

Republic of Macedonia Ministry of Finance

QUARTERLY ECONOMIC REPORT Q2/2014

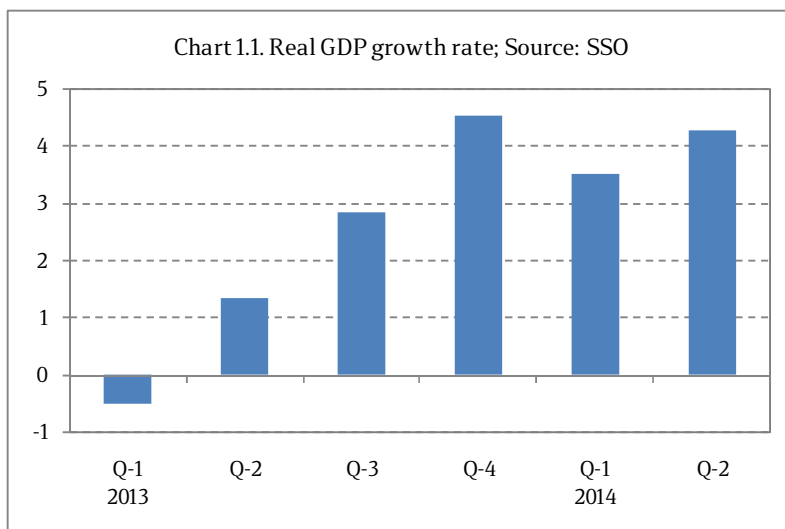
Summary

- **GDP** in Q2 2014, compared to the same quarter last year, grew by 4.3% **in real terms**;
- **Number of employed persons** in Q2 2014 was higher by 1.3% compared to the same quarter of the previous year; **Number of unemployed persons** dropped by 1.3% on annual basis, which resulted in reduction of **unemployment rate** to 28.2% in Q2 2014;
- **Inflation rate** in Q2 2014, measured according to CPI, dropped by 0.9%, compared to the same quarter in 2013;
- Average **gross salary** in Q2 2014 amounted to Denar 31,172 and, compared to the gross salary in Q2 2013, it was higher by 0.5% in nominal terms and lower by 1.5% in real terms;
- Total **budget revenues** were higher by 0.4% in Q2 2014 compared to the same quarter in 2013, while total **budget expenditures** surged by 3.6;
- Total **deposit potential** of banks increased by 0.4% in Q2 2014 on quarterly basis;
- **Credit activity** of banks to non-government sector experienced 2.9% increase in Q2 2014 on quarterly basis;
- **Macedonian Stock Exchange Index MSEI-10** decreased by 5.3% in June 2014 compared to March 2013, while total turnover realized on the stock exchange increased by 9.3%;
- In Q2 2014, on annual basis (Q/Q-4), **import grew** by 16.6% and **export** surged by 5.9%, whereby total **foreign trade**, expressed in euros, grew by 10.0%.

1. Macroeconomic Trends and Real Sector

In Q2 2014, compared to the same quarter in 2013, GDP showed **real growth** of 4,3%, following the 3.5% growth in the first quarter, whereby average GDP growth in the first half in 2014 accounted for 3.9%¹. Nominal GDP growth in Q2 2014 accounted for 6.3%, compared to the same quarter last year, implying that GDP deflator amounted to 1.9%.

Analyzed according to the **GDP production side**, positive development was observed across all sectors. GDP growth was driven by the services sector, whereby the highest growth in real terms was observed at the trade, transport and catering sector - 5%, followed by the following sectors: financial activities and insurance



activities - 4.1%, information and communications - 4%, real estate-related activities - 2.7%, art, entertainment and recreation - 2%, expert, scientific and technical activities - 0.7% and public administration and defense - 0.4%. In Q2 2014, construction sector experienced 0.6% in real terms, following the 10.4% growth in the previous quarter. Real growth rate in agriculture accounted for 1.7%.

Industrial production growth in Q2 2014 amounted to 0.2%, being an slowdown of growth compared to the previous quarter. Thereby, according to monthly data on industrial production, growth in the industry in Q2 2014 accounted for 5.6% and was result of the realized positive growth rates at: processing of wood and wood products (74.3%), production of chemicals and chemical products (38,8%), mining of coal and lignite (38.6%), production of machines and devices (34.6%), production of rubber products (32.8%), production of textile (31.6%), production of electrical equipment (27.7%), production of fabricated metal products, except machines and equipment (25.2%), other mining and quarrying (23.4%), production of clothing (12.6%), repair and installation of machinery and equipment (10.1%), other production industry (9.9%), production of furniture (8.5%), printing and production of recorded media (5.9%), production of paper and paper products (5.8%), production of basic pharmaceutical products and preparations (5.5%), production of other transportation equipment (3.3%), production of beverages (1.3%), production of food products (0.9%) and production of leather and similar leather products (0.1%). Hence, positive annual growth was registered at 20 branches, comprising 74.1% of the industrial production.

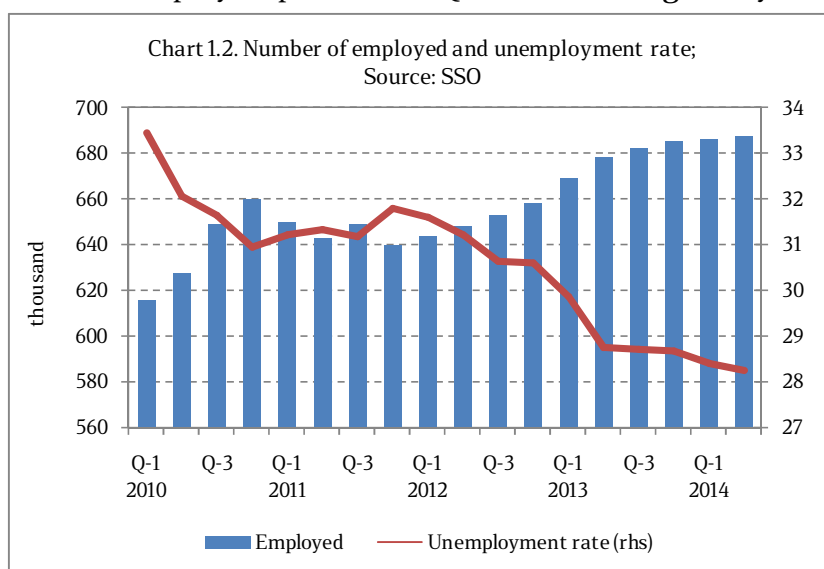
¹ Data on GDP were prepared according to the European System of Accounts - ESA 2010.

Decline was seen at: production of coke and refined oil products – 90.2%, electricity, gas, steam and air-conditioning supply – 26.4%, mining of metal ore – 18.4%, production of metals – 2.6% and production of tobacco products – 1.1%.

Analyzed according to the **expenditure side of GDP**, in Q2 2014, growth was driven by export and consumption. Export of goods and services increased by 12.4% in real terms, mainly as a result of the increased export potential of the country. Final consumption in Q2 2014 increased by 4.5%, being a result of the increase of personal consumption by 4.6% and public consumption by 3.5%. Increase of personal consumption was mainly result of the positive trends on the labour market and the intensified growth of crediting to households in this period. In Q2 2014, gross investments surged by 1.3%, following the higher growth of 13.9% in the previous quarter. Increased export, as well as increased consumption, contributed to growth of import of goods and services of 8.1%.

Positive trends continued on the labour market in Q2 2014 continued. According to the **Labour Force Survey**, number of employed persons in Q2 2014 was higher by 1.3%

compared to the same quarter of the previous year. Increase of employment was accompanied by the drop of the number of unemployed persons, decreasing by 1.3% on annual basis. Number of active population in Q2 2014 was higher by 0.6% on annual basis. Such trends on the labour market caused for the



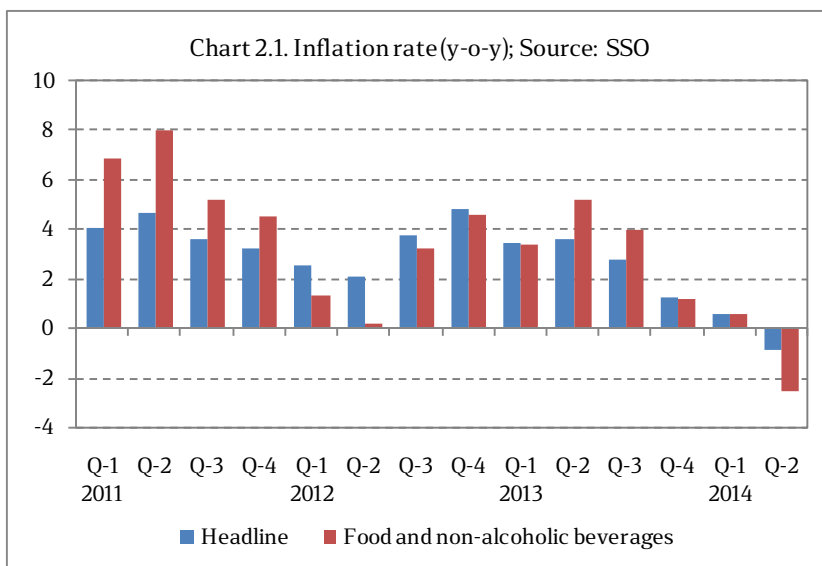
unemployment rate in Q2 2014 to reduce to 28.2%, i.e. to drop by 0.6 p.p. compared to the same quarter of the previous year. Employment rate in Q2 2014 amounted to 41.1%, being higher by 0.5 p.p. compared to the same quarter of the previous year. Active population in Q2 2014 accounted for 57.3% of total working-able population, increasing by 0.2 p.p. compared to the same quarter of the previous year.

2. Prices, Costs and Productivity

Inflation in Q2 2014, measured according to CPI, dropped by 0.9%, in relation to the same quarter in 2013, as opposed to 0.6% growth registered in the previous quarter. Such inflation rate drop was mainly due to the reduced prices in the categories recreation and culture by 3.6% and food and non-alcoholic beverages by 2.5%. Prices of

food and non-alcoholic beverages experienced an accelerated decline, mainly as a result of the drop of prices of oil, fruit and vegetable. Price decline was also registered at the following categories: restaurants and hotels by 1.7%, housing, water, electricity, gas and other fuels by 1.6%, furniture, household furnishings and maintenance of household furnishings by 1.5% and communications by 1.1%.

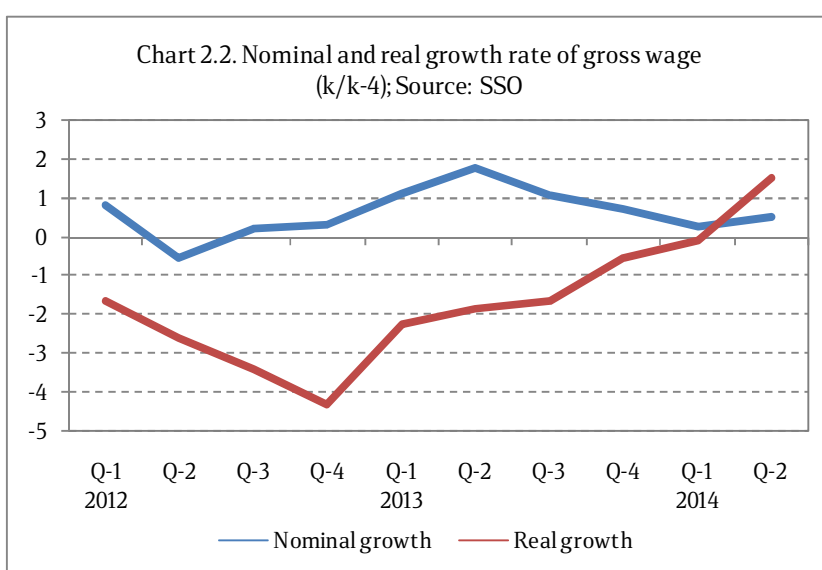
Highest increase of consumer prices was seen at the health category by 10%, as a result of the increase of prices of medical products, appliances and medical equipment. Price increase was also registered at the following categories: alcoholic beverages and tobacco by 2.7%, other goods and services by 1.8%, clothing and footwear by 1.4%, transport by 0.4% and education by 0.2%.



Retail prices in Q2 2014 declined by 1.2% in relation to the same quarter in 2013, as opposed to 0.2% growth registered in the previous quarter.

The largest drop in retail prices was observed at the category services, declining by 1.6%, thus contributing with 0.6 p.p. to the total drop of the retail prices. As regards the category goods, prices dropped by 1%, mainly as a result of the decline of prices of agricultural products by 7.9%. Prices of industrial products declined by 0.2% as a result of the drop in retail prices of food industrial products by 0.7% and non-food industrial products by 0.2%. Retail price of beverages increased by 2.5% and retail price of tobacco remained unchanged in Q2 2014.

Average net salary in Q2 2014 amounted to Denar 21,297, being higher by 0.8% in nominal terms



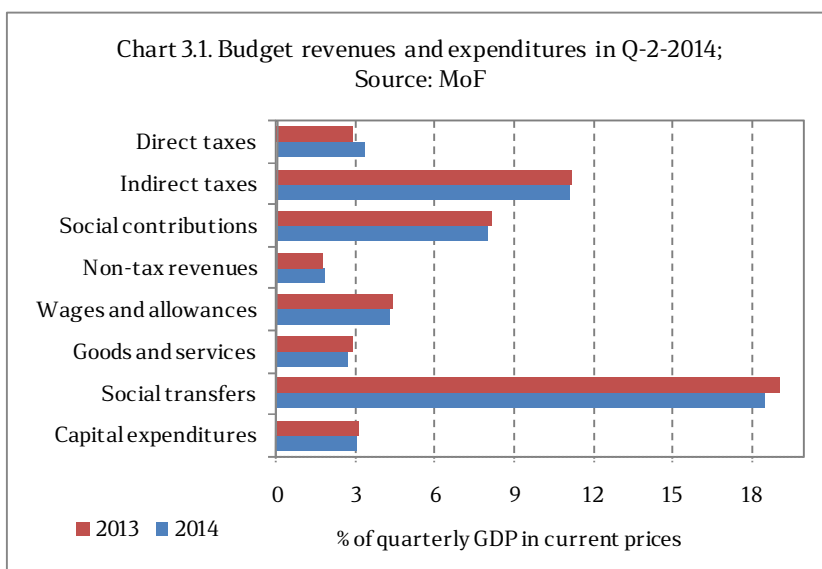
compared to net salary in Q2 2013. Net salary experienced an increase of 1.7% in real terms. Average **gross salary** amounted to Denar 31,172, increasing by 0.5% in nominal terms, i.e. surging by 1.5% in real terms, compared to the gross salary in Q2 2013.

Economic activity increase in Q2 2014 was also accompanied by the increase of the number of employed persons. Thereby, economic growth was stronger than the growth of employment, resulting in increase of **labour productivity** by 2.9%, following the increase of 0.9% in the previous quarter.

3. Fiscal Sector

Higher performance of total budget revenues by 0.4% was observed in the second quarter of 2014, compared to same quarter in 2013, accompanied by lower budget expenditures by 3.6%. This caused for the **budget deficit** to amount to Denar 3,621 million in Q2 2014 or 2.7% of GDP realized in this quarter (central budget deficit amounted to Denar 2,633 million, i.e. 1.9% of GDP).

Total **budget revenues** participated with 26.7% in the quarterly GDP, being higher by 0.4% compared to the same quarter in 2013, mostly due to the higher performance of tax revenues by 4.4%, contributions by 4.4%, while non-tax revenues surged by 11.0%. Thereby,



higher collection of tax revenues was recorded at value added tax, personal income tax and custom duties, as well as profit tax and excises, while with respect to revenues from other taxes, significantly lower collection was registered.

VAT revenues dominated, accounting for 51.1% of the total tax revenues, surging by 1.5% in Q2 2014, compared to the same quarter in 2013. Regarding the structure of gross VAT revenues, gross collection was experienced slight growth of 1.5%, while VAT refund was lower by 7.2% compared to the same period in 2013.

As for the VAT structure, VAT share was the biggest when importing, increasing by 1.5%, while VAT on the basis of sales in the country increased by 1.3% and share of VAT grants and interest was insignificant (0.6%). Excise revenues were higher by 14.8% compared to the same quarter in 2013. As for direct taxes, revenues on the basis of personal income tax profit tax increased by 16.0%, while revenues on the basis of profit

tax surged by 32.2% compared to the same quarter previous year, whereby one should take into account that the revenues for this tax were mainly a result of the tax collected on the basis of monthly advance payments and paid dividends and other distribution of profit and withheld tax paid to foreign legal entities.

Observed from the point of view of structural share in GDP, direct taxes increased their share in GDP by 0.4 p.p. on annual basis (3.3% of GDP), while share of indirect taxes dropped by 0.1 p.p. (11.1% of GDP).

Collection of social contributions was higher by 4.4%, whereby higher collection was recorded at all contributions, i.e. pension insurance contributions – 4.5%, health insurance contributions – 4.2% and employment contributions – 4.5%. Non-tax revenues, accounting for 1.8% of total quarterly GDP, were higher by 11.0% compared to the same period in 2013.

Capital revenues in Q2 2014 were lower by 56.6% on annual basis (these revenues include revenues on the basis of lease of construction land, sale of flats, as well as revenues on the basis of dividends). Revenues on the basis of grants were lower by 29.0% compared to Q2 2013.

Total **budget expenditures** in Q2 2014 were higher by 3.6% compared to the same quarter in 2013. Current expenditures, accounting for 26.3% of the quarterly GDP, increased by 3.5% on annual basis. Capital expenditures, accounting for 3.1% of the quarterly GDP, compared to the same quarter in 2013, were higher by 4.0%, i.e. they participated with 10.4% in the total expenditures. As for current expenditures, expenditures for goods and services were lower by 1.7%, while expenditures related to salaries and allowances experienced an increase by 2.4% compared to the same quarter last year. Funds for transfers, which participated with 2/3 in the total expenditures (62.9%), were higher by 3.3% on annual basis. Social transfers grew by 6.6%, accounting for 49.3% of the total expenditures. Transfers to the Pension and Disability Insurance Fund, accounting for the most of the social transfers, increased by 6.7% and participated with 30.2% in the total expenditures. Category other transfers, which includes transfers to local government units, accounted for 13.2% in the total expenditures, i.e. they dropped by 7.6% compared to the same quarter in 2013. Block grants to local government units surged by 7.9%, while subsidies and transfers dropped by 37.7%.

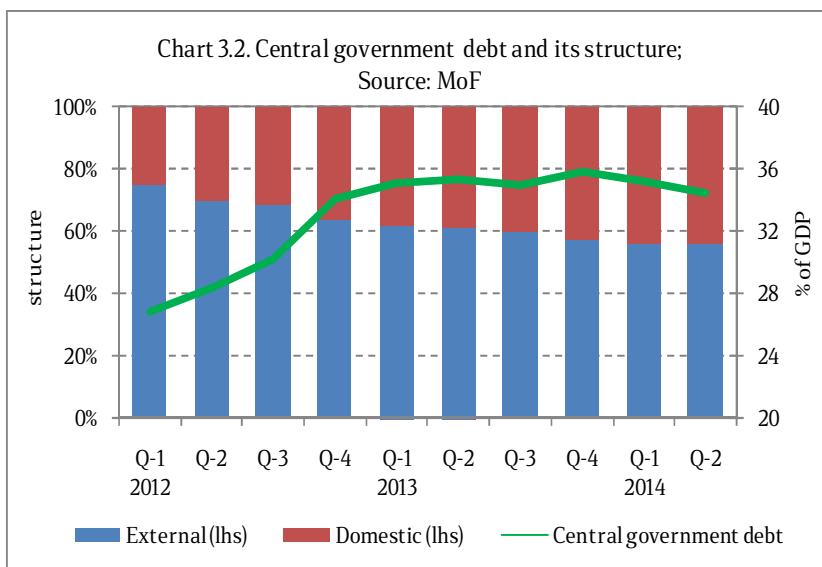
Expenditures related to interest payments were higher 39.2% on annual basis, while compared to Q1 2014, they dropped by 28.6 p.p.. Domestic debt interest-related expenditures increased by 56.4% on annual basis, whereby foreign debt interest-related expenditures surged by 12.3% on annual basis, and compared to Q1 2014, they were higher by 36.6%.

Fiscal burden, measured as defined share of the budget revenues² in relation to nominal GDP, accounted for 23.8% in Q2 2014, dropping by 0.2 p.p. in relation to Q1 2014. Total

² It includes tax revenues, social contributions and administrative fees and duties.

budget expenditures accounted for 29.4% of quarterly GDP, which was by 6.6 p.p. lower compared to Q1 2014, i.e. it declined by 0.8 p.p. on annual basis.

Total **central government debt** at the end of Q2 2012 dropped by 0.7 p.p. as share of GDP compared to Q1 2014. Share of central government external debt in the total central government debt increased by 0.4 p.p. compared to Q1 2014, while share of central government domestic debt in the total central government debt dropped by the same amount of percentage points. Hence, share of central government domestic debt dropped to 43.6% of the total central government debt.



4. Monetary and Financial Trends

In the second quarter of 2014, NBRM kept the reference interest rate unchanged at 3.25%, taking into account that no significant changes in the implementation of monetary policy occurred. Interest rate on 7-day deposit facility remained unchanged at 1.25%.

Primary money³ in Q2 2014 registered quarterly drop of 2.5% (drop of 0.4% in Q1 2014) in conditions of increased total liquidity of banks by 4% and ready money in circulation by 0.9%. Compared to June 2013, primary money surged by 2.2% as a result of the increase of ready money in circulation by 5.4%.

During the second quarter of 2014, narrowest money supply **M1** experienced quarterly growth of 1.4% compared to Q1 2014. **Monetary aggregate M2** dropped by 0.4% in Q2 2014, while the widest **monetary aggregate M4** increased by 0.5%.

On quarterly basis, **total deposit potential**⁴ of banks increased by 0.4% in Q2 2014, being a slowdown compared to the previous quarter, when 2.2% growth was registered. From sector structure point of view, increased deposit potential was result of the growth of

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).

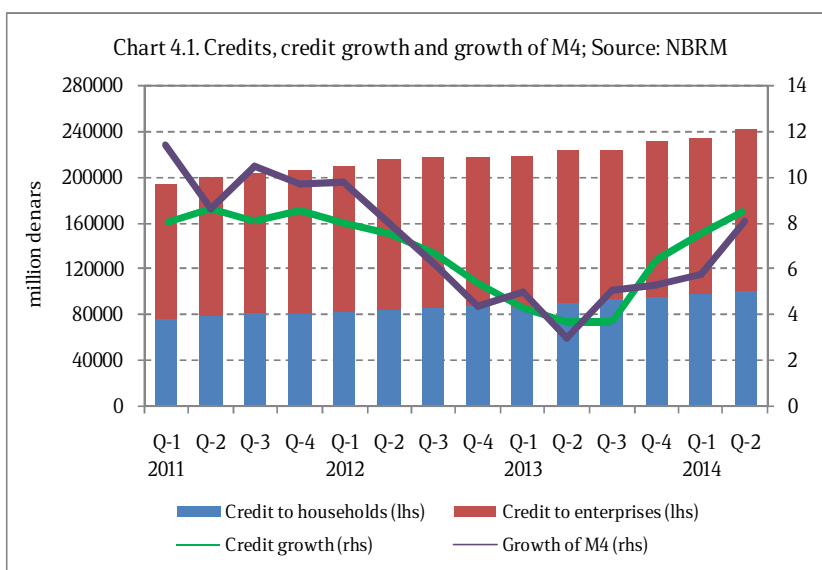
⁴ Deposits also include calculated interest.

deposits of households of 1.1%. At the same time, deposits of private enterprises experienced quarterly drop of 2.4%.

From currency point of view, Denar deposits increased by 0.7%, while foreign currency deposits grew by 0.1%, compared to the previous quarter. Level of euroization, measured through the share of foreign currency deposits in the total deposit potential, reduced by 0.2 p.p., i.e. by 42.6%.

From maturity point of view, in the past period, there was continuous growth of share of long-term deposits in total deposit potential, reaching 26.3% in Q2 2014, being in line with the quarterly increase of long-term deposits by 3.3% (5.1% in Q1 2014). Short-term deposits dropped by 1.2% in the analyzed period.

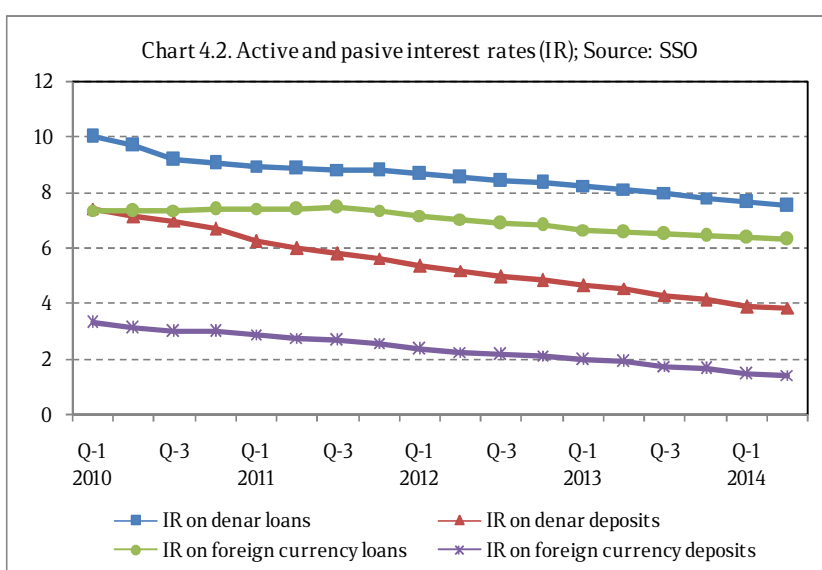
In Q2 2014, **credit activity of banks to the non-government sector** experienced an intensified quarterly growth of 2.9%, in conditions of growth of credits to households of 3.9% and credits to private enterprises of 2%. From currency point of view, Denar credits were driving force of the increase of total credits



and they grew by 3.5% on quarterly basis, while foreign currency credits in Q2 2014 registered quarterly growth of 0.6%.

From maturity point of view, long-term credits in Q2 2014 experienced quarterly growth of 2.1%, while short-term credits surged by 1.8%.

In the second quarter in 2014, NBRM kept the **interest rate on CB bills** unchanged at 3.25%. Interest rates of deposit banks in Q2 2014 experienced downward swings on quarterly

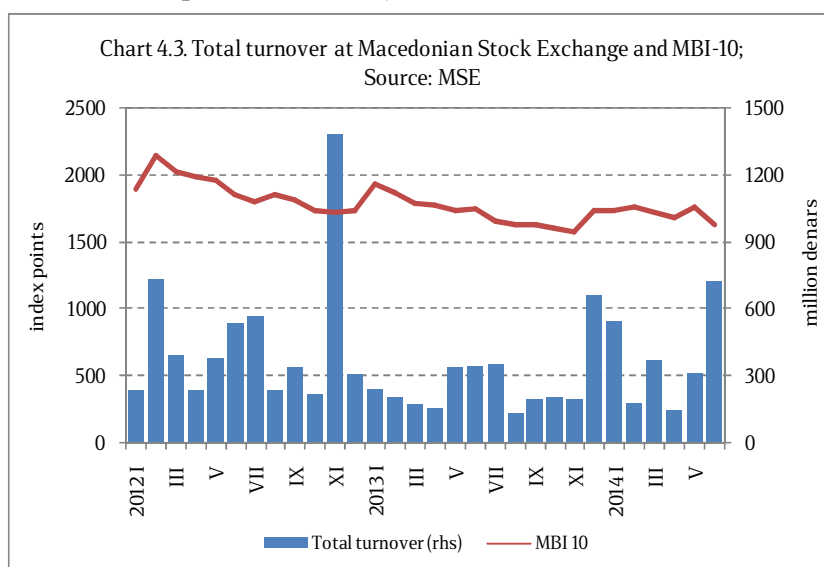


basis. In fact, interest rate on Denar credits reduced by 0.1 p.p. compared to the previous quarter, amounting to 7.5%. Thus, the downward trend of this interest rate, which started at the beginning of 2010, continued. Interest rate on currency deposits reduced from 6.4% in Q1 2014 to 6.3% in Q2 2014. Interest rate on Denar deposits remained at 3.9%, while interest rate on foreign currency deposits dropped by 0.1 p.p., amounting to 1.4% in Q2 2014.

Interest rate on newly approved Denar credits in Q2 2014 also surged on quarterly basis by 0.1 p.p., amounting to 6.7%, while interest rate on newly approved foreign currency credits dropped by 0.1 p.p., amounting to 6.1%. Interest rate on newly received Denar deposits dropped by 0.3 p.p., accounting for 2.1%, while interest rate on newly received foreign currency deposits amounted to 0.4%, unlike in the previous quarter, when it accounted for 0.5%.

On the **capital market** in the second quarter of the year, total turnover of the Stock Exchange experienced growth of 9.3% compared to the previous quarter, being a result of the high amount of block transactions registered in June. Traditional trading turnover dropped by 16.9%.

Compared to the same quarter in the previous year, total turnover grew by 40.7% in conditions of increased turnover



realized through block transactions. Traditional trading turnover dropped by 23.0% on annual basis.

Macedonian Stock Exchange Index MSEI -10, as aggregate indicator of stock exchange trends, amounted to 1,633.20 index points at the end of the second quarter, decreasing by 5.3% compared to March 2014, while compared to June 2014, the index was lower by 6.4%.

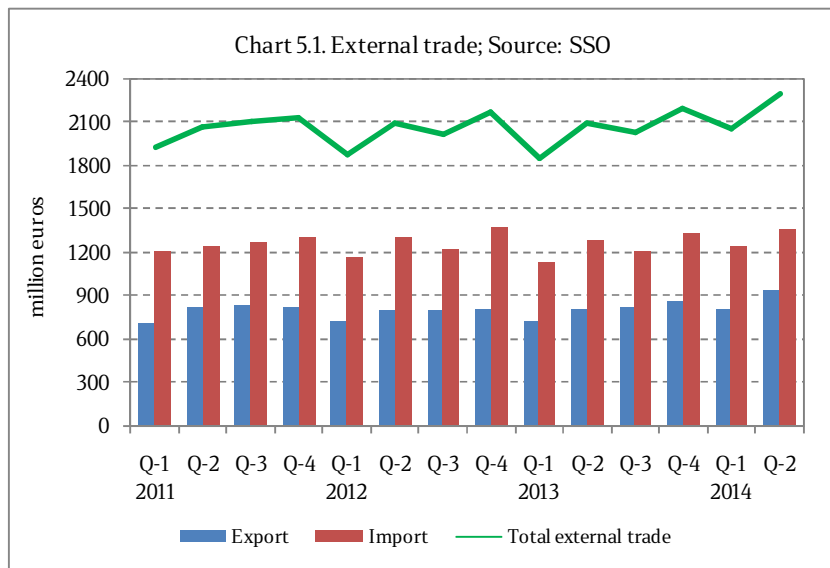
5. External Sector

5.1. Foreign Trade

According to the data of the State Statistical Office in Q2 2012, total foreign trade amounted to EUR 2,305.2 million, increasing by 10.0% compared to the same quarter in 2013.

In Q2 2014, **export** of goods amounted to Denar 938.4 million and, compared to the same quarter of the previous year, it grew by 16.6%, while compared to the previous quarter, it increased by 15.2%.

Analyzed by **SITC sectors** (Standard International Trade Classification), positive trends in **the export** in



Q2 2014, compared to the same quarter in 2013, were registered at the following:

- export of machines and transport equipment increased by almost twice (within which category, export at the following categories increased: electrical machines, devices and spare parts by twice or EUR 37.2 million; industrial machines and spare parts by 71.2% or EUR 35.3 million; and road vehicles by more than three times or EUR 17.3 million);
- export of chemical products increased by 21.6% (chemical materials and products increased by 32.7% or EUR 38.8 million);
- export of various finished products increased by 20.7% (within which export in the category clothing increased by 20.9% or EUR 21.3 million); and
- export of food products increased by 5.0% (of meat and meat products by 39.5% or EUR 3.3 million).

On the other hand, negative export trends were seen at:

- export of products classified by material dropped by 6.5% (export of iron and steel dropped by 9.0% or EUR 14.2 million);
- export of mineral oils and lubricants dropped by 22.5% (within which export in the category oil and oil products reduced by 20.3% or EUR 3.6 million);
- export of beverages and tobacco decreased by 7.2% (beverages by 25.4% or EUR 3.6 million); and
- export of raw materials, except fuel, decreased by 9.0% (whereby export of metal ore and metal scrap declined by 9.9% or EUR 4.2 million).

In Q2 2014, observed by **economic purpose**, following products were most exported: goods for industrial procurement (49.7%), followed by consumer goods (19.8%), products

for investments without transport equipment (19.8%), food and beverages (9.8%), transport equipment (6.6%) and fuels and lubricants (1.3%).

Import of goods in Q2 2014 amounted to EUR 1,366.8 million, increasing by 5.9% compared to Q2 2013, while in relation to the previous quarter, it increased by 10.2%.

Analyzed **by SITC sectors**, the highest growth of **import** in Q2 2014, compared to Q2 2013, was seen at:

- import of products classified according to the material surged by 21.4% (whereby increase was seen at the following categories: import of non-ferrous metals grew by 63.9% or EUR 65.7 million; and of yarn, fabrics and textile products by 15.9% or EUR 15.3 million);
- import of machines and transport equipment increased by 3.5% (import of electrical machines, devices and spare parts surged by 52.2% or EUR 25.1 million);
- import of raw materials, except fuel, increased by 27.1% (import of metal ore and metal scrap increased by 47.8% or EUR 11.5 million); and
- import of various finished products surged by 12.2% (import of professional, scientific and control instruments and devices increased by 16.5% or EUR 1.8 million, and of footwear by 18.3% or EUR 1.3 million).

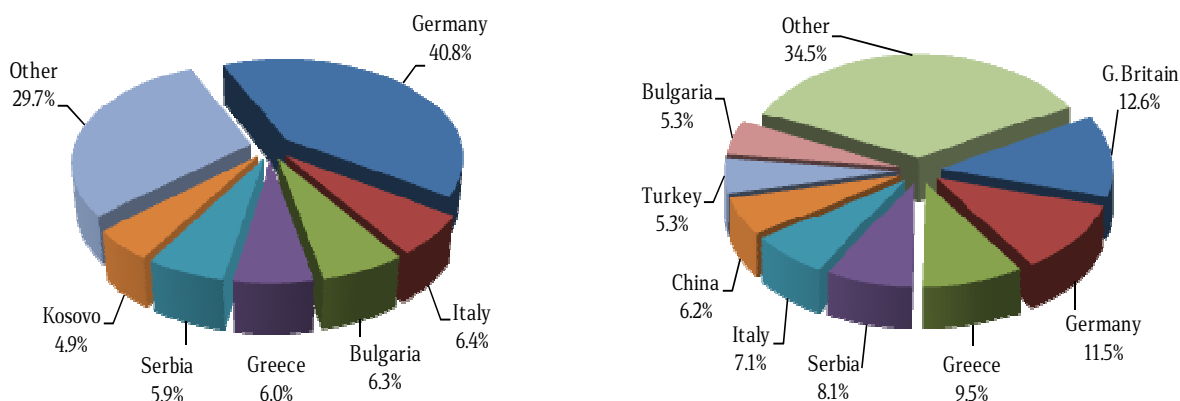
Highest decline of import was seen at the following:

- chemical products by 15.8% (products for colouring and tanning by 57.7% or by EUR 15.3 million; and inorganic chemical products by 51.1% or EUR 8.0 million);
- food products by 6.1% (whereby decrease was seen at the following categories: cereals and cereal preparations by 16.9% or EUR 3.7 million; and meat and meat products by 11.3% or EUR 3.6 million);
- mineral oils and lubricants by 0.3% (whereby import of oil and oil products reduced by 1.8% or EUR 2.5 million);
- beverages and tobacco by 1.1% (beverages by 9.7% or EUR 0.9 million).

Observed by **economic purpose** in Q2 2014, the following products were most imported: goods for industrial procurement (48.6%), followed by fuels and lubricants (13.2%), products for investments without transport equipment (12.8%), consumer goods (10.3%), food and beverages (9.8%) and transport equipment (5.2%).

In Q4 2012, foreign trade of the Republic of Macedonia with the European Union (EU 27) surged by 19.3% in relation to Q2 2013, whereby share of trade with EU in the total foreign trade increased by 3.5 p.p. compared to the second quarter in 2013, accounting for 70.4%, whereby export of goods participated with 77.6% and import of goods accounted for 65.6%.

Chart 5.2. Countries having the highest share in export (left) and import (right) in Q2 2014
Source: MoF calculation based on SSO data



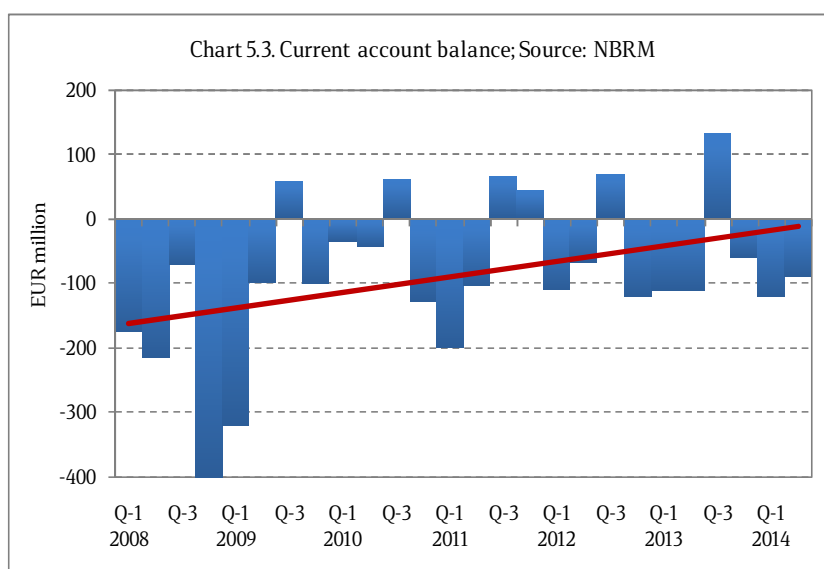
As a result of the structural changes in the trade with abroad, in Q2 2014, 94.2% of the trade deficit of the country was a result of the deficit in the trade with Great Britain, Greece, China, Turkey and Serbia, while the rest of the deficit was a result of the trade with: the USA, Italy, Romania, Slovenia, Austria and others. Surplus was realized in the trade with Germany, Kosovo, Belgium and Bosnia and Herzegovina.

5.2. Balance of Payments

Deficit registered on the BOP **current account**⁵ amounted to EUR 88 million or 4% of GDP⁶ in Q2 2014, narrowing in relation to the previous quarter by 2 p.p.

On annual basis, current account balance in Q2 2014 dropped by 22.6% as a result of the increased inflows on the secondary income account by 6.5% and narrowed trade deficit by 7.3%, while the reduced surplus on the services account by 79.8% and the declined inflows on the primary income account by 21.2% had adverse effects.

In conditions of a more dynamic growth of export of goods (16.7%),



⁵ Starting June 2014, National Bank of the Republic of Macedonia (NBRM) started disseminating data from external statistics (balance of payments, international investment position and gross external debt and gross external claims), prepared according to the new international standards, defined in the "Balance of Payments and International Investment Position Manual" (BPM6). Methodological changes are disseminated in more details on NBRM website.

⁶ GDP for the second quarter in 2014, published by the State Statistics Office, is used in the calculation.

compared to the growth of import of goods (6.0%), **trade account** in Q2 2014 narrowed by 7.3% on annual basis, accounting for 20.4% of quarterly GDP.

In Q2 2014, in conditions of a more dynamic increase of import of services (by 41.5%) and lower intensity of increase of export of services (18.9%), **services**

account balance dropped by 79.8% on annual basis.

Trade openness of the Republic of Macedonia in Q2 2014 amounted to 110.9%, increasing by 7.5 p.p. compared to the same quarter in 2013.

Deficit on the **primary income** account in Q2 2014 amounted to EUR 47.9 million, deepening by 0.2% on annual basis, which had adverse effects on the current account trends.

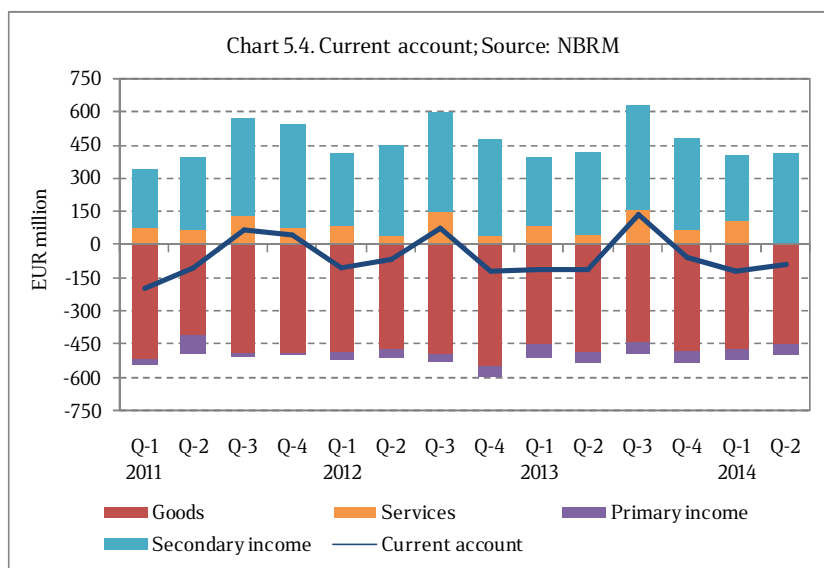
Balance on the **secondary income** account in Q2 2014 amounted to EUR 399.1 million, being higher by 6.8% in relation to Q2 2013. Such growth was due to the increase of income (3.5%) in the sector “financial corporations, non-financial corporations, households and non-profit institutions serving households”⁷, which participated with 92.7% in the secondary income account, as well as the increase of the income in the sector “government” by 75.1%, accounting for 7.3% in the secondary income account.

Capital account balance in Q2 2014 amounted to EUR 1.5 million, narrowing by 76.5% compared to Q2 2013, which was mainly due to the outflow of non-produced non-financial assets, as well as the three-fold reduced inflow of capital transfers.

Net borrowing of the country in Q2 2014 amounted to EUR 86.6 million, reducing by 17.1% on annual basis.

Direct investments in the country in Q2 2014 amounted to EUR 30.7 million, dropping by 6.6% on annual basis (mostly as a result of the increased liabilities on the basis of debt instruments, as well as the reduced inflows of equity).

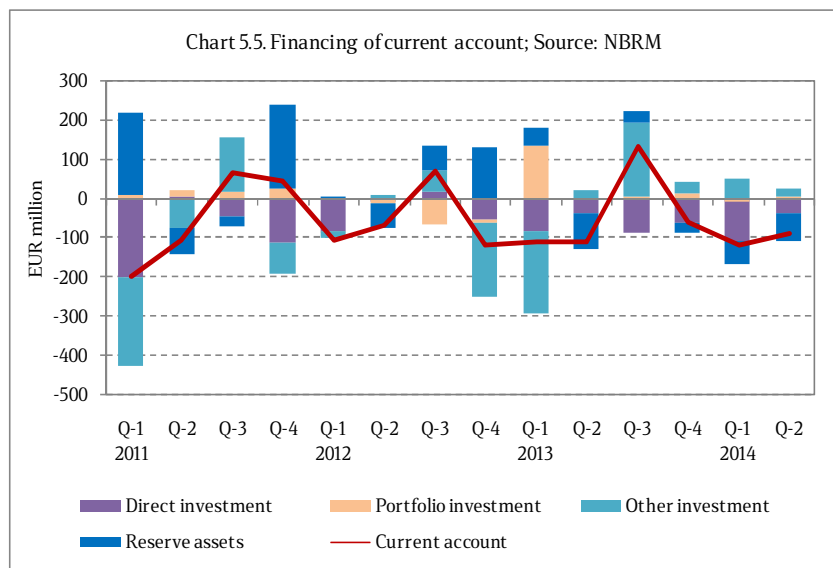
Portfolio investments in Q2 2014 amounted to EUR 7.8 million, being a three-fold increase on annual basis.



⁷ Secondary income account includes income from the sector 1. Government and income from 2. Financial corporations, non-financial corporations, households and non-profit institutions serving households, including 2.1/ Personal Transfers (current transfers between resident and non-resident households) and 2.2/ Other Current Transfers.

Other investments in Q2 2014 amounted to EUR 20.4 million, increasing by 6.7% on annual basis. As regards the category “other investments”, loans increased by 81.1%, while currencies and deposits dropped by 14.3%.

Foreign currency reserves in Q2 2014 dropped by 26.1% in relation to the same quarter in 2013.



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