, long-term credits remained to be the main driving force of the new crediting on quarterly basis, increasing by 2.1% in relation to Q4 2011, while short-term credits remained unchanged.

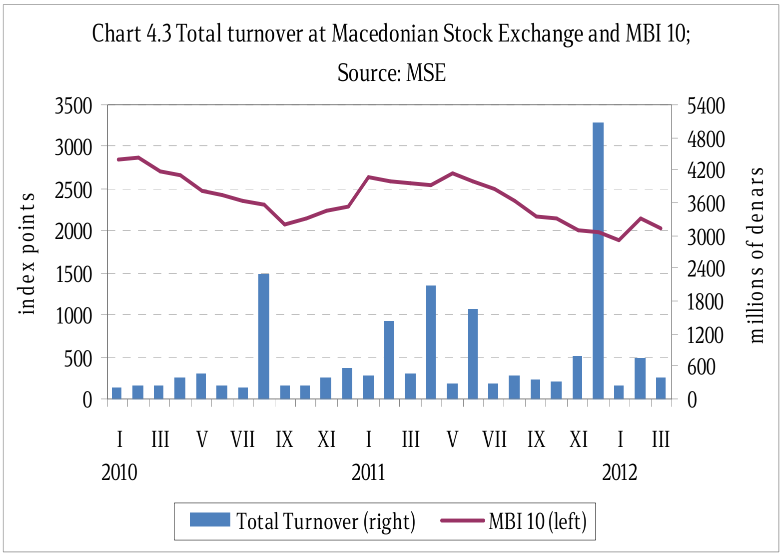
[4] Deposits also include calculated interest.

In the first quarter in 2012, NBRM kept the reference interest rate unchanged at 4%. Interest rates of deposit banks in Q1 2012 experienced certain movement. In fact, interest rate on Denar credits of deposit banks reduced by 0.1. p.p. on monthly basis, amounting to 8.7%. Thus, the downward trend of this interest rate, which started at the beginning of 2010 continued. Interest rate on foreign currency credits, following the registered longer period of stability, reduced by 0.2 p.p., accounting for 7.2%. On the other hand, interest rates on Denar and foreign currency deposits reduced by 0.3 p.p. and 0.2 p.p. respectively on quarterly basis, accounting for 5.4% and 2.4% respectively.



Thus, interest rate on newly approved Denar credits was 7.9%, showing 0.3 p.p. decline on quarterly basis, while interest rate on newly approved foreign currency credits significantly declined by 0.4 p.p., amounting to 6.7%. Interest rate on newly approved Denar deposits experienced high drop by 0.5 p.p. compared to Q4 2011, accounting for 3.2%, while interest rate on new foreign currency deposits remained the same, amounting to 0.8%.

As for the capital market, in the first quarter of the year, there was increase in sales realized through traditional trading by 22.8% compared to Q4 2011. However, as a result of the lower amount of block transactions, total sales decreased by 77.9% on quarterly basis. Compared to the same period last year, traditional trading dropped by 15.2%.



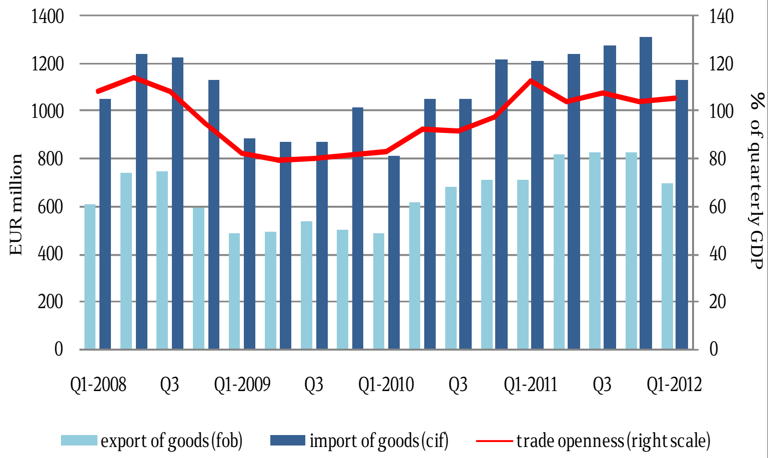
Macedonian Stock Exchange Index MSEI-10, as aggregate indicator of stock exchange trends, increased by 2.6% compared to December 2011, while compared to March 2011, it dropped by 21.2%.

5. External Sector and Balance of Payments

In Q1 2012, total trade with abroad (f.o.b. basis) amounted to EUR 1,782 million, experiencing downward trend by 5.5% compared to the same quarter in 2011, as a result of the high comparative basis of the same quarter in the previous year when total trade with abroad (f.o.b. basis) was the highest observed from 2003 onwards.

In Q1 2012 export of goods amounted to EUR 693.5 million and compared to the same quarter of the previous year, it contracted by 2.7% as a result of the high comparative bases in the first quarter of the previous year, when export was one of the highest observed from 2003 onwards.

Chart 5.1 External trade and trade openness;
Source: SSO and calculations of MoF



Analyzed by SITC sectors (Standard International Trade Classification), positive trends in the export were registered at the following:

-machines and transport equipment by 49.9% (within which category of industrial machines and spare parts surged by 203.9% or EUR 21.4 million);

-beverages and tobacco by 34.6% (beverages by 76% or EUR 8.2 million and tobacco by 14.4% or EUR 3.2 million).

On the other hand, negative trends in export, compared to Q1 2011 were seen at the following:

- mineral oils and lubricants by 8.4% (within which category oil and oil products reduced by 4.3% or EUR 2.0 million);

-chemical products by 10.1% (chemical materials and metal products by 11.2% or EUR 12.9 million);

-- products classified by material by 6.1% (iron and steel by 3.8% or EUR 6.1 million and metal processings by 38.7% or EUR 3.9 million),

-food products by 7.9% (fruit and vegetables by 27.7% or EUR 6.5 million).

In Q1 2012, observed by economic purpose, the following products were most exported: goods for industrial production (51.7%), followed by personal consumption goods (32.2%), investment goods (9.3%) and energy (6.9%).

Import of goods (f.o.b.) in Q1 2012 amounted to EUR 1,088.5 million, contracting by 7.3% (EUR 85.5 million) compared to Q1 2011, while in relation to the previous quarter, it contracted by 14%.

Analyzed by SITC sectors, most positive movement of import in Q1 2012, compared to Q1 2011, was seen at:

- mineral oils and lubricants by 25.8%, whereby category electricity grew by 65% or EUR 29.2 million, being mainly due to the low temperatures, while category gas- natural or industrial ones increased by 61.3% or EUR 15.3 million.

- beverages and tobacco by 82.4%, whereby category tobacco and tobacco processed goods increased by 203.1% or EUR 6.3 million.

- raw materials except fuel by 16.6%, whereby category metal ore and metal scrap surged by 20.5% or EUR 8.7 million.

- Food products by 6.7%, whereby category cereals and cereal processings increased by 24.7% or EUR 4.6 million, while category meat and meat products grew by 17.9% or EUR 3.8 million.

Most negative movement of import in Q1 2012 was seen at the following:

- products classified according to the material by 24.1% (whereby decrease was seen at the following categories: non-ferrous metals by 47.5% or EUR 52.3 million; iron and steel by 32.9% or EUR 27 million; textile yarns and similar by 5.6% or EUR 4 million);

- chemical products by 26.9% (tar and raw chemicals by 70% or EUR 28.6 million; colours and tanning substances by 43.1% or EUR 12.5 million; chemical materials and metal products by 36.1% or EUR 9.8 million);

- machines and transport equipment by 7.0% (within which category electrical machines and spare parts by 21.3% or EUR 8.3 million; industrial machines and spare parts by 11.0% or EUR 3.3 million; road vehicles by 3.4% or EUR 2 million).

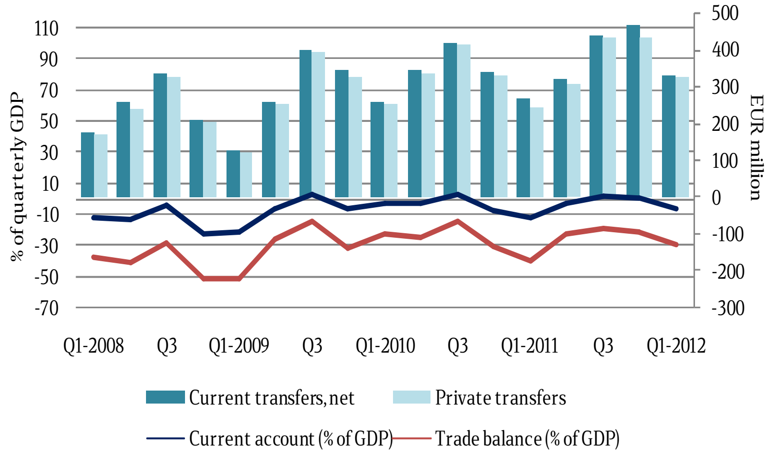
However, the numbers should be taken with caution since they include the base effect of the first quarter last year.

Observed by economic purpose in Q1 2012, goods for industrial production (35.9%) were most imported, followed by: energy (27.1%), personal consumption goods (23.2%) and investment products (13.8%).

Trade openness of the Republic of Macedonia in Q1 2012 amounted to 105.4%, narrowing compared to the same quarter in 2011 by 7.2 p.p., as a result of the decrease of trade and the realized negative growth rate at the level of GDP in this quarter.

In Q1 012, foreign trade of the Republic of Macedonia with the European Union

Chart 5.2 Analysis of Current account;
Source: NBRM



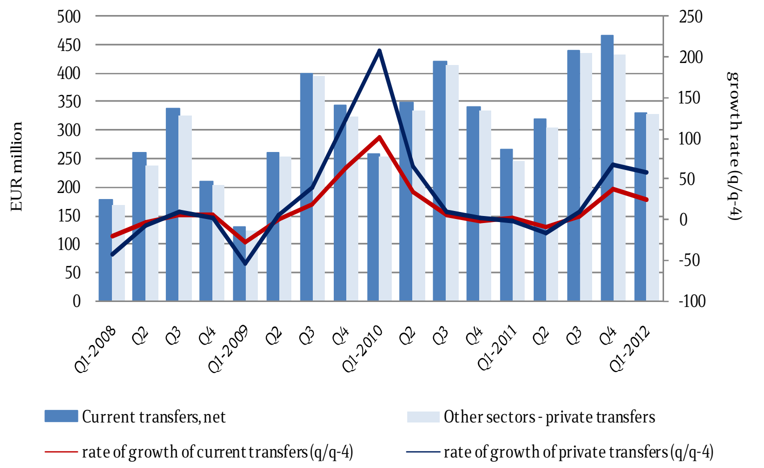
(EU 27), in relation to the same period in the previous year, reduced by 8.4%, whereby share of trade with EU in the total foreign trade remained at same level as in the same period in 2011, accounting for 57.8%, whereby export of goods participated with 64.8% and import of goods accounted for 53.6%. As a result of the structural changes in the trade with abroad, in the first quarter of 2012, 71% of the trade deficit of the country was a result of the trade deficit with Serbia, Russia, Great Britain and Greece, while the rest of the deficit was a result of the trade with: China, Turkey, Bulgaria, Switzerland, Slovenia, etc. Trade surplus was realized with Germany, Albania, Montenegro, Belgium, Bosnia and Herzegovina, Korea, etc.

In Q1 2012, current account deficit was realized, amounting to EUR 99.7 million or -5.9% of GDP, compared to the deficit realized in the previous quarter (Q4 2011) amounting to EUR 12 million. Compared to the same quarter in 2011, negative gap in the current account was narrowed by 50.1% (EUR 200.3 million deficit in Q1 2011 compared to EUR 99.7 million deficit in Q1 2012).

In Q1 2012, the balance of services experienced deficit in the amount of EUR 9.8 million, decreasing by EUR 29 million compared to Q1 2011.

On the other hand, net current transfers higher by 24.3% or in the absolute amount of EUR 330.7 million, contributes to the reduced current account deficit in Q1 2012 by 50%.

Chart 5.3 Overview of official and private transfers;
Source: NBRM



In Q1 2012, trade balance (-23.4% of GDP) experienced negative movement compared to the previous three quarters in 2011 and positive movement compared to the first quarter in 2011 (when trade balance amounted to -27.6% of GDP).

Trends of export and import in Q1 2012 was with significantly reduced intensity compared to the previous three quarters, whereby negative growth rates were realized and such trends contributed for the level of trade deficit in relation to GDP to deepen compared to Q4 2011 and Q3 2011.

In the same quarter, net current transfers increased by 24.3% in relation to Q1 2011, being a result, to a great extent, of the higher private transfers. Private transfers registered an increase of 33.9% (EUR 83 million), continuing to have dominant share (99%) in the current transfers.

Report prepared by:

Ministry of Finance
Macroeconomic Policy Department

Anita Popovska MA
Angela Vasovska
Aneta Acevska
Koprinka Sapunova
Nedjati Kurtishi

Checked by:

Sanja Kikovska-Georgievska PhD

Approved by:

Jordan Trajkovski

Jordan.Trajkovski@finance.gov.mk

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