

Q4-2011

Republic of Macedonia
Ministry of Finance

QUARTERLY ECONOMIC REPORT Q4/2011

Summary

- **Real GDP growth** in Q4 2011 was 0.2% on annual basis, following the 4.1% growth in the first three quarters in 2011. Accordingly, average economic growth in 2011 was 3%.
- **Unemployment rate** in Q4 2011 was 31.8%, while employment rate accounted for 38.5%;
- **Inflation rate** in Q4 2011 showed a slowed down growth of 3.2% compared to the same quarter in 2010, measured according to CPI;
- Average **gross salary** in Q4 2011 amounted to Denar 30,870, experiencing nominal growth of 0.6%, while it declined by 2.5% in real terms;
- **Total budget revenues** were higher by 3.2% in Q4 2011 and **total budget expenditures** dropped by 2% compared to the same quarter in 2010;
- Total **deposit potential of the banks** continued to strengthen in Q4 2011 as well, accounting for 3.4%, while **credit activity of banks** towards non-government sector experienced 1.5% growth on quarterly basis;
- **Macedonian stock exchange index MSEI-10** declined by 13.3% in December 2011 compared to December 2010;
- In Q4 2011, on annual level (Q/Q-4), **increase of both export** by 16.2% and **import** by 8.2% was registered, whereby total **foreign trade**, expressed in euros, surged by 11.2%;
- **Trade openness** of the Republic of Macedonia in Q4 2011 was 106.9%, experiencing an upward trend compared to the same quarter in 2010 by 7.9 p.p..

1. Macroeconomic Trends and Real Sector

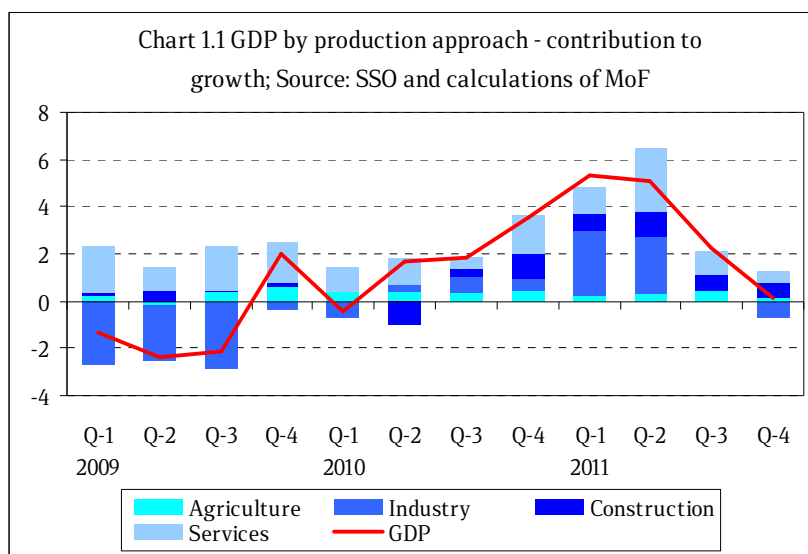
Real GDP growth in Q4 2011 remained in the positive zone, accounting for 0.2% on annual basis, following the 4.1% growth in the first three quarters in 2011. Accordingly, average economic growth in 2011 was 3%.

Nominal GDP growth in Q4 2010 accounted for 3% compared to the same quarter last year, implying that GDP deflator amounted to 2.8%. Average nominal growth in 2011 accounted for 5.9%, while GDP deflator in 2011 accounted for 2.7%.

Real GDP growth in Q4 2011, compared to Q3 2011, amounted to 7.7%, due, to a certain extent, to the positive seasonal effects. Accordingly, seasonally adjusted quarterly GDP growth in Q4 2011 amounted to 0.1%.

Analyzed by the **production side of GDP**, construction activity continued experiencing two-digit growth rates, accounting for 10.4% in Q4. Average growth in the construction sector in 2011 was 15.6%.

Hotels and restaurants sector also registered two-digit growth in Q4 – 11.3%. Trade sector experienced a solid growth of 4.1% in Q4. In fact, in the course of 2011, Trade sector showed excellent performance, registering an average growth of 7.1%



Public administration sector continued realizing positive growth rates, accounting for 1.5% in Q4. Agriculture registered an increase of 1.1% in Q4, following the 4.2% increase in the previous quarter. Positive growth was also observed in the Financial services sector (0.9%), following the decline in the activity in the previous three quarters, and the average growth in 2011 was – 1.8%.

Positive performance in the above-mentioned sectors was, to a great extent, neutralized by the drop in the activity in the Transport, storage and communications sector by 4.8% and the decline of the industrial production by 4.1%. Anyhow, average growth of industrial production in 2011 was positive and amounted to 5.8%, being a result of the high increase of 15% registered in the first half of the year.

Analyzed by **expenditure side**, GDP growth in Q4 was driven by domestic demand, in particular gross investments, which experienced two-digit increase of 12%, following the increase of even 46% in the previous quarter. Increase of investments corresponds to the growth in the construction sector, high increase of domestic production of capital goods, as well as the solid level of foreign direct investments. Average growth of

gross investments in 2011 was 22.7%. Gross investments in 2011 accounted for 25.4% of GDP.

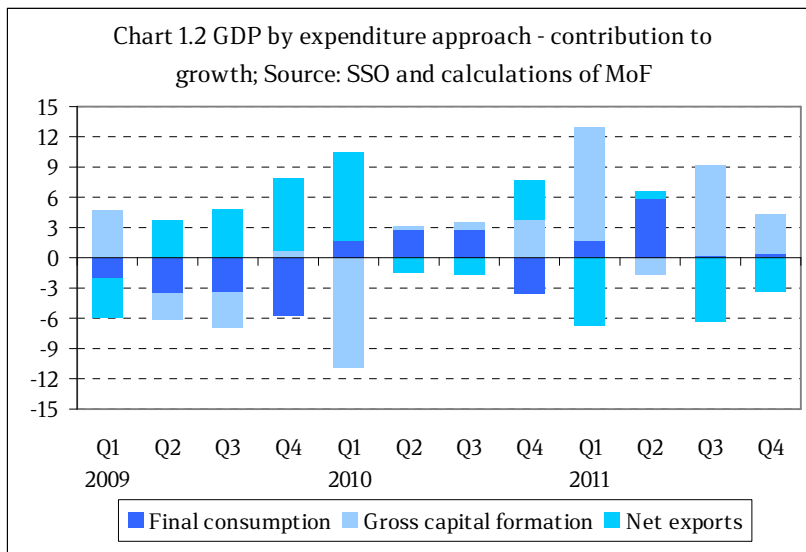
Final consumption in Q4 experienced slight increase of 0.3%, as a result of the growth of private consumption of 1.6%. Growth of private consumption corresponded to the increase in the trade, as

well as the positive growth of consumer goods production. Public consumption in Q4 registered decline of 4.8%, pointing to continuous negative growth of public consumption observed in the course of 2011.

With respect to net export demand, it had negative contribution to the economic growth. Export of goods and services in Q4 showed real growth of only 0.5%, continuing the downward trend of export growth, due to the slowdown of the economic growth in the EU. Import of goods and services in Q4 registered real growth of 5.7%.

According to the **Labour Force Survey**, active population in Q4 2011 declined by 1.8% compared to the same quarter in 2010. This was a result of the decline in the number of employed persons, being lower by 3.1% annually, while number of employed in Q4 2011 increased by 0.9%. Working-able population in Q4 2011 recorded growth of 0.4%.

Such trends on the labour market caused for the **unemployment rate** in Q4 2011 to increase by 0.9 percentage points, compared to the same quarter in 2010, accounting for 31.8%. Employment rate was 38.5%, decreasing by 1.4 p.p., compared to the same quarter in 2010, while activity rate dropped to 56.5% from 57.8% in Q4 2010. In fact, number of employees, analyzed according to the type of ownership of business entities, in the private sector dropped by 3.9% annually, while number of employees in the other parts of the economy dropped by 0.4%.



2. Prices, Costs and Productivity

Inflation rate, measured according to CPI, was 3.2% in Q4 2011 compared to the same quarter in 2010, showing a slowed down growth compared to the previous quarter (3.6%).

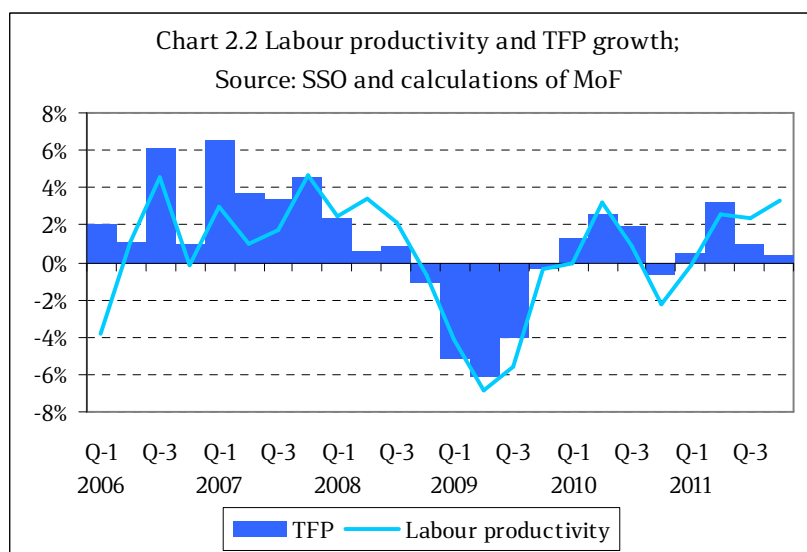
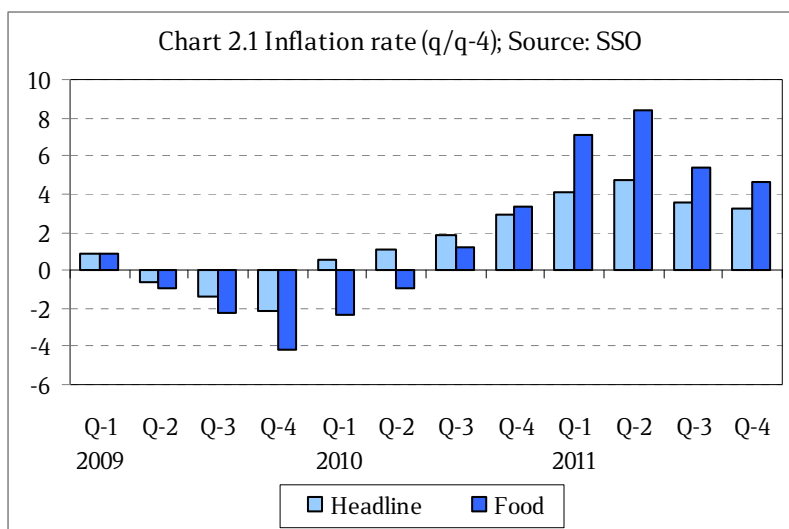
Highest price increase was registered in the Food category – 4.7%, followed by price increase in the Housing category – 3.5%, mostly due to the increase of electricity prices by 5.4%. Prices in the Hygiene and Health category surged by 2.8%, while prices in the Means of Transport and Services category were higher by 2.4%, mostly as a result of the higher prices

of liquid fuels and oils by 12%. Price increase was also registered at the following categories: Hotels and Restaurants - 1.8%, Clothing and Footwear - 1.6%, Administrative and Financial Services – 1.1%, Culture and Entertainment – 0.8% and Tobacco and Beverages – 0.2%.

Core inflation (which excludes the effect of food and energy) was 1% in Q4 2011, being lower by 0.3 p.p. compared to the core inflation in the previous quarter (1.3%).

Retail prices in Q4 2011 increased by 3.6% compared to the same quarter in 2010. Prices of industrial products, which surged by 5%, contributed the most (with 2.9 p.p.) to the total increase of the retail prices. Within this category, highest price increase was recorded at non-food products – 5.9%. Prices of food products surged by 4.7%. Retail price of beverages increased by 0.6%, while retail price of tobacco remained unchanged. Retail prices in the Agricultural Products category experienced slight increase of 0.6%, characterized with the almost the same intensity as in the previous quarter.

Average **net salary** in Q4 2011 amounted to Denar 21,050, being higher by 1.3% in nominal terms, compared to same quarter in 2010. On real basis, net salary dropped by 2.3% (shaded field in Chart 2.2). Average **gross salary** amounted to Denar 30,870, increasing



by 0.6% in nominal terms, while it dropped by 2.5% in real terms.

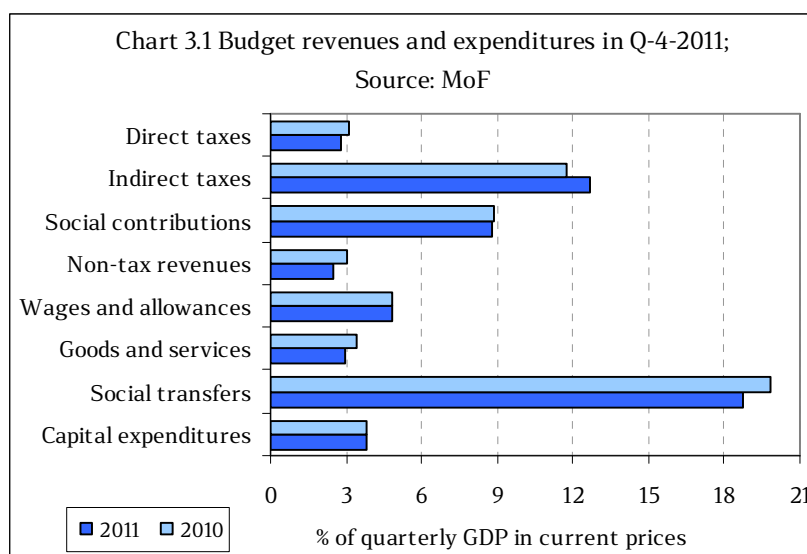
Slight growth of economic activity in Q4 2011 was also accompanied by the drop in the number of employees. Such trends implied increase of the **labour productivity** by 3.3%, following the increase of 2.3% in the previous quarter. In fact, physical capital also increased by 3.9% in Q4 2011. Such trends of growth factors caused for **total factor productivity (TFP)** to increase by 0.3% in Q4 2011, following the increase of 1% in the previous quarter. Chart 2.3 shows TFP and labour productivity trends.

3. Fiscal Sector

Higher performance of budget revenues was observed in the last quarter in 2011, compared to the same quarter in 2010, accompanied by relatively lower budget expenditures. Budget deficit accounted for Denar 2,092 million in Q4 2011, being 1.7% of GDP realized in this quarter (central budget deficit amounted to Denar 2,527 million, i.e. 2.1% of GDP, being an increase by 1.3 p.p. compared to the previous quarter).

Anti-cyclical fiscal policy continued to be conducted in the fourth quarter in 2011 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 3.2% compared to the same quarter in 2010, mostly due to the better performance of tax revenues by 7.1%, while contributions showed more modest growth, i.e. they increased by 2.6%, and non-tax revenues dropped by 15.2%. Thereby, record high collection of VAT was observed, while collection of excises and



personal income tax showed a modest increase, unlike the performance of the profit tax, which dropped by 28.3% and collection of customs duties revenues, which declined by 8.4%. VAT revenues, accounting for the most of the total tax revenues - 54.6%, surged by 14.1% in Q4 2011, compared to the same quarter in 2010, i.e. they were higher by 1.6% compared to 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, 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 3.5% compared to the same quarter in 2010. As for direct taxes, profit tax revenues declined by 28.3 p.p. compared to the

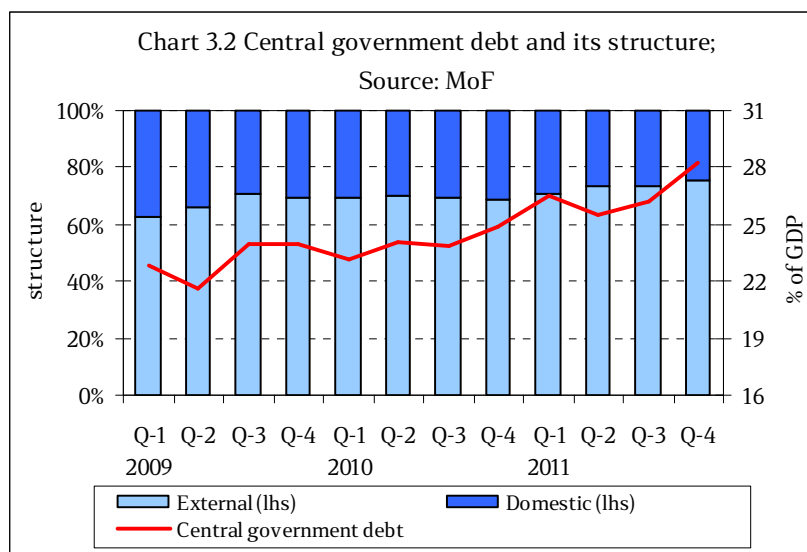
previous quarter (one should take into account that in 2010, only profit distributed for dividend was taxed, and starting April 2010 revenues on the basis of tax on paid dividend and other distribution of profit was registered, participating with significant percentage in the structure of this tax). PIT revenues were higher by 3.8% compared to the previous year. Analyzed by structural share in GDP, direct taxes decreased their share in GDP by 0.3 p.p. on annual basis, while share of indirect taxes grew by 0.2 p.p..

Collection of social contributions was higher by 2.6%, whereby higher collection was recorded at all contributions, i.e. pension insurance contributions - 2.8%, health insurance contributions - 2.2%, employment contributions - 3.0%. Non-tax revenues, accounting for 2.5% of total quarterly GDP, showed lower performance by 15.2%, compared to the same period in 2010.

Capital revenues in Q4 2011 were higher by 3.6% 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 donations dropped by 1.2%, compared to Q4 2010.

In Q4 2011, total **budget expenditures** were lower by 2.0% compared to the same quarter in 2010. Current expenditures, accounting for 87.8% of the total expenditures, dropped by 2.6% on annual basis. Capital expenditures, participating with 12.2% in the total expenditures, were higher by 2.4% compared to Q4 2010, whereby their performance in Q4 2011 was with better dynamics than in the previous years, accounting for 21.6% of the total planned funds for 2011. As for current expenditures, expenditures for goods and services dropped by 11.1%, while expenditures related to salaries and allowances experienced relatively moderate rise, i.e. they increased by 2.4% compared to the same quarter in 2010. Funds for transfers, participating 60.3% in the total expenditures, were lower by 2.6% on annual basis, while the share of the category „Other Transfers“ in the total transfers accounted for 22.1% (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 27.2% in total expenditures, were higher by 5.8% compared to the same quarter in 2010, i.e. they were higher by 4.6% compared to Q3 2011. Interest-related expenditures increased by 3.0%, whereby domestic debt interest-related expenditures dropped by 10.3%, and expenditures related to interest on foreign debt surged by 8.6%.

Fiscal burden, measured as participation of budget



revenues¹ in relation to nominal GDP, was 26.6% in Q4 2011, increasing by 0.8 p.p. in relation to Q3 2011. Total budget expenditures accounted for 31.1% of GDP, which was by 0.6 p.p. lower compared to Q3 2011, i.e. by 1.5% lower on annual basis.

Total central government **debt** at the end of Q4 2011 accounted for 28.2% of GDP, increasing by 2.0 p.p. compared to Q3 2011. Share of central government external debt in the total central government debt increased by 2.1% compared to Q3 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 24.3% 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, 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 last quarter in 2011, monetary policy remained unchanged. NBRM kept the reference interest rate at the level of 4% in conditions of favourable macroeconomic climate and weakened inflationary pressures as a result of slowdown of growth of food prices.

In Q4 2011, **primary money**² experienced strong quarterly growth by 15.3% compared to the decline of 4%, registered in the previous quarter. Total liquidity of banks, which surged by 18%, contributed the most to the growth, and currency in circulation experienced high growth of 11.8% on quarterly basis.

In the course of the fourth quarter in 2011, quarterly growth of money supply and total deposit potential of banks was intensified. Monetary aggregate **M1** increased by 6.6% on quarterly basis compared to Q3 2011, as a result of the increase of currency in circulation, instigated, to a great extent, by seasonal factors, as well as the increase of deposit money. **Broader monetary aggregates M2 and M4** grew by 3.8% and 4.1% respectively in Q4 2011, compared to the previous quarter.

Increase of **total deposit potential**³ of banks continued to be intensified in the fourth quarter of the year as well. Hence, total deposits surged by 3.4% on quarterly basis compared to 2.5% in Q3 2011. New savings were fully in domestic currency, while foreign currency deposits had a negative contribution. In fact, Denar deposits increased by 8.1% on quarterly basis, while foreign currency deposits dropped by 1% due to the decline in foreign currency savings of private enterprises.

¹ It included tax revenues, social contributions and administrative fees and duties and road toll.

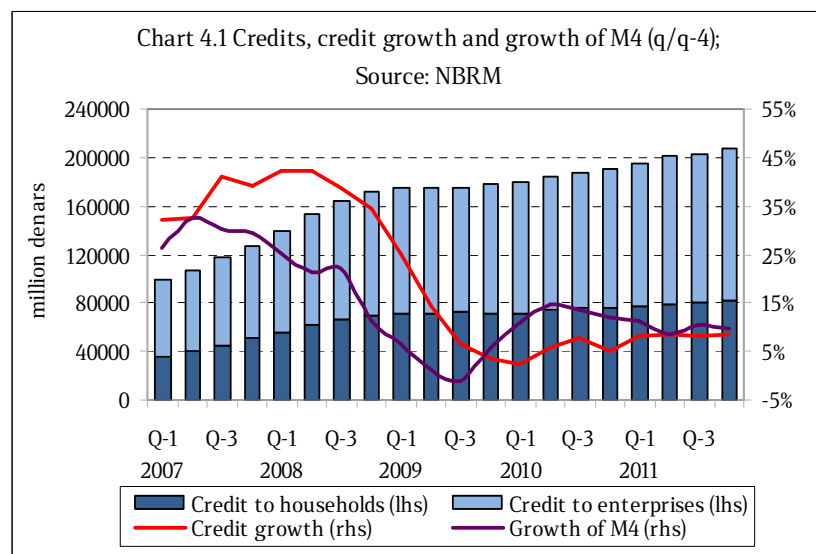
² It includes currency in circulation (including cash in hand), Denar and foreign currency reserve requirement and the surplus of liquid assets over the reserve requirement (in Denars).

³ Deposits also include calculated interest.

From sectoral point of view, deposits of households grew by 4.2%, while deposits of enterprises surged by 4.3%. New savings of households were predominantly in domestic currency, which contributed positively to reduction of the level of euroization to 48.7% (from 50.9% in Q3 2011), measured through the share of foreign currency deposits in the total deposit potential. Deposits of private enterprises increased by 4.3% in relation to Q3 2011.

According to maturity, short-term deposits increased by 2.8% in Q4 2011 compared to the previous quarter, while growth of long-term deposits intensified to 5% (1.6% in Q3 2011).

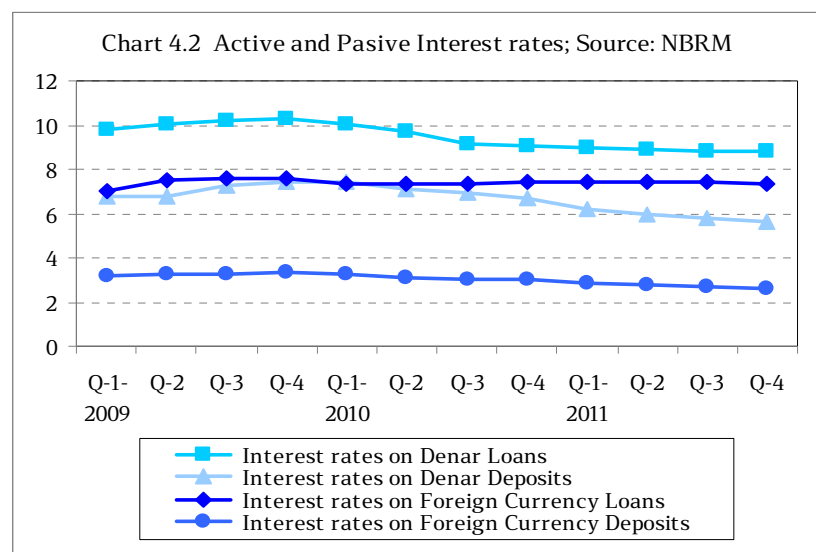
Credit activity of banks to non-government sector registered a growth rate of 1.5% in Q4 2011 on quarterly basis, in conditions of increased crediting to corporate sector and households. Increased crediting to private enterprises by 1.7% contributed the most (67.9%) to the growth of credit activity, while credits to households increased by 1% in relations to Q3 2011.



From currency point of view, foreign currency credits showed slowed down growth of 3.4% on quarterly basis (compared to the growth of 6% in Q3 2011). Denar credits, following the 0.2% drop in the previous quarter, experienced quarterly growth of 0.8% in Q4 2011.

From maturity point of view, long-term credits remained to be the main driving force of the new crediting on quarterly basis, increasing by 2.3% in relation to Q3 2011, while short-term credits experienced a mitigated decline of 0.3%.

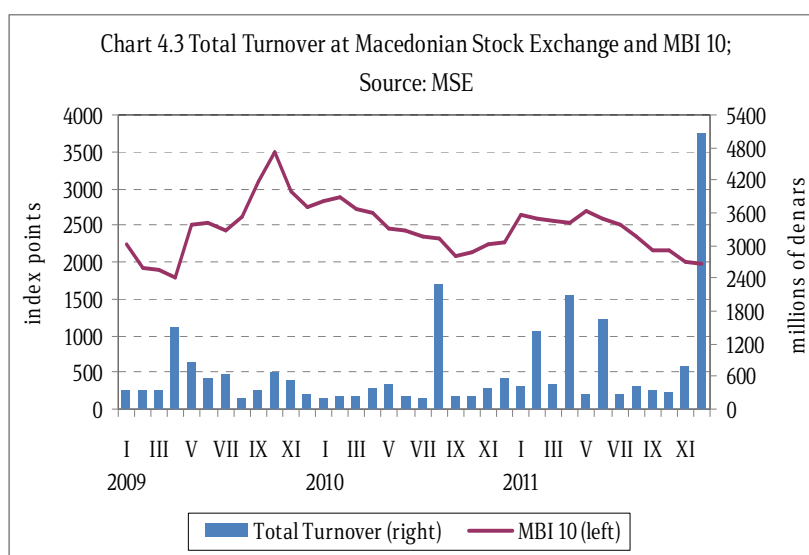
In the fourth quarter in 2011, NBRM kept the reference **interest rate** unchanged at the level of 4%. In Q4 2011, interest rates of deposit banks experienced no significant changes. In fact, interest rates of deposit banks on Denar and foreign currency



credits kept the level from the previous quarter, i.e. they were 8.8% and 7.4% respectively. On the other hand, interest rates on Denar and foreign currency deposits declined on quarterly basis by 0.1 p.p., and they were 5.7% and 2.6% respectively.

Interest rate on newly approved Denar credits was 8.2%, showing 0,1 p.p. decline on quarterly basis, while interest rate on newly approved foreign currency credits declined significantly by 0.3 p.p., amounting to 7.1%. Interest rate on new Denar deposits experienced high increase of 0.6 p.p. compared to Q3 2011, amounting to 3.7%, while interest rate on new foreign currency deposits remained unchanged, i.e. 0.8%.

Total turnover on the **capital market** in the fourth quarter experienced high increase in relation to Q3 2011, as a result of the block transactions realized in December 2011, while turnover realized through traditional trading dropped by 32.5%. Compared to the same period last year, traditional trading declined by 42.2%.

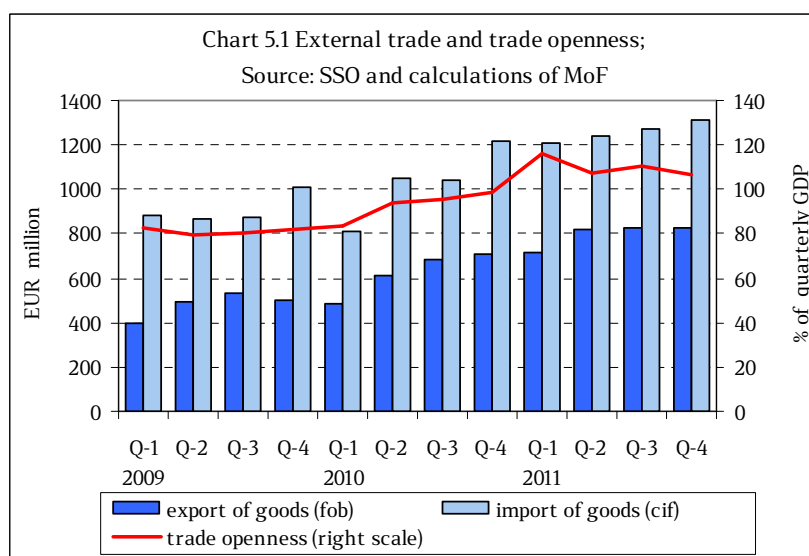


Macedonian Stock Exchange Index MSEI-10, as aggregate indicator of stock exchange trends, decreased by 8.7% compared to September 2011, while in relation to December 2010, it dropped by 13.3%.

5. External Sector and Balance of Payments

In Q4 2011, total foreign trade (f.o.b. basis) amounted to EUR 2,090 million, being the highest amount since 2003 onwards, increasing by 11.2% compared to the same quarter in 2010, as a result of simultaneous increase of export and import of goods.

In Q4 2011, **export** of goods amounted to EUR 823.9 million which,



following the registered export in the third quarter in the amount of EUR 825 million, was the second highest amount since 2003 and, compared to the same quarter in the previous year, it increased by 16.2%.

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

- machines and transport equipment by 126.8% (electrical machines and spare parts and industrial machines and spare parts by EUR 20.2 million and industrial machines and spare parts not mentioned elsewhere by EUR 20.8 million or contributing to growth with 2.8 p.p. and 2.9 p.p. respectively);
- chemical products, i.e. chemical materials and metal products - EUR 20.1 million, contributing to growth with 2.8 p.p. (such trends were due to the high growth of export of „catalysts with precious metals or precious metal compounds by “Johnson Matthey””);
- oil and oil products - EUR 5.2 million, contributing to growth with 0.7 p.p.
- products classified by material by 9.4% (iron and steel by EUR 24.6 million or contributing to growth with 3.5 p.p.), etc.

In Q4 2011, observed by **economic purpose**, goods intended for industrial production and personal consumption goods contributed the most to the annual growth of export with 52% and 33% respectively, followed by investments with 9% and energy with 6%.

Import of goods (f.o.b.) in Q4 2011 amounted to EUR 1,226.3 million, increasing by 8,2% (by EUR 96 million) compared to Q4 2010, while in relation to the previous quarter, it increased by 3.1%. Analyzed by SITC sectors, in Q4 2011, highest positive movement as regards import was registered at the following categories: mineral oils and lubricants (oil and oil products by EUR 28.9 million, electricity by EUR 14.7 million), iron and steel by EUR 7.6 million, participating with 0.6 p.p. in the total growth, followed by items from non-metal minerals by EUR 6.2 million, textile yarns by EUR 5 million, etc. Import growth at these categories of goods, which are intermediary inputs in the production process, points out to preconditions ensured for the production activity in the next quarters.

With respect to the categories cellulose and paper waste, import declined by 87.2%, while import at the categories tar and raw chemicals and transport equipment dropped by 74.3% and 59.5% respectively. However, the numbers should be taken with caution since they do not include base effect from the fourth quarter last year.

Observed by economic purpose, in Q4 2011, products intended for industrial production participated with 40% in the annual growth of import, personal consumption goods contributed with 24% and energy with 21%, while investments accounted for 14%.

Trade openness of the Republic of Macedonia in Q4 2011 amounted to 106.9%, an increase compared to the same quarter in 2010 by 7.9 p.p., as a result of the more intensive increase of trade and slower increase of the level of GDP in this quarter.

In Q4 2011, in conditions of improved trade with the European Union (EU 27), in relation to Q4 2010, by 8%, share of trade with EU in the total foreign trade declined by 1.6 p.p., accounting for 55.5%, whereby export of goods participated with 42% and import of goods accounted for 58%. As a result of the structural changes in trade with abroad, in the fourth quarter in 2011, 63.5% of the trade deficit of the country was a result of the trade deficit with Russia, Great Britain, Turkey and Greece, while the remaining deficit was due to the trade with the following: Bulgaria, China, Switzerland, Slovenia, Serbia, etc. Trade surplus was realized with Germany, Albania, Montenegro, Belgium, Bosnia and Herzegovina, etc.

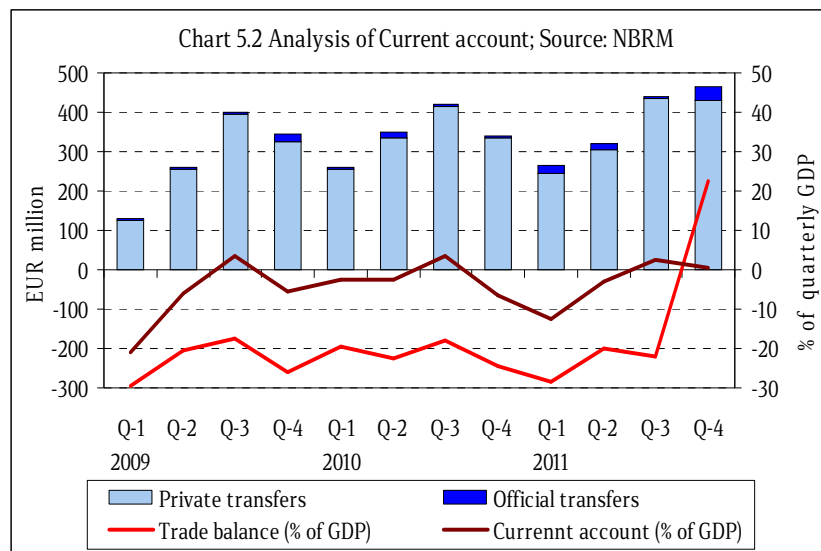
In Q4 2011, surplus on the current account in the amount of EUR 12 million or 0.6% of GDP was realized, compared to the deficit realized in the same quarter in 2010 in the amount of EUR 127.9 million.

In Q4 2011, improved positive balance of services by 8.9% in relation to Q4 2010 and increased net current transfers by EUR 128 million were the main factors for the current account to experience a surplus in the amount of EUR 12 million in Q4 2011.

Trade balance (-22.6% of GDP) experienced decline in Q4 2011 compared to the previous two quarters in 2011, and a positive development compared to the first quarter in 2011.

Annual growth of export and import in Q4 2011 was with a lower intensity in relation to the previous three quarters, and such trends caused for the level of trade deficit, in relation to GDP, to drop by 1.7 p.p. compared to Q4 2010.

In the same quarter, **net current transfers** increased by 37.5% in relation to Q4 2010, being a result, to a great extent, of the higher private transfers. Private transfers registered an increase of 29.8% (EUR 99.2 million), continuing to have dominant share (92.5%) in the current transfers.



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April 2012, Skopje