

Republic of Macedonia
Ministry of Finance

QUARTERLY ECONOMIC REPORT
Q3/2012

Summary

- According to SSO data, **real GDP growth** of 0.2% was recorded in Q3 2012 on annual basis, thus stopping the negative growth in the previous two quarters. Seasonally adjusted quarterly GDP growth in Q3 2012 amounted to 0.5%;
- According to the **Labour Force Survey**, number of employed persons in Q3 2012 was higher by 0.6% compared to the same quarter of the previous year. Number of unemployed persons dropped by 1.9% on annual basis, which resulted in reduction of unemployment rate by 30.6% in Q3 2012;
- **Inflation rate** in Q3 2012 experienced intensified growth of 3.8% compared to the same quarter in 2011, measured according to CPI;
- Average **net salary** in Q3 2012 amounted to Denar 20,842, being at the same level as in Q3 2011. Net salary decreased by 3% in real terms;
- Total **budget revenues** were higher by 2.9% in Q3 2012 compared to the same quarter in 2011, while total **budget expenditures** surged by 9.2%;
- Total **deposit potential of banks**, following the drop in the second quarter, increased by 0.7% in Q3 2012 on quarterly basis;
- **Credit activity of banks** to non-government sector, experienced slowed down growth rate of 0.6% in Q3 2012 on quarterly basis;
- **Macedonian Stock Exchange Index MSEI -10** declined by 1.9% in September 2012 compared to June 2012;
- In Q3 2012, on annual basis (Q/Q-4), contraction of **export** of 4.6% and **import** of 4.2% was registered, whereby total **foreign trade**, expressed in euros, dropped slightly by 4.4%;
- **Trade openness** of the Republic of Macedonia in Q3 2012 amounted to 102.0%, narrowing by 5.8 p.p. compared to the same quarter in 2011.

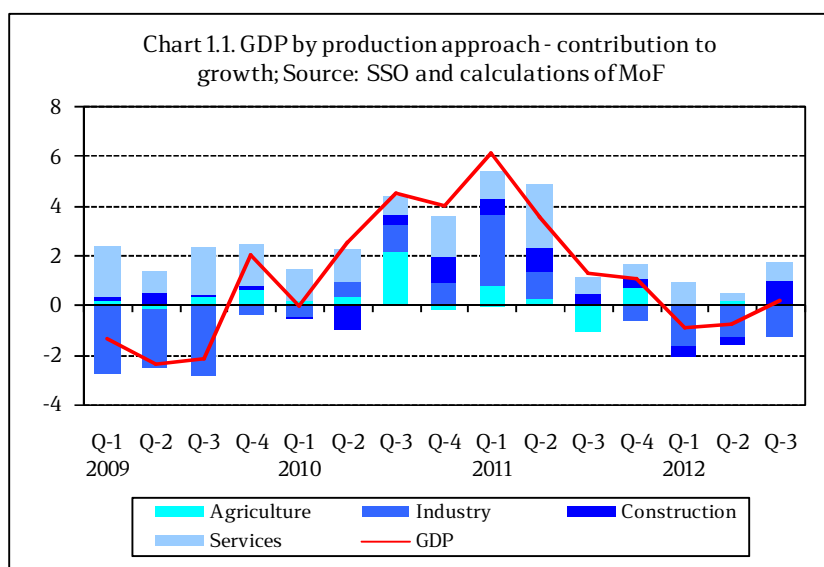
1. Macroeconomic Trends and Real Sector

According to SSO data, real GDP growth of 0.2% was recorded in Q3 2012 compared to Q3 2011, thus stopping the negative growth in the previous two quarters. At the same time, SSO revised growth rates in the first two quarters of 2012. Hence, growth rate in Q1 2012 was adjusted from -1.3% to -0.9%, growth rate in Q2 2012 was adjusted from -0.9% to -0.7%. Taking this into account, average growth rate in the first three quarters of 2012 amounted to -0.5%.

Real GDP growth in Q3 2012, compared to the previous quarter, accounted for 4.3%, partially due to the positive seasonal effects. Anyhow, seasonally adjusted quarterly GDP growth in Q3 was positive and it amounted to 0.5%.

Nominal GDP growth in Q3 2012 accounted for 1.7% compared to the same quarter last year, implying that GDP deflator amounted to 1.5%.

Analyzed according to **GDP production side**, highest growth in Q3 2012 was seen in the construction sector – 16.7%. Growth in the construction sector was expected, taking into account the high growth of value of carried out construction works in the period July - September. Transport, storage and communications sector experienced growth of 2.3%. Financial intermediation sector continued experiencing



positive growth rate, which amounted to 1.7% in Q3. Growth in public administration sector accounted for 1.6%. Trade sector experience positive signs in Q3, following the negative growth rates in the previous two quarters. Growth accounted for 0.8% and it was a result of increased whole sale. Agriculture sector registered growth of 0.6%. Hotels and restaurants sector declined by 2.2% following the positive growth rates realized in the previous two quarters. Industry sector in Q3 decreased by 7.6%, coinciding with the negative growth of economic activity in EU.

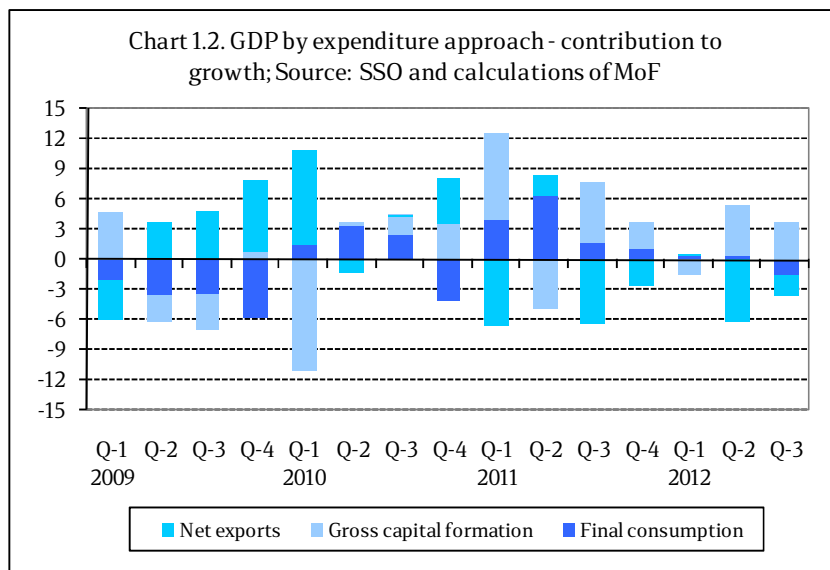
Drop in the **industrial production** rate¹ in Q3 2012 of -6.9% was mainly due to the decline in the production of tobacco (29.5%), production of clothing (6.4%), production of coke and refined oil products (97.7%), production of chemicals and chemical products (17.3%), production of metals (16.6%), manufacture of electrical equipment (53.9%), other mining and quarrying (16.8%), production of beverages (5.7%), production of leather (1.2%), production of paper (28.5%), printing and production of recorded media (25%),

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

production of other non-metal products (29.2%), mining and quarrying (10.4%), manufacture of electrical equipment (52.9%), production of motor vehicles, trailers and semi-trailers (40.1%), production of machines and devices not mentioned elsewhere (21.9%) and other production industry (33.3%). From the point of view of the structure of industrial production index, 66.9% of the branches experienced drop.

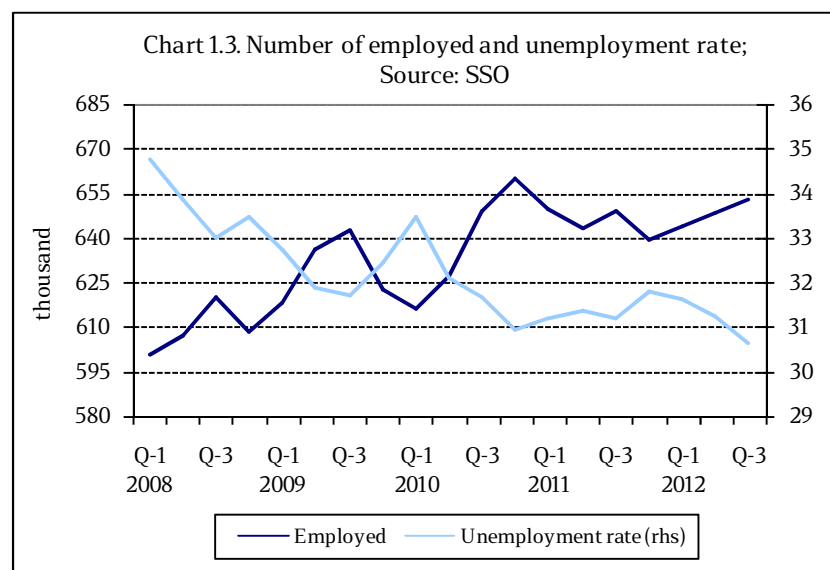
On the other hand, growth was observed at the following: extraction of coal and lignite (25.4%), mining of metals ores (14.5%), production of food products (1.8%), production of textile (29.1%), processing of wood and wood products (15.8%), production of basic pharmaceutical products (26.8%), production of rubber products (14.6%), production of fabricated metal products (144.4%), production of other equipment and transportation (25.6%), production of furniture (8.3%) and electricity supply (8.3%).

Analyzed according to the **expenditure side of GDP**, in Q3 2012, highest growth was seen at gross investments, accounting for 14.6%. Final consumption in Q3 dropped by 1.5%, being a result of the decline of personal consumption by 2.4%. On the other hand, public consumption dropped by 2.3%. Drop of economic activity in the EU



countries, and respectively of the external demand, resulted in decline of export of goods and services by 2.9% on real basis. On the other hand, import of goods and services increased by 1.2%, as a result of the increase of investments.

According to the **Labour Force Survey**, number of employed persons in Q3 2012 was higher by 0.6% compared to the same quarter of the previous year. Active population in the third quarter decreased by 0.2%, accompanied by reduction in the number of unemployed persons by 1.9% on annual basis. Such trends on the labour market caused for

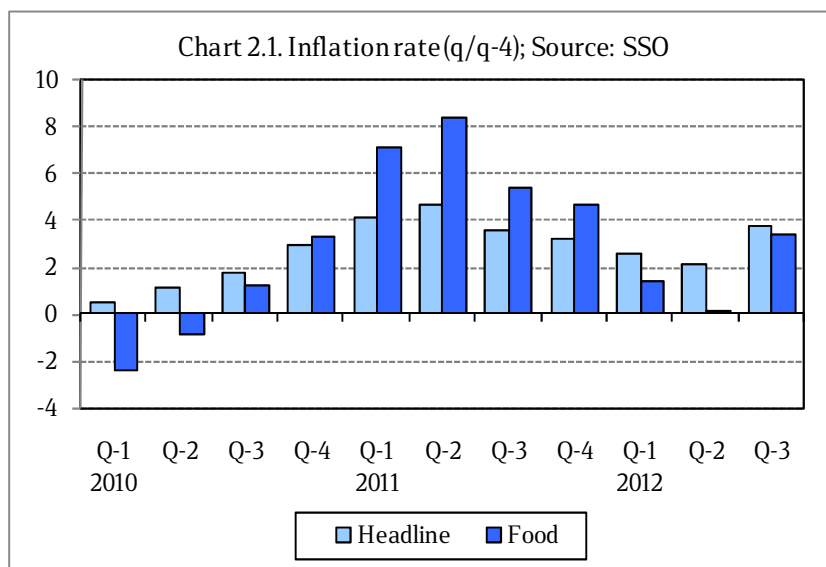


the unemployment rate in Q3 2012 to reduce to 30.6%, i.e. to drop by 0.6 p.p. compared to the previous quarter and the same quarter of the previous year. Employment rate in Q3 2012 amounted to 39.1%, as it amounted in the same quarter of the previous year, while compared to the previous quarter, it was higher by 0.3 p.p.. Active population in the third quarter accounted for 56.3% of total working-able population.

2. Prices, Costs and Productivity

Inflation rate, measured according to CPI, was 3.8% in Q2 2012 compared to the same quarter in 2011, being a strong growth compared to the previous quarter (2.1%). Highest price increase was registered in the housing category – 8.6%, being mostly due to the increase of heating prices by 12.6% and the electricity prices by 14.9. Compared to the previous quarter, increase of prices in housing category intensified by 3.2 p.p..

Increase of prices in the category food in Q3 2012 amounted to 3.4% compared to the increase by 0.2% in the previous quarter. Prices in the category clothing and footwear urged by 5.6%, while increase of prices in the category hygiene and health accounted for 2.5%. Prices in the category means of transport and services surged by 2.4%, mainly as a result of the increased prices of liquid fuels and oils. Prices of the category restaurants



and hotels category were higher by 2.1%, while prices of categories culture and entertainment and tobacco and beverages experienced increase by 1.4% and 0.1% respectively. Prices in the category administrative and financial services reduced by 1%.

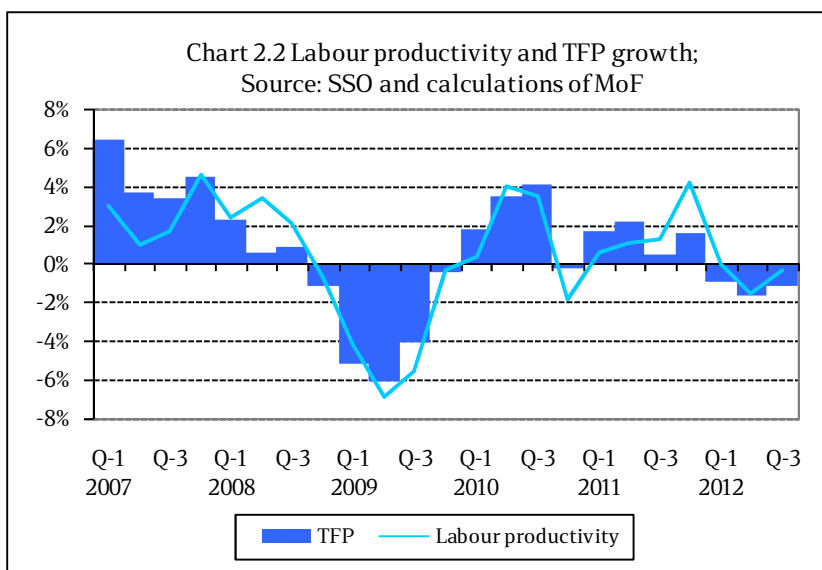
Core inflation (which excludes the effect of food and energy) was 1.8% in Q3 2012, being higher by 0.1 p.p. compared to the core inflation in the previous quarter (1.7%).

Retail prices in Q3 2012 experienced accelerated increase by 3.4% 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 – 6.3%. Prices of food products surged by 1.8%. Retail price of beverages increased by 0.1%. Retail prices in agricultural products category increased by 8.7%.

Average **net salary** in Q3 2012 amounted to Denar 20,842, being at the same level compared to same quarter in 2011. Net salary decreased by 3% in real terms. Average

gross salary amounted to Denar 30,601, remaining at the same level in nominal terms, while it declined by 3% in real terms.

Increase of economic activity in Q3 2012 was also followed by positive annual increase in the number of employees, resulting in slight decrease of **labour productivity** by 0.4%, following the drop of 1.6% in the previous quarter. In fact, in Q3 2012, physical capital experienced increase by 1.1%. Such tendencies of growth factors caused



for **total factor productivity (TFP)** to decrease by 0.6% in Q3 2012, followed by the drop of 1.4% in the previous quarter. Chart 2.2 shows TFP and labour productivity trends.

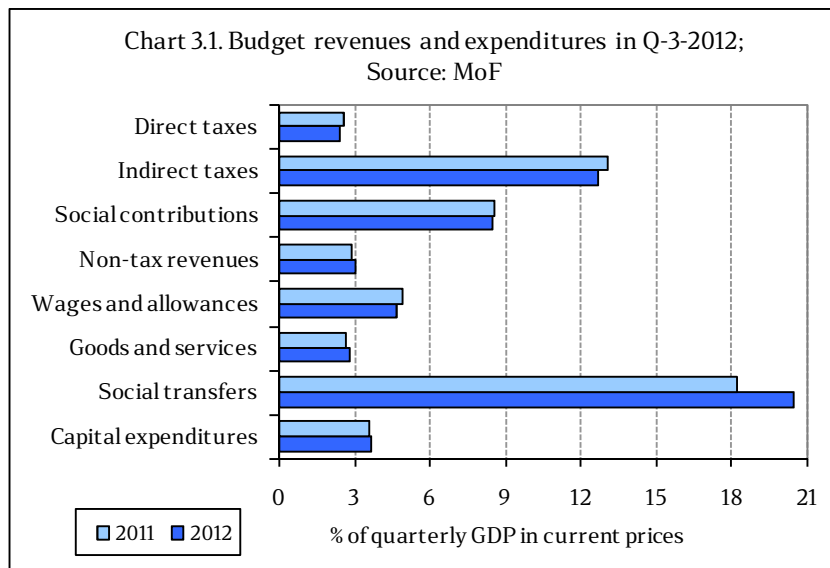
3. Fiscal Sector

Lower performance of total budget revenues was observed in the third quarter of 2012, compared to same quarter in 2011, accompanied by higher budget expenditures. Budget deficit was in the amount of Denar 3,978 million in Q3 2012, being 3.3% of GDP realized in this quarter (central budget deficit amounted to Denar 3,794 million, i.e. 3.2% of GDP, surging by 0.5 p.p. compared to the previous quarter).

Anti-cyclical fiscal policy continued to be conducted in the third quarter in 2012 as well, aimed at mitigating the consequences of the global economic crisis on the Macedonian economy and maintaining macroeconomic stability. Thereby, fiscal sustainability of public finance was not jeopardized.

Total **budget revenues** were higher by 2.9% compared to the same quarter in 2011, being mostly due to the lower performance of tax revenues by 1.2%, while contributions and non-tax revenues were higher by 0.7%, i.e. 8.1%. Thereby, there was significantly lower collection of Value Added Tax, personal income tax, profit tax and customs duties, while excises experienced growth. VAT revenues, accounting for 52.3% of the total tax revenues, were lower by 5.2% in Q3 2012 compared to the same quarter of 2011. Regarding the structure of gross VAT revenues, there was decrease in VAT collection on the basis of import by 7.9%, while VAT on the basis of sales in the country experienced moderate increase by 0.8% in line with the trade sales, and dynamics of VAT refund slowed down by 5.6%. Excise revenues were higher by 9.4% compared to the same quarter in 2011, being identical increase compared to the performance in the second quarter. As for direct taxes, profit tax decreased by 9.6% or 2.7 p.p. compared to

the previous quarter (one should take into account that revenues on the basis of tax paid for dividend and other distribution of profit participated with significant percentage in the structure of this tax). Revenues on the basis of personal income tax were the same, i.e. lower by 0.5% compared to the third quarter in the



previous year. Observed from the point of view of structural share of GDP, direct taxes reduced their share in GDP by 0.1 p.p. on annual basis, while indirect taxes dropped by 0.3 p.p..

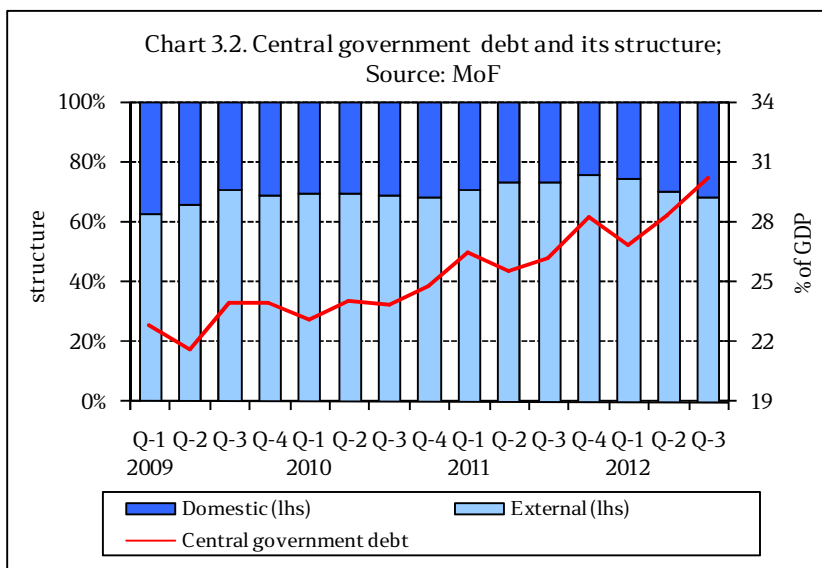
Collection of social contributions was higher by 0.7%, whereby higher collection was recorded at all contributions, i.e. pension insurance contributions - 0.7%, health insurance contributions - 0.8% and employment contributions - 0.2%. Non-tax revenues, accounting for 3.1% of total quarterly GDP, were higher by 8.1% compared to the same period in 2011.

Capital revenues in Q3 2012 were higher by 3.4 times 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 2.3 times, compared to Q3 2011.

Total **budget expenditures** in Q3 2012 were higher by 9.2%, compared to the same quarter in 2011. Current expenditures, accounting for 88.5% of the total expenditures, increased by 9.6% on annual basis. Capital expenditures, participating with 11.5% in the total expenditures, were higher by 6.2%, compared to Q3 2011. As for current expenditures, expenditures for goods and services increased by 7%, while expenditures related to salaries and allowances decreased by 2.9% compared to the same quarter last year. Funds for transfers, participating with 61.6% in the total expenditures, were higher by 13.6% on annual basis, while the share of the category „Other transfers“ in the total transfers accounted for 26.9% (including transfers to local government - block and earmarked grants, as well as other subsidies and transfers, which surged by 2.1 times on annual basis). Transfers to the Pension and Disability Insurance Fund, accounting for 26.0% in total expenditures, were higher by 5.3% compared to the same quarter in 2011, i.e. they were higher by 4.9% compared to Q2 2012. Interest-related expenditures increased by 7.0%, whereby domestic debt interest-related expenditures surged by 29.9%, and expenditures related to interest on foreign debt surged by 2.9%.

Fiscal burden, measured as participation of the budget revenues² in relation to nominal GDP, was 26.2% in Q3 2012, surging by 0.2 p.p. in relation to Q2 2012. Total budget expenditures accounted for 33.1% of GDP, which was by 0.7 p.p. lower compared to Q2 2012, increasing by 2.3% on annual basis.

Total central government debt at the end of Q3 2012 accounted for 30.2% of GDP, increasing by 1.9 p.p. compared to Q2 2012. Share of central government external debt in the total central government debt decreased by 1.7 p.p. compared to Q2 2012, while share of central government domestic debt in the total central



government debt surged by the same amount of percentage points. Hence, share of central government domestic debt increased to 31.6% 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.

Monetary and Financial Trends

Following the reduction of reference interest rate by 0.25 percentage points in the second quarter of 2012, in the third quarter of the year, the National Bank of the Republic of Macedonia retained the maximum reference interest rate at the same level, i.e. at 3.75%, assessing the set-up of monetary policy as adequate to the macroeconomic climate.

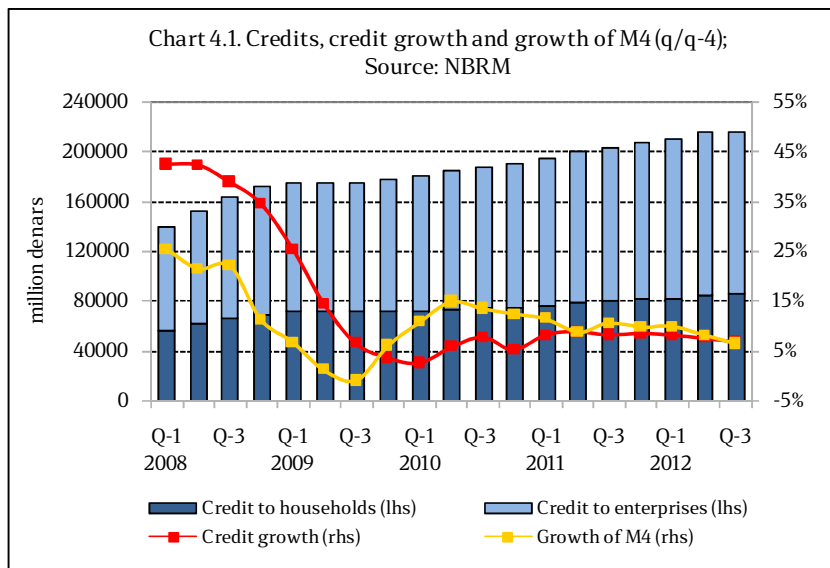
Primary money³ in Q3 2012 surged by 1.4% on quarterly basis, in conditions of increase of both ready money in circulation and total liquidity of banks by 1.5% and 1.2%, respectively.

During the third quarter of 2012, the narrowest money supply **M1** experienced quarterly increase by 3.3% compared to Q2 2012, as a result of the increase of ready money in circulation and deposit money by 2.1% and 3.8% respectively. **Monetary aggregate M2**,

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).

in Q3 2012 slowed down the quarterly drop to 0.4%, while the widest **monetary aggregate M4** experienced intensified increase by 0.8% compared to the previous quarter, being a result of the increase of the most liquid funds (ready money in circulation and deposit money).



Total deposit potential⁴

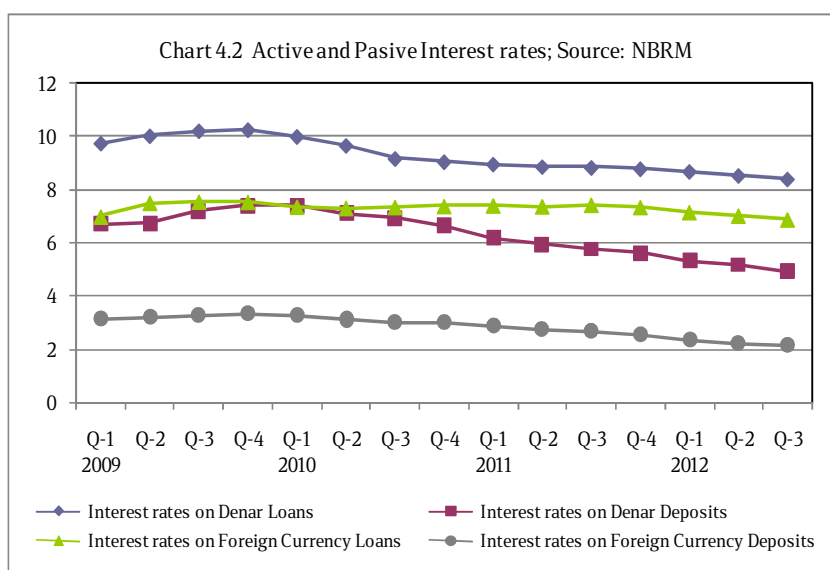
of banks, following the drop in the second quarter, in Q3 2012, it surged by 0.7% on quarterly basis.

Thereby, from the aspect of the sector deposits of households slowed down the quarterly growth to 0.5% compared to 2.2% in the previous quarter, while deposits of private enterprises mitigated the drop of 0.5% in relation to the previous quarter, when they reduced by 7.5%.

From currency aspect, Denar deposits, which increased by 2.3% on quarterly basis had dominant contribution to growth, while foreign currency deposits reduced by 1.1%, resulting in further reduction of the euroization degree by 0.8% , i.e. 46% measured through the share of foreign currency deposits in the total deposit potential.

From maturity point of view, long-term deposits, which increased by 5.5% (6.5% in Q2 2012) were driving force of the growth of total deposits. On the other hand, short-term deposits in Q3 2012 dropped by 1.6% compared to the previous quarter.

Credit activity of banks to non-government sector, in Q3 2012 experienced slowed down growth rate of 0.6% on quarterly basis, in conditions of slowed down credit growth to households sector by 1.9% and reduced crediting to corporate sector by 0.3%.



From currency point of view, foreign currency

⁴ Deposits also include calculated interest

credits experienced intensified drop by 3.5% on quarterly basis, while Denar credits surged by 2.1% on quarterly basis in Q3 2012, thus driving the growth of total credits.

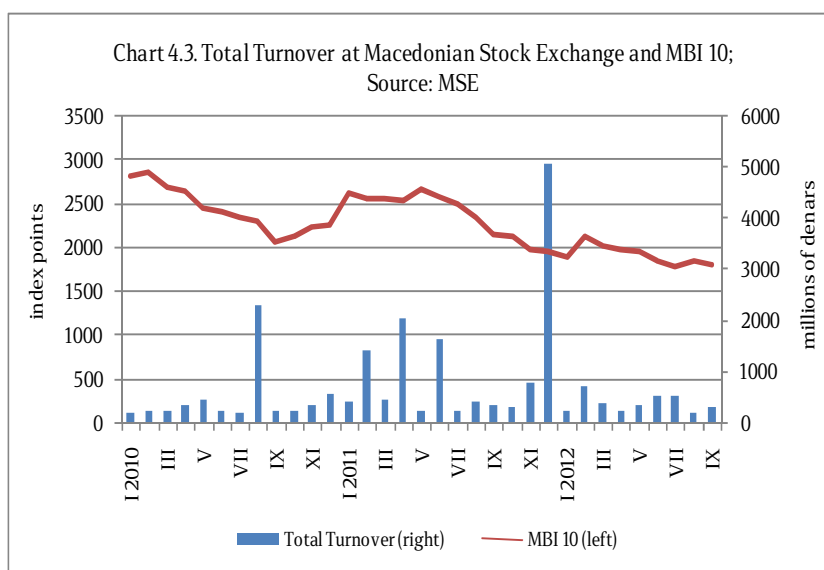
From maturity point of view, long-term credits, after a longer period of time of growth in Q3 2012 experienced quarterly drop by 1.8%, while short-term credits were higher by 2.9%.

In the third quarter in 2012, NBRM kept the maximum **reference interest rate** at 3.75%. Interest rates of deposit banks in Q3 2012 experienced certain downward swings on quarterly basis. In fact, interest rate on Denar credits of deposit banks reduced by 0.1 p.p. compared to the previous quarter, amounting to 8.4%. Thus, the downward trend of this interest rate, which started at the beginning of 2010 continued. Interest rate on foreign currency credits, reduced from 7% to 6.9%. Interest rates on Denar and foreign currency deposits reduced by 0.2 p.p. and 0.1 p.p. on quarterly basis, accounting for 5% and 2.2% respectively.

Interest rate on newly approved Denar credits reduced by 0.2 p.p. on quarterly basis, amounting to 7.8%, while, interest rate on newly approved foreign currency credits, surged by 0.2 p.p., accounting for 7%. Interest rate on new Denar deposits dropped by 0.3 p.p. compared to Q2 2012, accounting for 2.7%, while interest rate on new foreign currency deposits amounted to 0.7%, the same as in the previous quarter.

On the **capital market**, in the third quarter if the year, trading on the Stock Exchange dropped by 1.1% compared to Q2 2012, while in relation to the same quarter in the previous year, it surged by 4.2%.

Macedonian Stock Exchange Index MSEI - 10 as aggregate indicator of stock exchange trends at the end of the third



quarter amounted to 1,822.36 index points, decreasing by 1.9% compared to June 2012, while compared to September 2011, the index was lower by 15.8%.

5. External Sector

5.1. Foreign Trade

According to the data of the State Statistical Office in Q3 2012, total foreign trade amounted to Denar 2014.5 million, contracting by 4.4% compared to the same quarter in 2011.

In Q3 2012, **export** of goods amounted to Denar 792.3 million and compared to the same quarter of the previous year, it contracted by 4.6%, while compared to the previous quarter, it decreased by 0.5%.

Analyzed by **SITC sectors** (Standard International Trade Classification), positive trends in the **export** in Q3 2012 compared to the same quarter in 2011 were registered at the following:

- machines and transport equipment by 13.2% (within which category of industrial machines and spare parts surged by 58.4% or EUR 12.9 million);
- beverages and tobacco by 11.3% (tobacco by 17.4% or EUR 5.6 million).

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

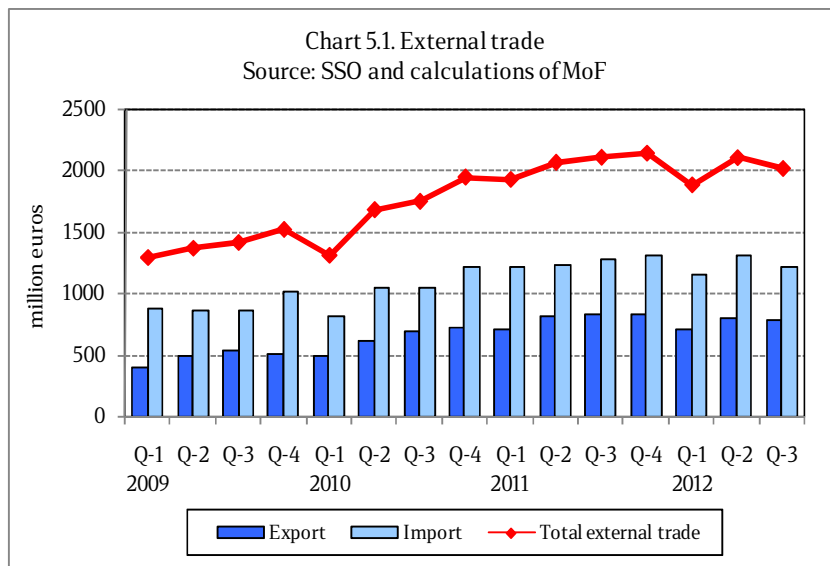
- mineral oils and lubricants by 37.9% (within which category oil and oil products reduced by 53.7% or EUR 38.4 million);
- raw materials except for fuel by 5.9%, whereby category raw manure and minerals (except for coal, oil, precious stones) dropped by 25.8% or EUR 2.2 million;
- products classified by material by 5.5% (iron and steel by 7.7% or EUR 13.6 million);
- food products by 1.7% (fish and fish products by 38.8% or EUR 1.3 million);
- chemical products by 2.3% (inorganic chemical products by 60.3% or EUR 2.9 million and chemical materials and products by 1.5% or EUR 1.3 million).

In Q3 2012, observed by **economic purpose**, the following products were most exported: goods for industrial production (50.6%), followed by personal consumption goods (34.2%), investment goods (9.2%) and energy (6.0%).

Import of goods in Q3 2012 amounted to EUR 1,222.1 million, reducing by 4.2% compared to Q3 2011, while in relation to the previous quarter, it contracted by 6.5%.

Analyzed by **SITC sectors**, most positive movement of **import** in Q3 2012, compared to Q3 2011, was seen at:

- food products by 11.8% (sugar, sugar processings and honey by 27.7% or EUR 3.9 million, meat and meat products by 10.7% or EUR 3.4 million; fruit and vegetables by 19.8% or EUR 1.9 million);

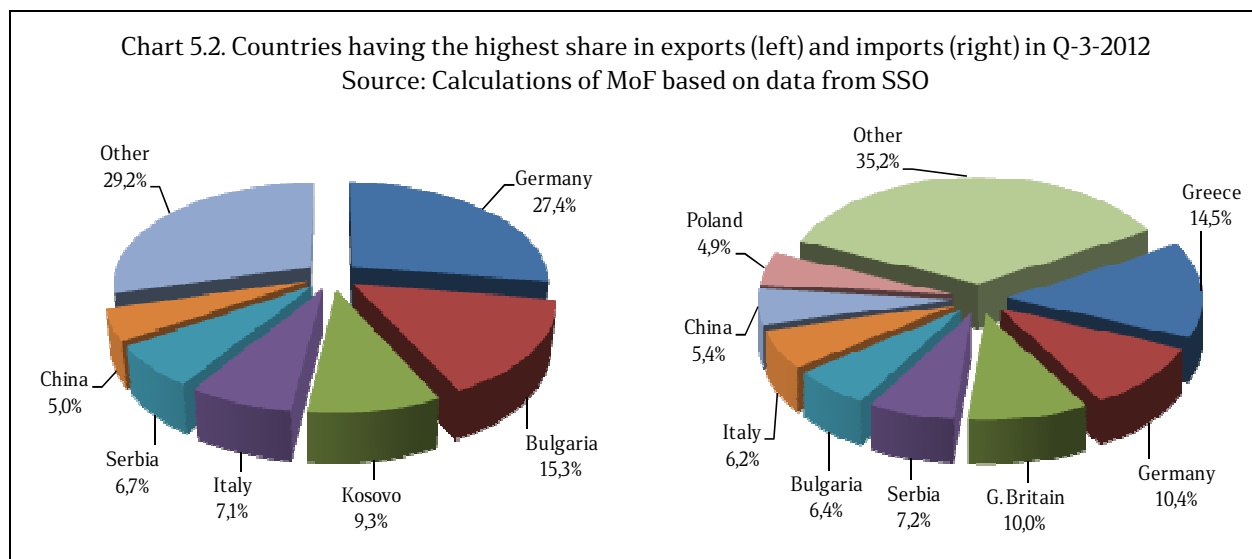


- chemical products by 5.9% (whereby increase was seen at the following categories: products for colouring and tanning by 26.6% or EUR 4.1 million; chemical materials and products by 18.8% or EUR 2.6 million).

Most negative movement of import was seen at the following:

- raw materials except fuel by 50.8% (metal ore and metal scrap declined by 64.4% or EUR 31.8 million);
- machines and transport equipment by 10.9% (whereby category road vehicles reduced by 42.0% or EUR 32.4 million);
- beverages and tobacco by 6.9% (tobacco decreased by 18.7% or EUR 1.2 million).
- mineral oils and lubricants by 5.4% (oil and oil products reduced by 6.7% or EUR 13.4 million);
- products classified by material by 0.7% (iron and steel by 12.5% or EUR 10.8 million);

Observed by economic purpose in Q3 2012, goods for industrial production (41.9%) were most imported, followed by: personal consumption goods (24.0%), energy (19.5%), and investment products (14.6%).



In Q3 2012, foreign trade of the Republic of Macedonia with the European Union (EU 27), in relation to Q3 2011, reduced by 5.8%, whereby share of trade with the EU in the total foreign trade increased by 7 p.p. compared to the third quarter in 2011, accounting for 63.0%, whereby export of goods participated with 62.5% and import of goods accounted for 63.3%.

As a result of the structural changes in the trade with abroad, in the second quarter of 2012, 70.7% of the trade deficit of the country was a result of the trade deficit with Austria, Romania, Switzerland, Slovenia and Croatia while the rest of the deficit was a result of the trade with: Turkey, Kosovo, Russia, China, etc. Trade surplus was realized with the USA, Bosnia and Herzegovina, Spain, the Netherlands and Poland.

5.2. Balance of payments

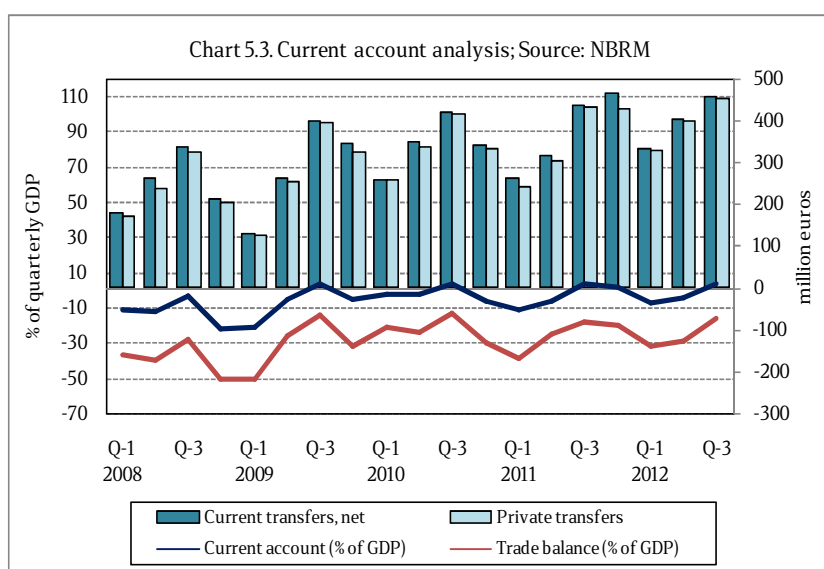
According to the National Bank data, in the third quarter of 2012, the current account balance experienced surplus of EUR 71.3 million, widening by 27.4% (EUR 15.4 million) on annual basis.

Widening was mainly a result of the reduced trade deficit and the increased inflows on the basis of net current transfers.

On the other hand, within larger downward adjustment of export compared to import, trade account registered narrowing compared to the previous quarter, acting in opposite direction, reducing the positive effect from the increased transfers. In such conditions, the current account balance registered improvement on annual basis, as well as improvement compared to the previous quarter.

5.2.1. Current account

In Q3 2012, current account balance was positive, accounting for 3.7% of GDP, being higher by EUR 15.4 million compared to Q3 2011. Increase of the positive balance was a result of the increase of net current transfers, which in Q3 2012, amounted to EUR 454.7 million, surging by 4.1% compared to Q3 2011, as well as due to the reduced deficit of net income by EUR 9.2 million or by 2.3% on annual basis compared



to Q3 2011. Reduced balance of services and the increased outflows on the basis of net incomes by 36.8% acted in opposite direction. Balance of services in Q3 2012 amounted to EUR 32.8 million, i.e. it decreased by 14.8%, compared to Q3 2011.

Trade openness of the Republic of Macedonia in Q3 2012 amounted to 102.0%, narrowing by 5.8 p.p. compared to the same quarter in 2011.

In Q3 2012 trade balance (-20.3% of GDP) experienced increase compared to the previous four quarters.

Net current transfers in Q3 2012 amounted to EUR 454.7 million, being higher by EUR 17.8 million or by 4.1% compared to Q3 2011. Increase is due to the private transfers, increasing by 4.8% and participating with 99.4% in the total net transfers. Private transfers in Q3 2012 amounted to EUR 451.8 million. More thoroughly analyzed, other transfers (89.4%) had dominant share in the private transfers, increasing by 5.4% and

amounting to EUR 403.9 million, while remittances from employees surged by 0.3% compared to Q3 2011, amounting to EUR 48 million.

Compared to the previous quarter, net current transfers grew by 12.4% or by EUR 50.3 million, mainly due to the increase of private transfers by 13.1% or EUR 52.3 million.

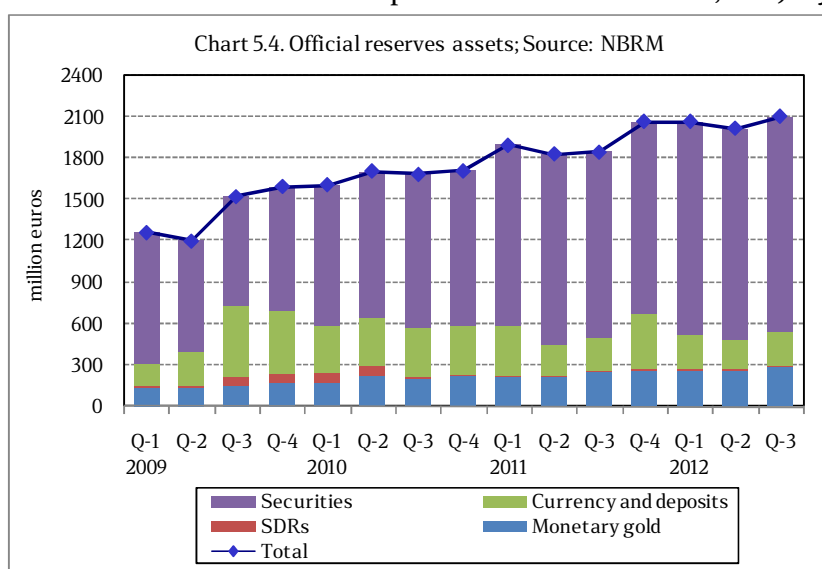
Coverage of trade deficit with private transfers in Q3 2012 accounted for 114.6%, increasing by 7.8 p.p. on annual basis.

5.2.2. Capital and Financial Account

Capital and financial account in Q3 2012 experienced deficit and the balance amounted to EUR -109.5 million, widening by EUR 27.6 million compared to Q3 2011. According to the financial account, in Q3 2012 the net direct investments experienced negative balance amounting to EUR 36 million being negative trend compared to Q3 2011, when surplus was realized in the amount of EUR 45.5 million. In Q3 2012, in August and September, direct investments in the Republic of Macedonia decreased, as a result of the reinvested profit and reduction of the other capital item. Unlike this, in July, increase of direct investments in the amount of EUR 19.5 million was registered.

In the end of Q3 2012, gross official reserves amount to EUR 2,103.6 million, being higher by 13.8% compared to Q3 2011. Foreign currency reserves, i.e. securities had dominant share in the official reserves, participating with 73.9%

or EUR 1,553.6 million and the monetary gold, which participated with 14% or EUR 300.7 million, while currencies and deposits participated in the total official foreign currency reserves with EUR 248.1 million (12%).



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