

Republic of Macedonia  
Ministry of Finance

QUARTERLY ECONOMIC REPORT  
Q2/2011

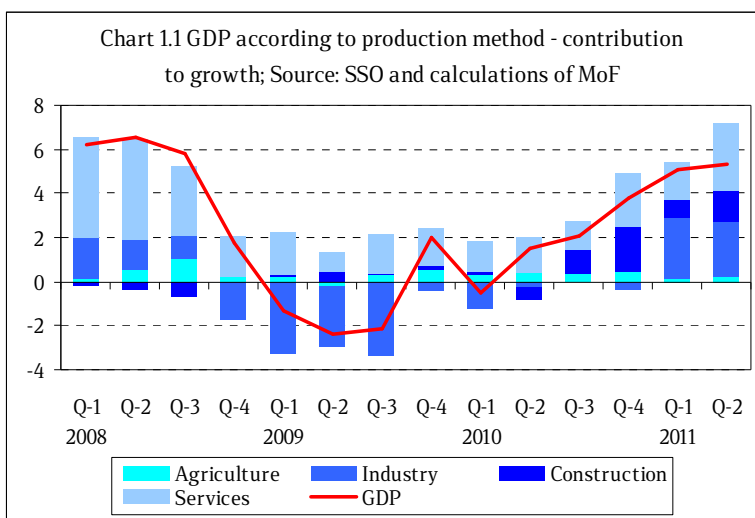
Summary

- Real **GDP** growth reached 5.3% in Q2 2011 in relation to the same quarter in 2010. Except for financial intermediation, all other sectors registered growth, construction sector and trade sector experiencing the highest growth of 26% and 18% respectively;
- Number of **employed persons** in Q2 2011 was higher by 2.5% compared to the same quarter in 2010. Such growth was also accompanied by decrease of the number of **unemployed persons** by 0.9%.
- **Inflation rate** in Q2 2011 amounted to 4.7% compared to the same quarter of 2010, measured according to CPI.
- Average **gross salary** in Q2 2011 amounted to Denar 30,633, experiencing nominal growth of 1.3%, while it declined by 3.2% in real terms.
- In Q2 2011, **total budget revenues** experienced higher performance by 11.5% and total **budget expenditures** increased by 16.8% compared to the same quarter in 2010;
- **Deposits** continued to increase in Q2 2011, realizing growth rate of 9.2% compared to the end of Q2 2010, and 1.6% compared to the previous quarter; **Credits to private sector** showed upward trend, increasing by 8.6% in relation to end of Q2 2010, and by 3% on quarterly basis;
- **Macedonian Stock Exchange Index MSEI -10** in June 2011 increased by 7% compared to June 2010. Turnover realized on the Macedonian Stock Exchange through traditional trading in Q2 2011 surged by 5% compared to the same period in 2010;
- In Q2 2011, significant increase of both **export** by 27.5% and import by 15.8% was registered on annual basis, whereby **total foreign trade** expressed in euros, surged by 20.2%;
- **Trade openness** of the Republic of Macedonia in Q2 2011 was 101%, pointing out to increase of the level compared to the same quarter in the previous quarter.

## 1. Macroeconomic Trends and Real Sector

**Real GDP growth** in Q2 2011 amounted to 5.3% compared to the same quarter in 2010, showing further growth acceleration, following the growth rate of 5.1% in Q1 2011. **Nominal GDP growth** in Q2 2011 accounted for 12%, compared to the same quarter in the previous year, implying that GDP deflator was 6.4%. Real GDP growth in Q2 2011 compared to Q1 2011 amounted to 14.4%, being mainly due to the seasonal effects. Accordingly, the seasonally adjusted quarterly GDP growth in Q2 2011 amounted to 1.8%.

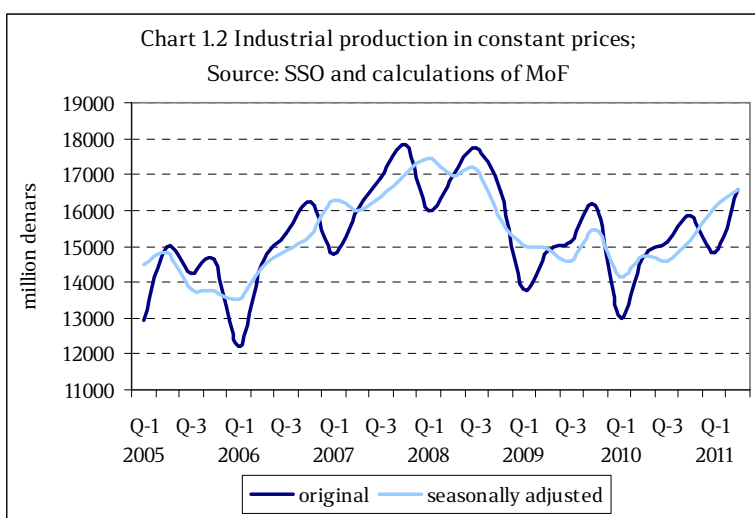
According to the **production side of GDP**, the highest annual real growth rate in Q2 2011 was registered in the construction sector - 26%. What is indicative for the growth of the activity in the construction is also the high performance of capital budget expenditures, being higher by around 80% in Q2 2011, compared to the same quarter in the previous year.



Retail and wholesale trade registered growth rate of 18% on annual basis, showing growth acceleration in this sector, compared to the growth rate of 6.8% realized in the previous quarter. Positive trends in trade were mostly due to the recovery of wholesale trade and the solid growth of retail trade.

Hotels and restaurants sector and agriculture sector registered growth rate of 3.7% and 2.5% respectively. Positive contribution to growth was also registered in the public administration sector - 3%. Financial intermediation sector continued its trend of negative growth in Q2 as well, experiencing negative growth rate of 2%.

Industrial production in Q2 2011 realized significant growth of 12.8%, following the growth of 13.7% in the previous quarter. Performance in the industry was mainly a result of the great performance in the processing industry. Business trends in the

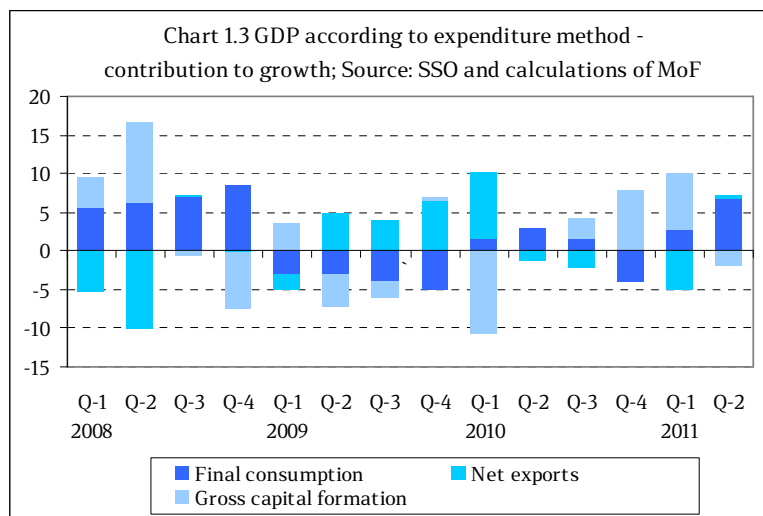


processing industry and the structural dynamics of import of goods in 2011 showed continuation of the sound growth rates in the industry sector. Transport, storage and communications sector did not follow the dynamics of industrial production, increasing by only 1%.

Growth in the **industrial production**<sup>1</sup> in Q2 2011 was mainly a result of the realized positive rates at: mining and quarrying (11.3%), production of tobacco products (26.7%), production of clothing (30.6%), printing and production of recorded media (7.5%), production of basic pharmaceutical products and pharmaceutical preparations (8%), production of furniture (141.7%), production of other non-metal products (14%), production of metals (21.4%), production of fabricated metal products (30.8%), production of electrical equipment (193.5%), production of machines and devices, not mentioned elsewhere (21.3%), production of other transportation equipment (159%) and production of rubber products (11.7%).

On the other hand, drop was recorded at electricity supply (12%), production of chemicals (9.4%), production of coke and refined oil products (6.8%), production of wood and wood products (22.9%), production of paper (18.1%). production of leather (39.3%), production of textile (19.1%), production of beverages (16.8%), production of food products (1.4%), production of motor vehicles, trailers and semi-trailers (9.9%), repair and installation of machines and equipment (84.8%) and other production industry (54%).

Analyzed according to the **expenditure side of GDP**, GDP growth was featured with positive contribution to domestic and net export demand. Export of goods and services experienced the highest real growth rate – 8.9%. Lower increase of import of goods and services by 4.5% implied positive contribution to net export in the economic growth. Thereby, certain slowdown of real growth of foreign trade was seen in Q2, despite the stable high nominal growth in the same period, as a result of the high increase of prices of stock market products.

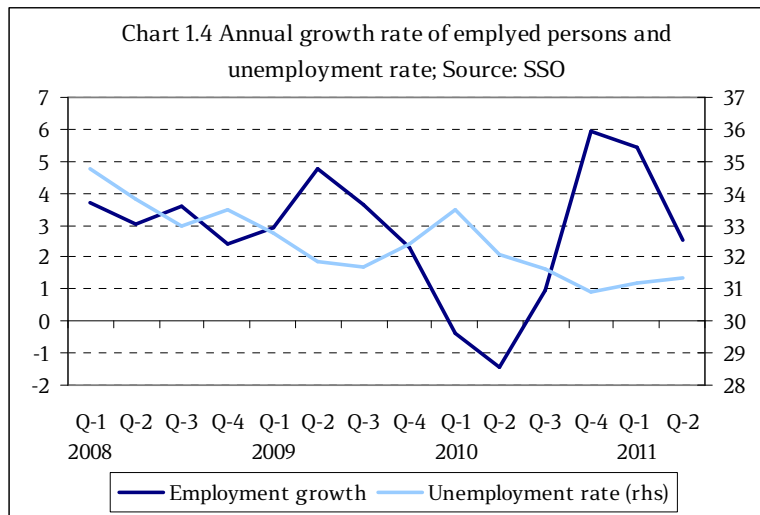


Positive contribution of domestic demand was a result of the personal consumption, increasing by 8.4% in Q2. Increase in the personal consumption is in line with the trends in the trade and VAT collection, as well as the growth of domestic production of consumer goods. On the other hand, public spending experienced slight decrease of 0.6%, following the drop of 3.2% in the previous quarter.

<sup>1</sup> Calculated on the basis of monthly releases of Industrial Production Index

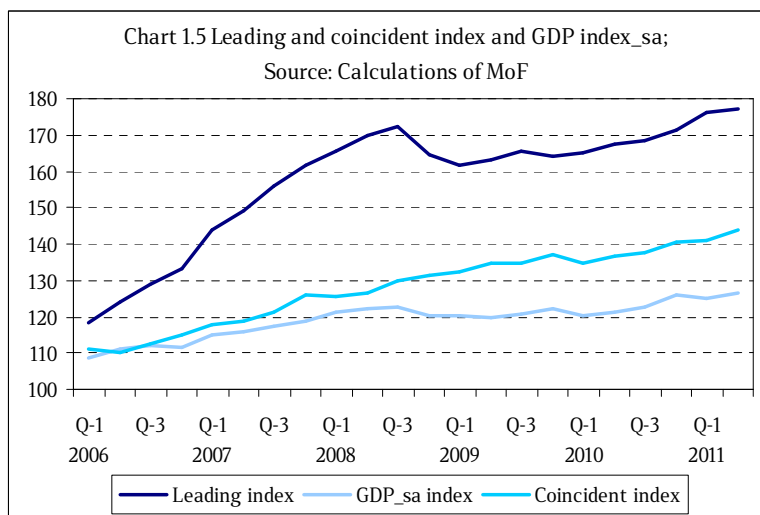
Gross investments, following the growth of 60% in the previous quarter, registered negative growth of 7.5% in Q2. However, indicators show positive trends of investments. Thus, domestic production of capital goods in Q2 experienced real growth of around 50%. Import of investment goods registered nominal growth of around 19%, while capital budget expenditures surged by around 80%.

According to the **Labour Force Survey**, number of employed persons in Q2 2011 was higher by 2.5% compared to the same quarter in 2010. Such growth was accompanied by decrease of the number of unemployed persons by 0.9% on annual basis. Growth of employment also absorbed significant reduction at the inactive population (0.8% drop) and certain increase at the working-able population (0.4% increase).



Such trends on the labour market caused for the **activity rate** in Q2 2011 to increase by 0.5 percentage points, compared to the same quarter in 2010, accounting for 56.6%. **Employment rate** increased to 38.8%, increasing by 0.8 p.p. compared to the same quarter in 2010, while **unemployment rate** dropped to 31.3% from 32.1% in Q2 2010 (see Chart 1.4). In fact, on net basis, increase in the number of employed persons in Q2 2011 was a result of the increase of working posts in the private sector, where number of employees increased by 6.2% on annual basis, while employment in the other parts of the economy decreased by 7.2%.

**Leading Composite Index**<sup>2</sup> in Q2 2011 increased by 1.2 index points, compared to the previous quarter. Compared to the same quarter in 2010,



<sup>2</sup>Prepared by the Ministry of Finance MakLead is an aggregate indicator, showing the trend of business cycle in advance. Index is comprised of eight leading indicators of the economic cycle: 1/average salary in processing industry; 2/average number of persons - beneficiaries of pecuniary allowance; 3/assessment by producers for their production stock for new orders; 4/index of agreed construction works; 5/ Stock market index MSEI -10; 6/money supply - M2; 7/interest differential and 8/total import reduced for the import of personal consumption

leading composite index was higher by 9.5 index points. As it is shown in Chart 1.5, dynamics of leading composite index registered certain slowdown in Q2 2011, pointing out that economic activity may experience growth with lower pace in the next half of the year.

**Leading diffusion index**<sup>3</sup> in Q2 2011 registered positive trends at 68.8% of the components of the leading composite index, showing identical performance compared to the previous quarter, and higher performance by 6.3 p.p. compared to the same quarter in 2010.

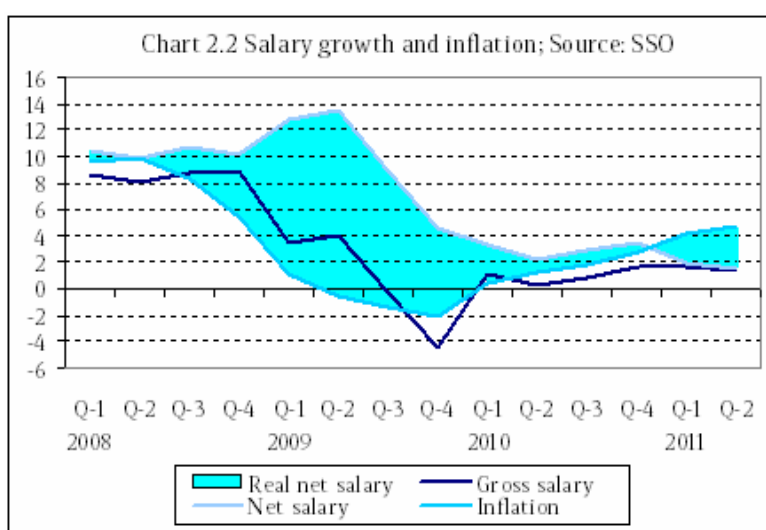
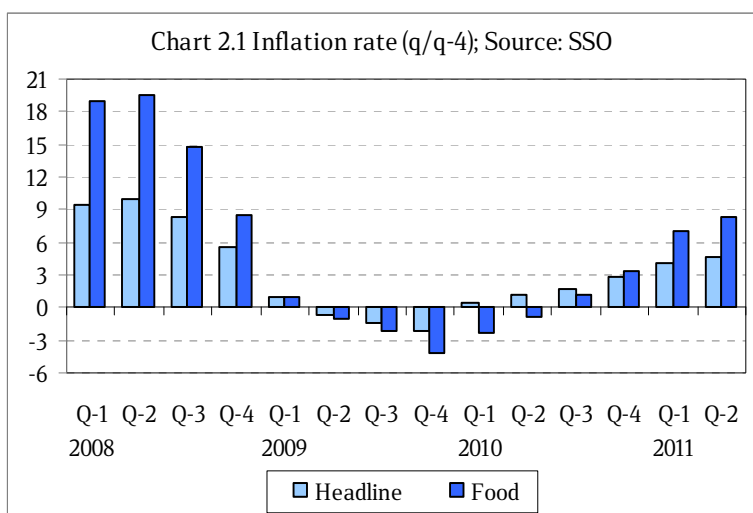
## 2. Prices, costs and productivity

**Inflation rate**, measured according to the CPI index, amounted to 4.7% in Q2 2011

compared to the same quarter in 2010 (4.1% in Q1 2011). Highest price increase was recorded at food category - 8.4%, followed by price increase in the category housing - 4.3%, mainly being driven by the increase of prices of electricity and lightening - 5.4%. Hygiene and health category increased by 3.5%, while category means of transport and services were higher by 2.8%, as a result of the higher prices of liquid fuels and oils. Price increase was also registered at hotels and restaurants (1.6%), clothing and footwear (1.4%), tobacco and beverages (1%) and administrative and financial services (2.4%). On the other hand, reduction of prices was observed only at the category culture and entertainment (-2.6%).

**Core inflation** (excluding the effect of food and energy) in the second quarter in 2011 was kept at relatively low level of 1.2%, compared to the previous quarter, when it amounted to 0.9%.

**Retail prices** in Q2 2011

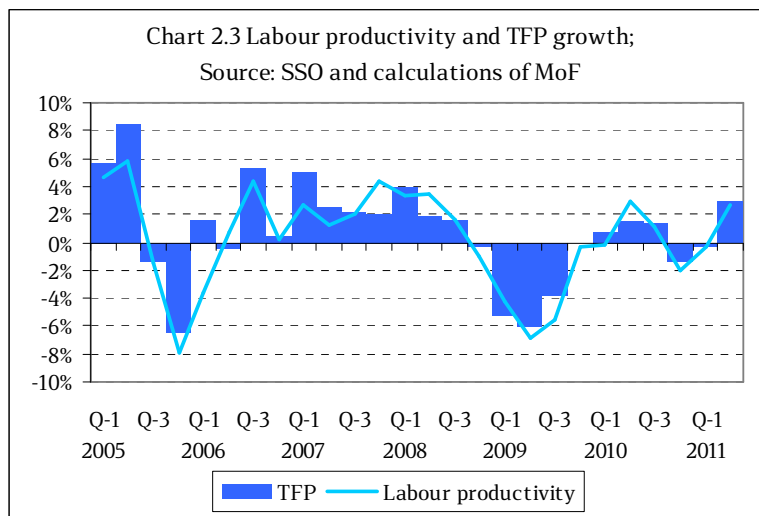


<sup>3</sup>Leading diffusion index measures the number (percentage) of components of the leading composite index, which increased in certain period

increased by 4.4% compared to the same quarter in 2010. Prices of industrial non-food products (contributing with 2 p.p.) contributed the most to the increase of the retail price index, which surged by 5.3% - mainly driven by increase in retail prices of liquid fuels and lubricants and prices of electricity and lightening. Retail prices of industrial food products increased by 7.3%, contributing with 1 p.p.. Agricultural products category experienced growth of 10.1% (contributing with 0.5 p.p.), while prices of services increased by 2.1%.

Average **net salary** in Q2 2011 amounted to Denar 20,864, being higher by 1.5% in nominal terms, compared to same quarter in 2010. On real basis, net salary dropped by 3.1% (shaded field in Chart 2.2). Average **gross salary** amounted to Denar 30,633, increasing by 1.3% in nominal terms, while it dropped by 3.2% in real terms.

High growth of economic activity in Q2 2011 was also accompanied by the increase of the number of employees. Thereby, higher growth of economic activity points out to increase of the **labour productivity**, by 2.7%, following the drop of 0.3% in the previous quarter. In fact, in parallel to the increase in the number of employees, physical capital also



increased by around 2% in Q2 2011. Such trends of growth factors caused for **total factor productivity (TFP)** to increase by 3.0% in Q2 2011, compared to the 0.3% decline in the previous quarter. Chart 2.3 shows TFP and labour productivity trends.

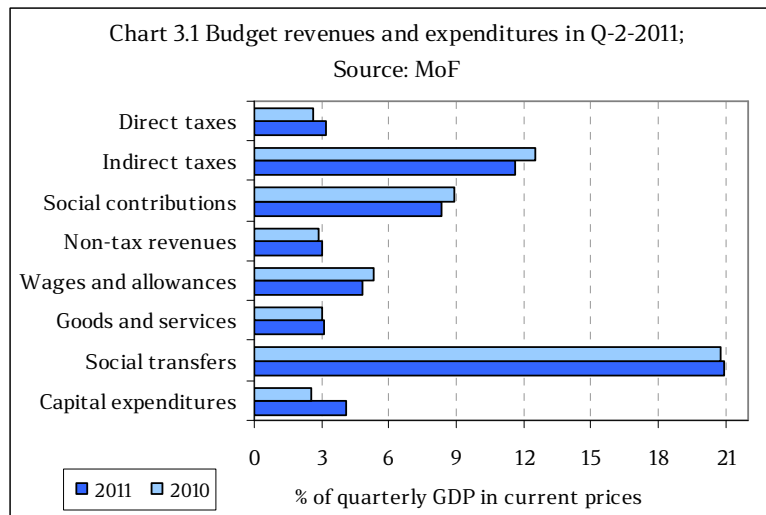
### 3. Fiscal Sector

Higher performance of budget revenues was observed in Q2 2011, compared to Q2 2010, accompanied by relatively higher budget expenditures. Budget deficit accounted for Denar 4,002 million in Q2 2011, being 3.4% of GDP realized in this quarter (central budget deficit amounted to Denar 2,921 million, i.e. 2.5%).

Anti-cyclical fiscal policy continued to be conducted in the second quarter of 2011 as well, aimed at mitigating the consequences of the global economic crisis on Macedonian economy and maintaining macroeconomic stability. Thereby, fiscal sustainability of public finance was not jeopardized.

Total **budget revenues** were higher by 11.5% compared to the same quarter of 2010, whereby tax revenues increased by 4.8%, while social contributions were higher by 5.3%, and non-tax revenues were higher by 20.5%. Thereby, higher collection of both the profit tax and the personal tax was seen, as well as moderate increase of the performance at VAT and excises. VAT revenues, covering 52.2% of the total tax revenues, were higher

by 4.2% in Q2 2011 compared to the same quarter of 2010, however, they showed more moderate dynamics (lower by 15.7 p.p. of the record performance in the previous quarter). Regarding the structure of gross VAT revenues, there was an increase in VAT collection on the basis of import, as well as increase of sales in the country in line with the trade sales, and dynamics of VAT refund was also intensified. Excise revenues were higher by 4.1%, compared to the same quarter in 2010, while collection of customs duties reduced by 46.4%. As for direct taxes, profit tax revenues increased by 2.4% (one should take into account that starting 2009, only profit distributed for dividend is taxed, and starting April 2010 revenues on the basis of tax on paid dividend and other distribution of profit is registered, participating with significant percentage in the structure of this tax).



Revenues on the basis of personal income tax were higher by 9.9%. Collection of social contributions was higher by 5.3%, whereby collection of pension insurance contributions increased by 5.6%, as for health insurance contributions, their collection surged by 4.4%, while collection of employment contributions grew by 6.5%. Non-tax revenues, accounting for 10.1% of total budget revenues, were higher by 20.5% in Q2 2011 compared to the same period in 2010.

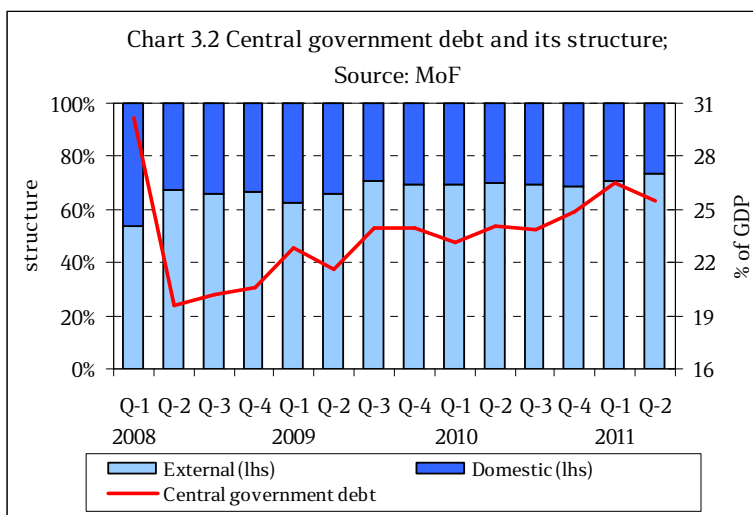
Capital revenues in Q2 2011 were higher by 7.6 times on annual basis, mainly on the basis of lease of construction land, as well as sale of flats. Revenues on the basis of donations were lower by 42.7%.

Total **budget expenditures** in Q2 2011 were higher by 16.8%, compared to the same quarter in 2010. Current expenditures, accounting for 87.8% of the total expenditures, increased by 11.4% on annual basis. Capital expenditures participating with 12.2% in the total expenditures were higher by 78.8% compared to Q2 2010, whereby their performance in Q2 2011 was with better dynamics than in the previous years, accounting for 20.9% of the total planned funds for 2011. As for current expenditures, expenditures for goods and services increased by 16.9%, while expenditures related to salaries and allowances remained stable, i.e. they increased by 2.4% compared to the same quarter last year. Funds for transfers, participating with almost 2/3 (62.3%) in the total expenditures, were higher by 12.9% on annual basis, while the share in the category "other transfers" in the total transfers amounted to 30.2% (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 24.5% in total expenditures, were higher by 4.5% compared to the same quarter in 2010. Interest-related expenditures increased by 11.5%, whereby domestic debt interest-

related expenditures dropped by 4.2%, and expenditures related to interest on foreign debt surged by 48.2%.

Fiscal burden, measured as participation of the budget revenues<sup>4</sup> in relation to nominal GDP, was 25.5% in Q2 2011, dropping by 1.9 p.p. in relation to Q1 2011. Total budget expenditures accounted for 33.6% of GDP, which was by 0.7 p.p. lower compared to Q1 2010.

Total central government **debt** at the end of Q2 2011 accounted for 25.5% of GDP, decreasing by 1.0 p.p. compared to Q1 2011. Share of central government external debt in the total central government debt increased by 2.5% compared to Q1 2011, while share of central government domestic debt in the total central government debt dropped by the same amount. Hence, share of



central government domestic debt decreased to 26.5% 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.

## 4. Monetary and Financial Trends

In the second quarter of 2011, there was not change in the set-up of the monetary policy. In conditions of reduced inflationary pressures and favourable macroeconomic climate, the reference interest rate remained the same compared to the previous quarter.

**Primary money<sup>5</sup>** in Q2 2011 increased by 2.4% compared to the previous quarter, following the seasonal drop, usually occurring in the first quarter of the year. Increase of primary money was a result of the increase in cash in circulation by 7.4%, while total liquidity of banks reduced by 1% on quarterly basis.

**Monetary aggregate M1** increased by 7.3% compared to Q1 2011 as a result of the increase of deposit money of enterprises and households, cash in circulation also

<sup>4</sup>It includes tax revenues, social contributions and administrative fees and duties and road toll

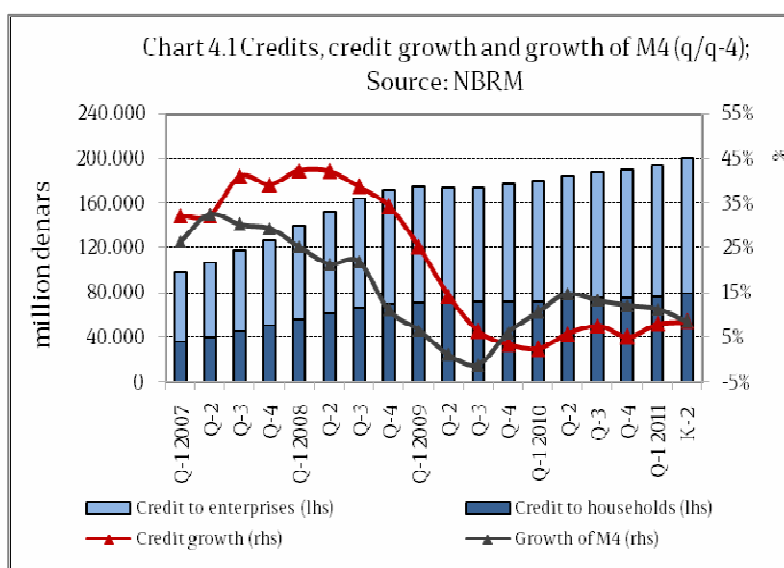
<sup>5</sup> It includes ready money in circulation (including cash in hand), denar and foreign currency reserve requirement and the surplus of liquid assets over the reserve requirement (in denars)



having positive contribution thereto. Broader monetary aggregates **M2 and M4** in Q2 2011 registered slow growth of 1.5% and 2% respectively compared to the previous quarter, which was under the influence of one-off factor, i.e. payment of dividend by large Macedonian economy to the foreign investor and the state in April 2011.

Total **deposit potential**<sup>6</sup> of the private sector increased by 1.6% on quarterly basis, being totally driven by the growth of deposits of households by 3.2%. On the other hand, deposits of private enterprises decreased by 2.6%, which was to a great extent due to the payment of dividends by a larger company to the foreign investor. The reduction was mainly seen at foreign currency short-term deposits of enterprises and at domestic currency deposits with currency clause.

From the point of view of currency, the new saving was dominantly in domestic currency (contributing with 61.8%) compared to the previous quarter. Domestic currency deposits increased by 2%, while growth of foreign currency deposits slowed down to 1.2%. Therefore, the level of euroization measured through the share of foreign currency deposits in the total deposit potential reduced to 51.1% (51.3% in Q1 2011).



From maturity point of view, short-term deposits in Q2 2011 dropped by 1.3% compared to the previous quarter (driven by the drop of short-term deposits of enterprises due to the fact with one-off effect mentioned above). Long-term deposits were higher by 7.3%.

**Credit activity of banks to non-government sector** in Q2 2011 continued to strengthen with registered growth rate of 3% on quarterly basis, being intensification in relation to the quarterly growth of 2.3% seen in the first quarter.

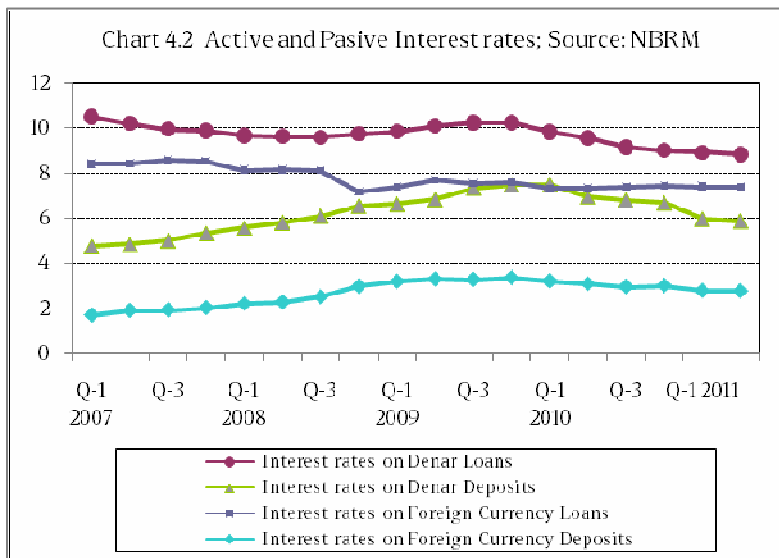
From the point of view of sector structure, intensified growth of credits to households was seen in Q2 2011 – 3.3%, by which they realize significant growth of the contribution to the new crediting (contributing with 42.3%). However, credits to private enterprises increased by 3%, continuing to have dominant contribution of 59.1% to the total credit growth.

From currency point of view, Denar credits showed intensified growth of 2.7% on quarterly basis (compared to the growth of 1.8% in Q1 2011). Increased crediting to households, being mainly in domestic currency contributed to a great extent to their growth. Foreign currency credits were higher by 4.1% compared to the previous quarter.

<sup>6</sup> Deposits also include calculated interest

According to maturity, short-term credits increased by 1.2% in relation to the end of Q1 2011, while long-term credits increased by 4%, thus increasing the share of long-term crediting to 63.2% in total credits.

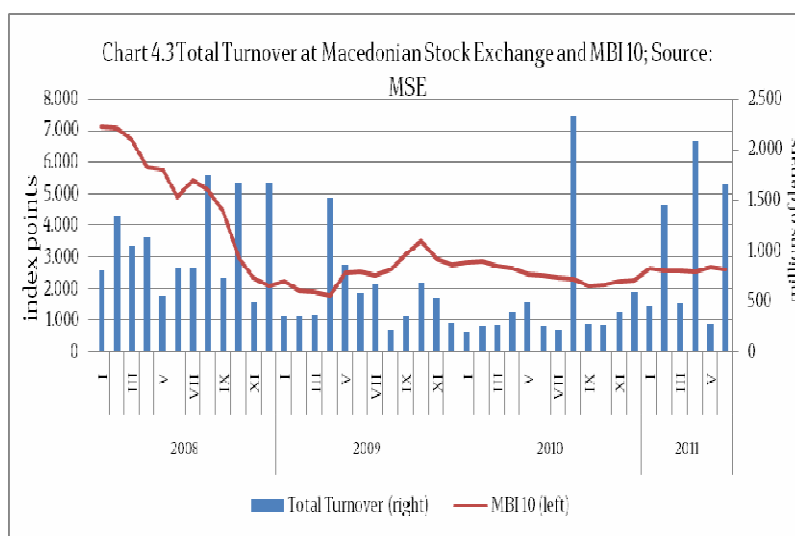
In the second quarter of 2011, NBRM kept the reference **interest rate** unchanged at the level of 4%. Despite that, the European Central Bank in April 2011 increased the reference interest rate by 0.25 p.p., after almost 2-year period of unchanged interest rate of 1%. Thus, the reference interest rate of the European Central Bank amounted to 1.25%.



Interest rates on Denar credits and deposits in deposits bank in Q2 2011 reduced by 0.1 p.p. compared to the previous quarter. Interest rate on total Denar credits reduced to 8.8%, while the interest rate on Denar deposits decreased to 5.9%. On the other hand, interest rates on foreign currency instruments did not change on quarterly basis, thus, the interest rate on foreign currency credits amounted to 7.4%, while the foreign exchange interest on credit balance amounted to 2.8%.

Interest rate on newly approved Denar credits was 8.2%, showing 0.1 p.p. increase on quarterly basis, while interest rate on newly approved foreign currency credits amounted to 7.4%, being high growth of 0.6 p.p. on quarterly basis.

As regards **capital market**, total turnover increased by 69.4% in the second quarter of the year, compared to the previous quarter as a result of the block transactions. In the same period, traditional trading turnover decreased by 3%, while compared to the same period last year, traditional trading increased by 5%, by which positive growth rate of the stock market turnover was registered for second quarter in a row.



Macedonian Stock Exchange Index MSEI-10, as aggregate indicator of stock market trends, increased by 0.9% compared to March 2011, while compared to June 2010, it surged by 7%.

## 5. External Sector and Balance of Payments

In Q2 2011, total foreign trade (f.o.b. basis) amounted to EUR 1,952 million, being the highest amount since 2003 onwards, increasing by 20.2% compared to the same quarter of 2010, as a result of simultaneous increase of export and import of goods and lower comparison basis than the same quarter in the previous year.

In Q2 2011, **export** of goods amounted to EUR 785.2 million, being the highest export since 2003 and compared to the same quarter of the previous year, it increased by 27.5%. Analyzed by SITC sectors (Standard International Trade Classification), positive trends in the export were registered at the following:

-- chemical products, i.e.

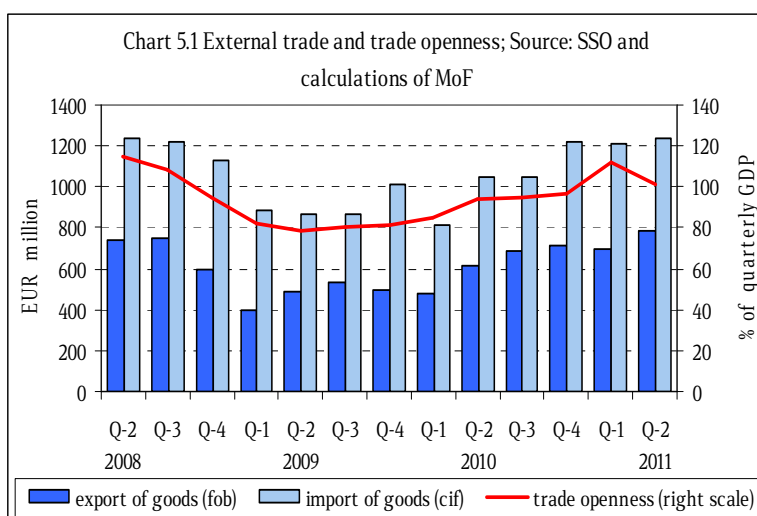
chemical materials and metal products – by EUR 63 million, contributing to growth with 10 p.p. (such trends were due to the high growth of export of “catalysts with precious metals or precious metal compounds by “Johnson Matthey”);

-- products classified by material by 21% (iron and steel by EUR 40 million or contributing to growth with 6.7 p.p.), etc.

In Q2 2011, observed by economic purpose, intermediary goods intended for industrial production contributed the most to the annual growth of export with 57.4%, followed by consumer goods with 18% and energy with 16%.

**Import of goods (f.o.b.)** in Q2 2011 amounted to EUR 1,167.2 million, increasing by 15.8% (EUR 159.4 million) compared to Q2 2010, while in relation to the previous quarter, it decreased by only 0.4%.

Analyzed by SITC sectors, in Q2 2011, in addition to the highest increase, as regards import of the category non-ferrous metals by EUR 52 million participating with 27% in the total increase, such growth was also observed at the following categories: mineral oils and lubricants (oil and oil products by EUR 34 million, electricity by EUR 20 million), followed by machines and spare parts by EUR 15.6 million, textile yarns by EUR 14.7 million, industrial machines and spare parts by EUR 14.1 million, etc. Import growth at these categories of goods, which are intermediary inputs in the production process, points out to strengthening of production activity in the next quarters. Import at categories road vehicles and non-organic chemical products decreased by 30% and 40%

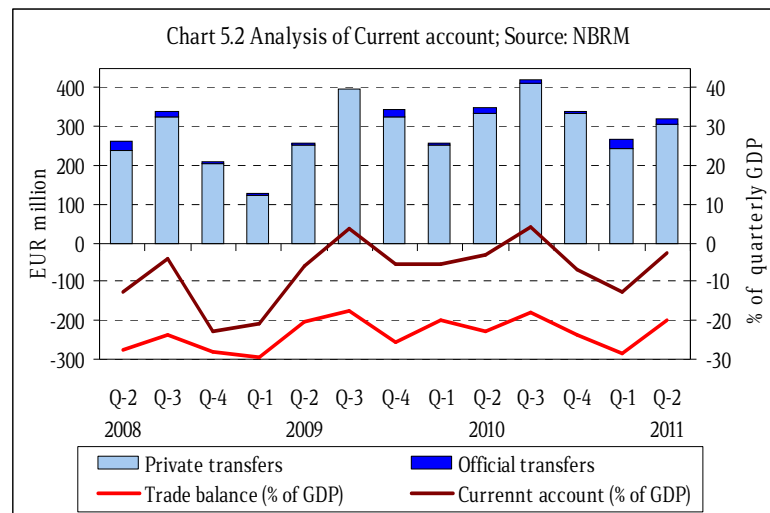


respectively. However, the numbers should be taken with caution since they include base effect of the second quarter last year.

Observed by economic purpose in Q2 2011, products intended for industrial production – 49% and energy – 33% contributed the most to the annual increase of import.

**Trade openness of the Republic of Macedonia** in Q2 2011 amounted to 101%, increasing compared to the same quarter of 2010 by 7.4 p.p., as a result of the more intensive increase of trade and slower increase of the level of GDP in this quarter.

In Q2 2011, in conditions of improved trade with the European Union (EU 27), in relation to Q2 2010, by 26.6%, share of trade with EU in the total foreign trade increased by 2 percentage points, accounting for 57.6%, whereby export of goods participated with 60% and import of goods accounted for 56%. As a result of the structural changes in trade with abroad, in the second quarter of 2011, 32% of



the trade deficit of the country was a result of the trade deficit with Great Britain and Russia, followed by Greece, Turkey, China, Bulgaria, Serbia, etc. Trade surplus was realized with Germany, Kosovo, Albania, Croatia, etc.

In Q2 2011, BOP **current account deficit** compared to the same quarter of 2010 was at almost the same level, accounting for 49.2% or 2.5% of GDP (amounting to 2.9% of GDP in the second quarter of 2010). In Q2 2011, better positive balance of services, lower deficit at the sub-balance of income and the reduced negative trade balance are the main factors for narrowing the current account deficit compared to the previous quarter.

In Q2 2011, **trade balance** (-19.8% of GDP) increased compared to the previous quarter this year and in the last quarter of 2010, returning to the level of Q1 2010 (-19.9% of GDP). Annual increase of export in Q2 2011 exceeded the increase of export in the first quarter of 2011. Such trends in both export and import caused for the level of trade deficit in relation to GDP to decrease by 2.9 p.p. compared to Q2 2010.

In the same quarter, **net current transfers** decreased by 8.3% in relation to Q2 2010, arising to a great extent from the lower private transfers. Private transfers, although registering decline of 8.6%, continued to have dominant share (95%) in the current transfers.

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