**National Bank of the Republic of Macedonia**

# ANNUAL REPORT
# 2013

Skopje, April 2014

Contents

## Governor's foreword

*Dear readers,*

*The global environment in 2013 was still affected by the consequences from the global downturn. However, what distinguishes this year compared to previous crisis years are the initial signals of recovery of the Euro area and the announcement for a gradual reduction of the quantitative easing in the U.S. economy, which of course increased the optimism and confidence on the financial markets. On the other hand, the announcements for gradual normalization of the monetary policy of advanced economies caused turbulence in the markets of emerging economies, which registered capital outflows and exchange rate fluctuations. After all, it was another confirmation of the global interconnectedness and a message to the macroeconomic policy - makers worldwide to gear up for making appropriate changes in the policy direction.*

*During 2013, the Macedonian economy recovered significantly, registering real GDP growth of 3.1%, versus the small decline in the previous year. The growth was mainly driven by net exports and increased private consumption, amid further gradual reduction of unemployment in the economy. In this context, it is important to point out the effect of the new production facilities which significantly contributed to the exports, providing greater export diversification and greater flexibility of exports, notwithstanding the fragile export demand. Improved performances in the trade balance allowed for narrowing of the current account deficit, whereafter it reduced to 1.9% of GDP, in circumstances where private transfers normalized after the extremely high level in the previous year. Moreover, the economic recovery was supported by the fiscal stimulus aimed at infrastructural projects, as well as by the accommodative monetary policy.*

*In general, the environment for the monetary policy conduct during 2013 can be assessed as favorable, given the relatively stable inflation rate and the solid level of foreign reserves. The average annual inflation in 2013 was 2.8%, with a trend of deceleration in the second half of the year, mainly due to the energy prices. In circumstances of a negative output gap, there were no pressures from the demand. On the foreign exchange market, the National Bank intervened with net purchasing of foreign currency. Indicators of foreign reserves adequacy pointed to a comfortable level of foreign reserves throughout the year, whereby the stable exchange rate expectations were maintained. Against such background, monetary policy was eased through the policy rate, as well as other instruments and non-standard measures, while the main challenge was to stimulate banks' credit growth.*

*The policy rate was trimmed down twice (in January and in July) by 25 basis points, respectively, and in July it was reduced to 3.25%, which is the lowest historical level. Further loosening was performed through the change in the reserve requirement, which became effective at the beginning of 2013, whereby the base for the reserve requirement of banks was reduced for the amount of the newly extended loans to sectors whose growth reduces the external vulnerability of the economy (net exporters and the energy sector). It is a nonstandard measure that will be implemented by the year 2014, when the need for its further application will be re-examined. In early July, reserve requirement on banks' Denar liabilities was reduced, amid simultaneous identical increase (by 2 percentage points) in the rate of foreign currency liabilities, and also the obligation for allocating a reserve requirement on liabilities to non-residents was abolished. These changes were aimed at supporting the process of deeuroization, releasing banks' liquid assets and stimulating a larger inflow of funds from non-residents, especially foreign financial institutions. In the last quarter of the year, changes were made to certain precautionary measures in the area of managing banks' liquidity and credit risks, which contributed to creating more space for* *higher yielding investments of banks, i.e. encouraging more active lending by the banking sector.*

*Regarding the more significant monetary developments that marked 2013, several aspects may be distinguished. First, in 2013, the deposit growth accelerated further, and the trend of deeuroization that was characteristic of the crisis period, continued. It was expressed by further reducing of the share of foreign currency deposits in total deposits and was followed by corresponding changes also in the currency structure of banks' assets. This process was carefully monitored and was also supported by appropriate measures by the National Bank. Second, the dynamics of bank loans to the private sector constantly occupied our attention and it was driven mainly by the banks' perceptions of the risks. The credit growth gradually slowed in the first half of the year, in the third quarter it was stable, and in the last quarter it moderately accelerated, reaching 6.4% at the end of the year. Starting from the second half of the year, banks' perceptions of risk in terms of the economic activity improved, and at the end of the year a certain relaxation in terms of the influence of the conservative strategies of major international groups that operate in the domestic market was registered. It was assessed that the measures undertaken by the National Bank positively contributed to the credit growth acceleration. Third, in the second half of the year, there was a trend of gradual slowdown of banks' non-performing loans (which, in fact, remained at a moderate level during the crisis period, compared to the region). That has further encouraged lending, particularly to the corporate sector at the end of 2013, versus the greater restraint in the beginning of the year, partly because of the higher credit risk of this sector. Fourth, the continuous monitoring of the monetary policy transmission mechanism through the interest rate channel indicated incomplete transmission of the changes in the policy rate, which mainly affected the banks' deposit interest rates. This called for changes also in the other available monetary policy instruments, as well as taking other measures (previously mentioned) for achieving our goals.*

*In general, behind us is another year of challenges, mainly imposed by the global economic crisis, which required flexibility in terms of the changes in the global and domestic environment, commitment to the tasks and certain creativity in designing the measures and decisions that were taken. With such an approach, this year too, we have managed to maintain price stability, while preserving the stability of the banking system and registering some positive shift also in the dynamics of bank loans.*

*In 2014, we expect a moderate acceleration of the growth of the domestic economy, mainly caused by the domestic demand. It is expected that the inflation will be largely influenced by the world prices of primary products, with more pronounced downward risks. In the external sector, relatively favorable movements and a moderate current account deficit are expected. Further inflows of foreign direct investment create the basis for further improvements in the structure of exports and strengthening of the external position in the long run. It is expected that the economic recovery and more stable environment will ensure growth of the deposit potential and stabilize the expectations of banks and other entities. In conditions of solid liquidity and solvency of banks, these factors, together with the expected effects of the already undertaken monetary and precautionary measures, would provide further growth of the financial support for the domestic economy through the banks. In this segment, in the context of the global recovery, which nevertheless is still seen as fragile and with significant variations in terms of individual regions and groups of countries, there remains the necessity of regular monitoring of global trends, and in accordance with the pace of recovery of the domestic economy, regular reassessments of the needs for proper adjustment of macroeconomic policies will be needed.*

*In the years of the crisis that are behind us, we faced with and overcame many challenges, but in 2014 and in the years after, we should undoubtedly expect new tasks.*

*What specifically contributed to overcoming the challenges in the past and what makes us feel prepared to face the challenges in the future is the human capital and the efforts to strengthen the institutional capacity, to which we paid due attention during 2013. Notably, we have further improved the qualification structure of the employees and increased the activities toward strengthening the research activity. In terms of strengthening the administrative capacity of the National Bank, a significant achievement is the realization of the project "NBRM Needs Analysis", funded by the EU Instrument for Pre-Accession Assistance. This project started in October 2012, lasted for nine months, and was implemented by the ECB in partnership with the central banks of eleven EU countries. The wrap-up report of this project indicated that the National Bank has already established practices and policies that are equal or close to EU standards in many areas, and also provided recommendations for further improvement in certain areas. These findings will be incorporated into the strategic planning of the National Bank and are expected to contribute to further improve the institutional capacity.*

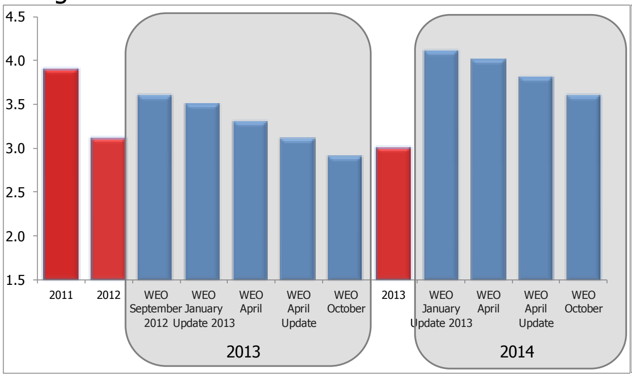
*The National Bank also in 2014 continues to actively monitor the trends in central banking and, if necessary, appropriately adapt the measures and instruments, taking into account the domestic macroeconomic environment and the impact of the external environment in order to achieve the main monetary policy objectives.*

# I. Monetary Policy in 2013

Also in the course of 2013, the monetary policy measures provided for maintaining the price and exchange rate stability, as main and intermediate monetary targets. In circumstances of an adequate level of foreign reserves and assessments for absence of major pressures on the exchange rate, the cycle of monetary easing continued in 2013. Monetary conditions were relaxed through the interest rate, but also through other instruments available to the central bank.

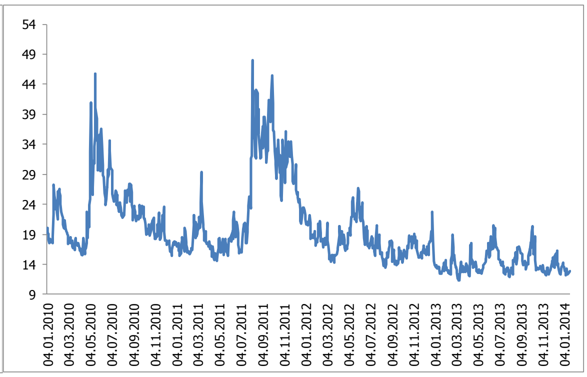
In 2013, the monetary policy was conducted in a relatively stable environment, although the negative risks and uncertainties regarding the global environment were still present. Although economic indicators pointed to further economic recovery, however, amid still present uncertainty and vulnerability, during the year the estimates for the global economic growth were revised downwards. Thus, in the balance of risks to growth, downward risks consistently prevailed. In such external environment, potential risks to the domestic economy this year, too, were located mainly in the export segment and in the access of domestic entities to external sources of capital. The worsened conditions on world metal markets also contributed to greater vulnerability of the export segment. Such circumstances, given the strategy of maintaining a stable exchange rate, could change the conditions for conducting monetary policy. In this context, the National Bank closely monitored the trends and their possible deviation from the intended path and gradually adapted the monetary policy for the purpose of successful achievement of the goals. Regarding the fiscal policy, as an important input assumption in making monetary decisions, its position throughout most of the year was basically in line with the originally announced path. However, towards the end of the year, amendments to the Budget were made, and the budget deficit was higher than originally anticipated.

Chart 1
Revisions of the global economic growth, annual change in%[1]




Source: World Economic Outlook (IMF WEO Database).

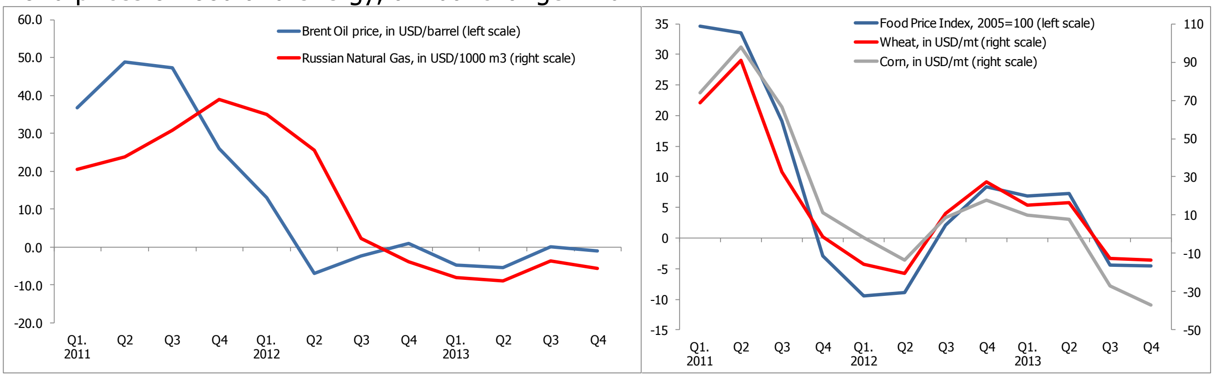
Chart 2
VIX index[2]




Source: Bloomberg.

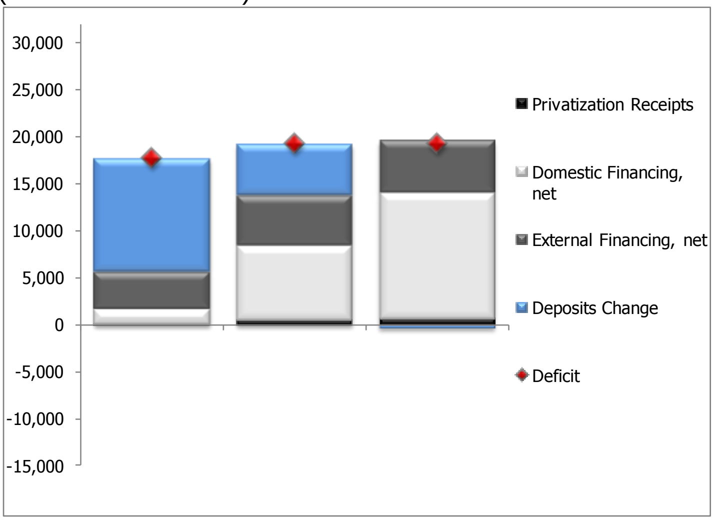
[1] The gray zone applies to revisions of projections for the relevant period.
[2] VIX index or CBOE volatility index-VIX is a basic tool for measuring market expectations regarding the expected volatility in the short term. It is calculated on the basis of the prices of the options contained in the S&P 500 index. Since its introduction in 1993, VIX index is considered the world's leading barometer of investor sentiment and market volatility. During 2013 it was again volatile, indicating still present uncertainty and volatility in market expectations.

Chart 3
World prices of food and energy, annual change in%




Source: IMF database.

Chart 4
Structure of financing the budget of the Republic of Macedonia[3]
(in millions of denars)




Source: Ministry of Finance.

The movements in the domestic economy during the year and the projections for the forthcoming period indicated some room for relaxing the monetary conditions. Monetary policy easing was made in the course of the year. At the beginning of the year, in January, the changes in the Decision on the reserve requirement[4] came into force, which contributed to the monetary easing. Also, at the beginning of January, the National Bank reduced the interest rate on CB bills from 3.75% to 3.5%. The interest rate was lowered in circumstances of uninterrupted favorable movements, observed from the monetary point of view. Thus, the level of foreign reserves at the end of 2012 suggested that the position of the balance of payments provided a better basis for monetary easing. Inflation in the domestic economy constantly decelerated, given the falling world prices of primary products. Although core inflation was consistently high and was a factor for monetary caution, the

[3]Domestic financing is the difference between total inflows on the basis of continuous and structural securities (Treasury bills and bonds) and total outflows based on repayments of domestic debt.
Positive change in deposits - withdrawal of deposits from the account with the National Bank; negative change - accumulation of deposits on the account with the National Bank.
[4] On November 29, 2012, the National Bank Council adopted a new Decision on the reserve requirement, which allowed reduction of the basis for the reserve requirement of banks for the amount of newly granted loans to net exporters and companies for financing projects for domestic electricity production for own and/or commercial use, as well as investments in debt securities in the domestic currency issued by the respective nonfinancial companies. The Decision provides for complete exemption from the mandatory allocation of reserve for banks' liabilities based on issued debt securities in the domestic currency and original maturity of at least two years.

assessments showed that it was partially a result of temporary factors and did not indicate pressures through the demand channel. Also, despite the healthy fundamentals and high banks' credit expansion potential, credit activity was moderate and mainly targeted households.

Chart 5
Annual GDP growth[5], in%

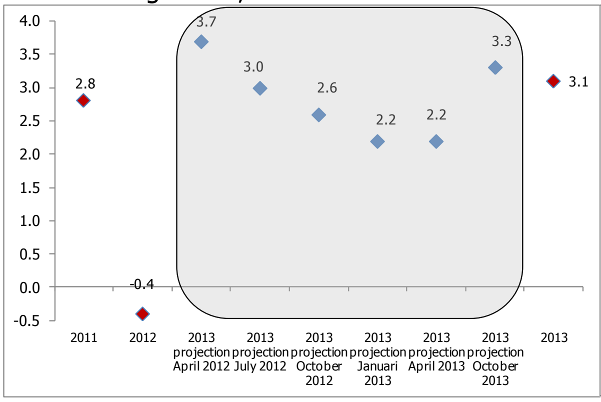
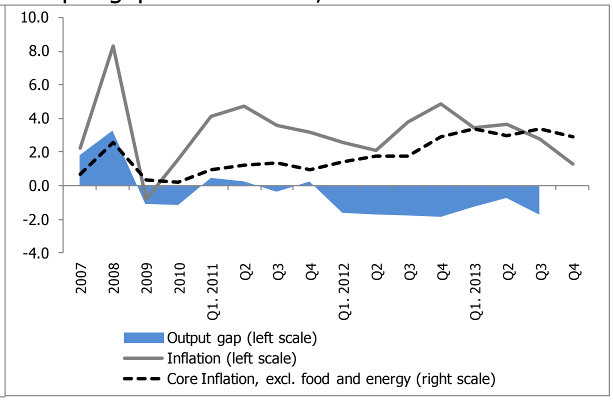



Chart 6
Output gap and inflation[6], in%




Source: SSO and NBRM.

Chart 7
Euroization level, in%

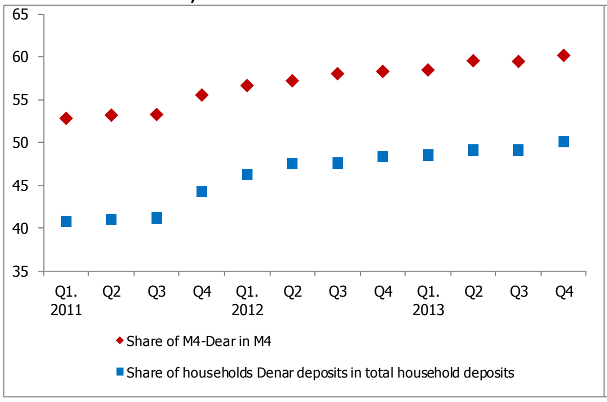
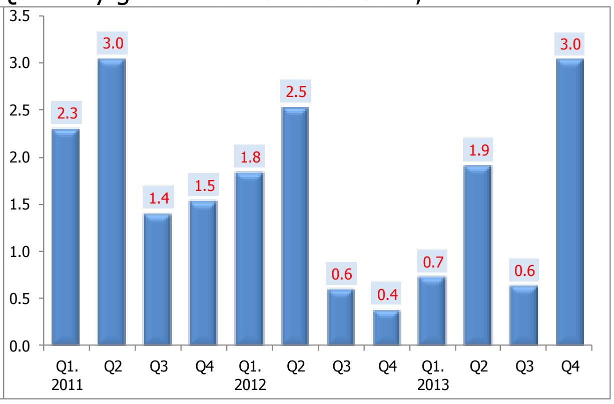



Chart 8
Quarterly growth rate of total loans, in%



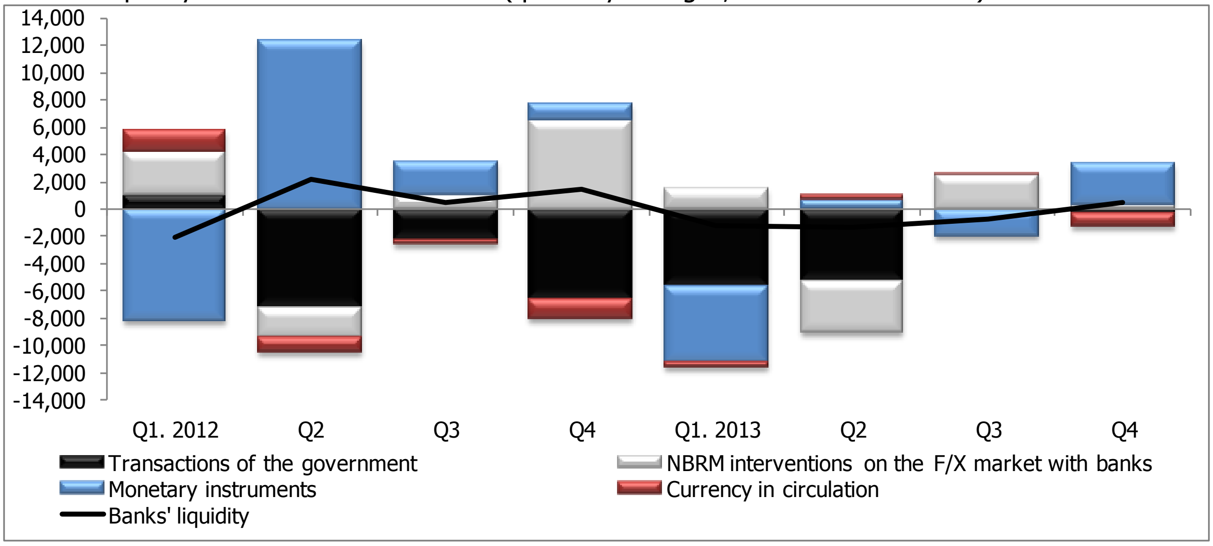

Source: NBRM.

The environment for conducting monetary policy was favorable also during the second quarter of the year. However, by the end of the quarter, the monetary setup of the National Bank remained unchanged, thus leaving room for the materialization of the monetary measures already taken by the end of 2012 and beginning of 2013. In terms of risk, although the degree of euroization still decreased, in circumstances of stabilization of the confidence in the euro, potential risk was the possible shift in currency preferences of savers in favor of foreign currency savings. Hence, there was a clear need for caution regarding the interest rate spread between the Denar and foreign currency savings in this period. Additionally, potential deterioration was observed also in the export segment, primarily in the metal industry, due to the unfavorable expectations for the world metal prices. Data on economic activity during this period showed further recovery, but it was still assessed that the negative output gap will close towards the middle of 2014. Despite the absence of pressure from domestic demand in such circumstances, core inflation was still

[5] Estimated data for 2013.
[6] The productivity gap is an indicator of the cyclical position of the economy and it is calculated as the deviation of the realized from the potential level of GDP relative to the potential level of GDP ($GDP_a = \frac{GDP_a - GDP_p}{GDP_p}$).
Inflation is calculated as the average annual inflation in the quarter.

relatively high, highlighting the second-round effect of the last growth in food and energy prices on other prices. The global recovery was still fragile, followed by mainly downward risks with a potential effect on the external position of the domestic economy and foreign reserves. Given these risks, the National Bank made no change in the monetary policy in this period.

Chart 9
Flows of liquidity creation and withdrawal[7] (quarterly changes, in millions of denars)




Source: NBRM.

In the absence of major internal and external pressures on the monetary policy conduct, in July 2013 the monetary policy was relaxed by changing the reserve requirement and by reducing the policy rate by additional 0.25 percentage points. Monetary changes in the reserve requirement contributed to the increase in the rate of reserve requirement on foreign currency liabilities from 13% to 15% and reduction in the rate of reserve requirement on Denar liabilities from 10% to 8%. These changes increased the liquidity in the system, which could potentially be used as financial support to the private sector. Furthermore, these changes contributed to further increase the attractiveness of saving in Denars. At the same time, it also affected the cost of attracting long-term capital from abroad, through allocating 0% reserve requirement for banks' liabilities to non-residents - financial companies with contractual maturity of over one year, as well as for all liabilities to nonresidents with contractual maturity of over two years. It was expected that long-term capital inflows stimulated by this decision will have a positive effect on the balance of payments position and the risks identified in the external sector, as well as on the sources of funding for banks. In such circumstances, when it was expected that some of the already existing risks will be mitigated through the changes in the reserve requirement, and given the favorable performance in terms of the monetary policy, in mid-July the monetary policy was relaxed by reducing the policy rate to the level of 3.25%. This decision was supported by the positive developments in inflation and the expectations that it will remain within the projected frames. Foreign reserves were maintained at an appropriate level and within expectations, providing sufficient capacity to mitigate the possible pressures on the exchange rate. At the same time, the assessments in this quarter showed that the external position of the economy is likely to be better than expected, due to lower import pressures and improved export performance, primarily of the new foreign facilities. Banks continued to apply a policy of weaker credit activity, amid risk assessments, primarily in the corporate segment, and conservative strategies of large banking groups that operate in the domestic

[7] Positive change - liquidity creation; negative change - liquidity withdrawal.

market. Relaxation of the monetary policy in this period sent a clear signal for lower risks in the domestic economy and the external position and for a strong capacity to implement the exchange rate policy through the adequate level of foreign reserves. At the same time, the goal of the monetary changes was to stimulate lending and support the economic recovery.

Chart 10
Current account and its more important components, % of GDP[8]

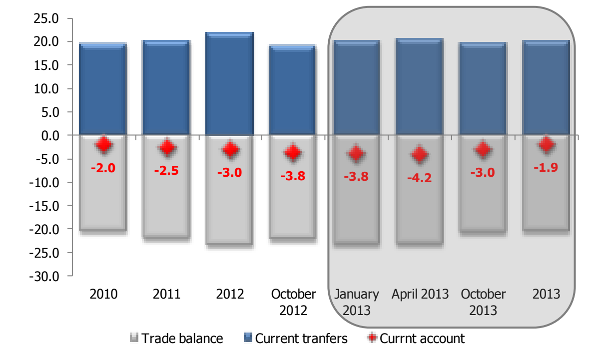
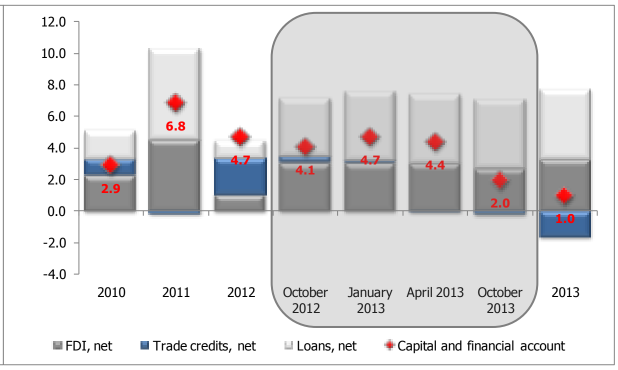



Chart 11
Capital and financial account and more important components of the balance of payments, % of GDP[9]

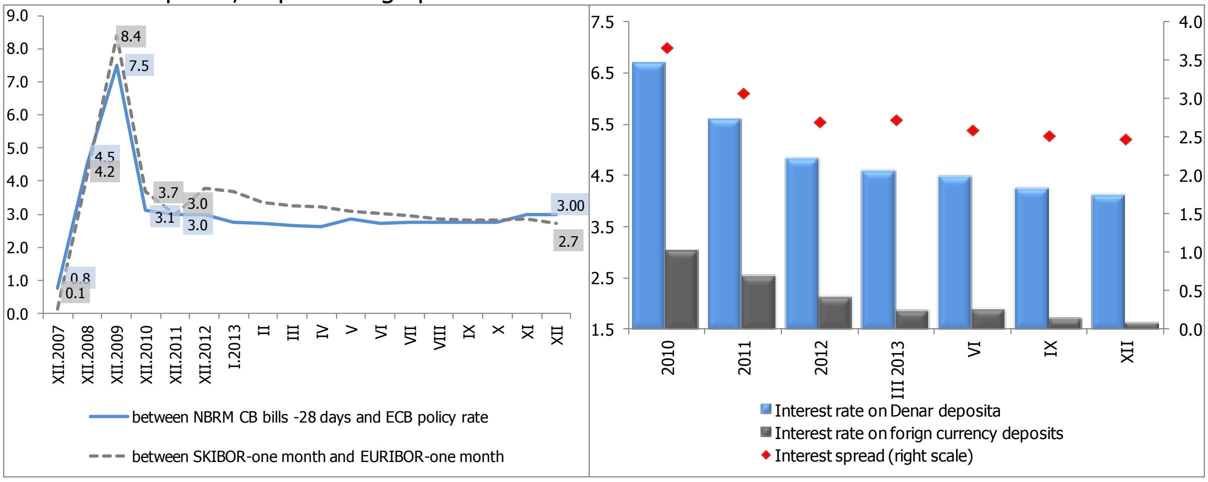



Source: NBRM and SSO.

Following the monetary policy easing in July, in the last quarter of the year, monetary conditions, as seen through the policy rate, were not changed. However, during the quarter changes were made which had an easing effect. Thus, in October amendments were made to the Decision on banks' liquidity risk management, whereby the obligation of banks to hold liquid assets is reduced, leaving them room to streamline their free resources toward higher-yielding investments. In November, changes were made also in the reserve requirement[10], which also contributed to stimulating a more active credit policy of banks. Furthermore, in December, the new Decision on the credit risk management came into force (adopted in March 2013), which provides for a certain easing of the conditions regarding the classification and determining the impairment of loans, which could also stimulate the banking sector's lending activity. In this period, macroeconomic indicators did not deviate significantly from expectations, i.e. they continue to indicate slow and gradual recovery of the domestic and of the global economy. The growth of inflation continued to decelerate, and the foreign reserves adequacy indicators continued to point to an appropriate level, given the relatively favorable developments in the balance of payments. Toward the end of the year, the activity on the credit market accelerated and positive change in the lending structure in favor of corporate lending was registered. Despite such developments, banks pointed to inherent risks, which were a result of developments in the real economy. Adverse risks mainly arose from the pace of growth of the world economy and, consequently, our major trading partners. Changes in metal prices on world markets, which were repeatedly revised downwards, also posed a risk throughout the year.

[8] Estimated GDP data
[9] The gray zone refers to the revisions in the projections for 2013.
[10] The National Bank adopted amendments to the Decision on the reserve requirement whereby the National Bank shall not pay remuneration for the reserve requirement (previous remuneration rate was 1% for the reserve requirement in Denars and 0.1% for the reserve requirement in Euros), which should stimulate banks to use the available instruments, as well as the advantages of the macro-prudential measures taken so far, more actively. The Decision is being applied from 1 January 2014. Also, a new Decision on Central Bank bills was adopted, which introduces a methodology for determining the potential demand for CB bills. More details about these changes are presented in Annex 7 to the Quarterly Report, January 2014.

Chart 12
Interest rate spread, in percentage points




Source: NBRM.

Due to the "de facto" fixed nominal exchange rate of the Denar against the Euro, an important component in the monetary response is the change in interest rates in the Euro area, as an anchor economy. During 2013, the European Central Bank cut its key interest rate on two occasions, thus opening a room for relaxing also of the domestic monetary policy. Given the different characteristics and dominant factors of influence in the domestic and in the European economy, the monetary policy easing of the two central banks was not completely synchronized. Starting from the risk assessments for that period, the National Bank made the monetary easing earlier in the year. In this period, the European Central Bank maintained the same interest rates, in conditions of slowing inflation, weak economic activity and negative credit growth, but also balanced risks to inflation in the future. Amid weak credit and deposit flows and slowing inflation, in May, the European Central Bank cut its policy rate to 0.5%. In November, the ECB made another reduction of the key interest rate by 0.25 percentage points, in order to provide further support to the recovery of the Euro area. Taking into account the changes in the key interest rates of the National Bank and the European Central Bank in 2013, during this year the interest rate spread decreased by 0.2 percentage points, on average.

Chart 13
NBRM interventions on the foreign exchange market and sterilization through monetary instruments[11]

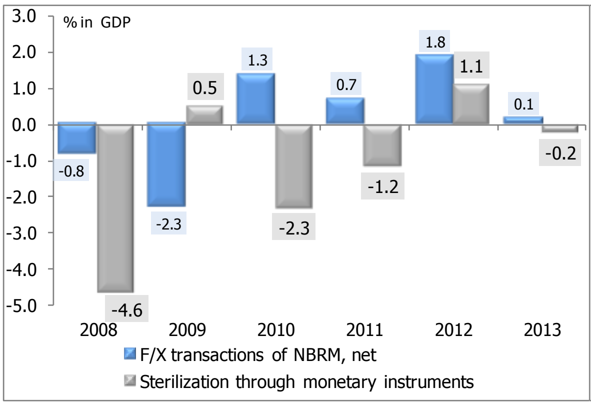
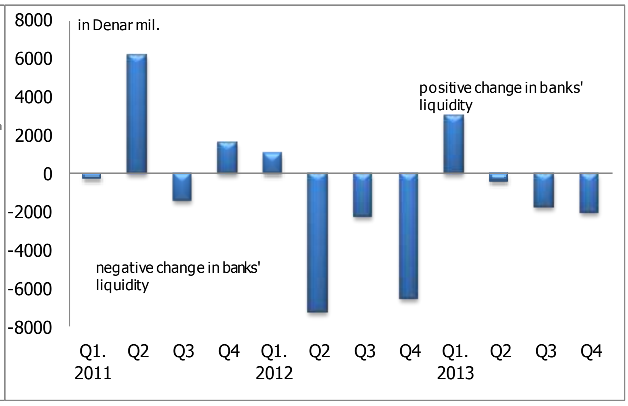



Chart 14
Government transactions (quarterly changes)




Source: NBRM and SSO.

[11] Preliminary data on GDP. Data on GDP in 2013 is estimated.

Generally, in the course of 2013, the monetary policy conduct provided for successful achievement of the objectives. Inflation registered a downward trend, with the total average annual inflation in 2013 being 2.8% unlike the last year's average of 3.3%. This was in line with the expectations and indicates inflation that is within acceptable and controlled framework. Core inflation registered an average annual growth of 3.2% in 2013. Under circumstances of a negative output gap and absence of pressure from the domestic demand, the intensification of core inflation is mostly explained by the second-round effects of the earlier rise in the prices of food and energy, but also by the impact of certain one-off factors that emerged during the year. At the end of the year, core inflation registered a downward trend and reduced to 2.5% on an annual basis. The successful management of the temporary mismatch between supply and demand of foreign currency by the National Bank interventions in the foreign exchange market, contributed to maintaining a stable exchange rate of the Denar against the Euro, which was 61.58 per one euro, on average, for the entire year. Relatively stable was also the movement of the real effective exchange rate, showing almost unchanged price competitiveness, on average. In 2013, foreign reserves declined on an annual basis, and at the end of the year they were at the level of 25.9% of GDP. The fall in reserves was mainly due to the negative price changes and currency differences. The withdrawal of banks' foreign currency deposits with the National Bank also contributed to the reduction of foreign reserves as a one-off factor, which involved change from one to another type of foreign currency liquid assets of banks. Government transactions also contributed to the reduction of foreign reserves, but more moderately in comparison with the previous year. Analyzed according to the quarterly dynamics, the National Bank's interventions on the foreign exchange market pertained to net purchasing of foreign currency, with the exception of the second quarter of the year. Despite the annual decline, foreign reserves adequacy indicators pointed to a comfortable level of foreign reserves all year around. During the year, the National Bank had at its disposal reserves that were sufficient to absorb potential major shocks in the balance of payments. Under such circumstances, amid constant and clear communication with the public about the projected path of reserves and risks surrounding these projections in the context of adopting monetary decisions, one may say that this year, too, the foreign reserves contributed to the maintaining of stable exchange rate expectations.

Chart 15
Factors of change of the gross foreign reserves (in millions of euros)

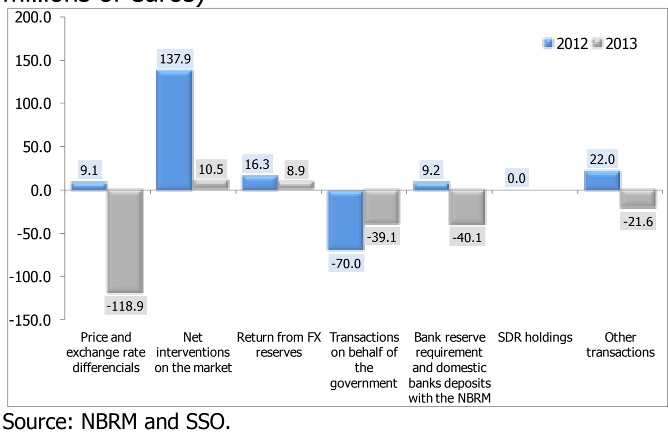
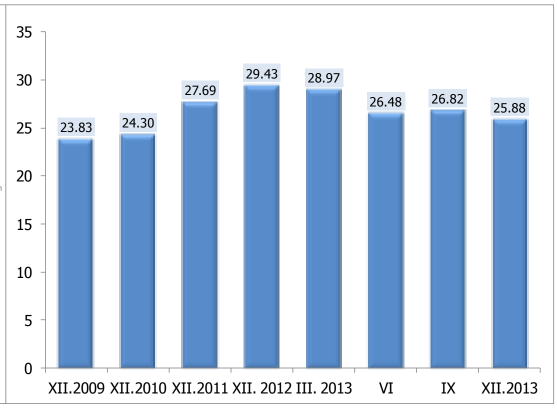


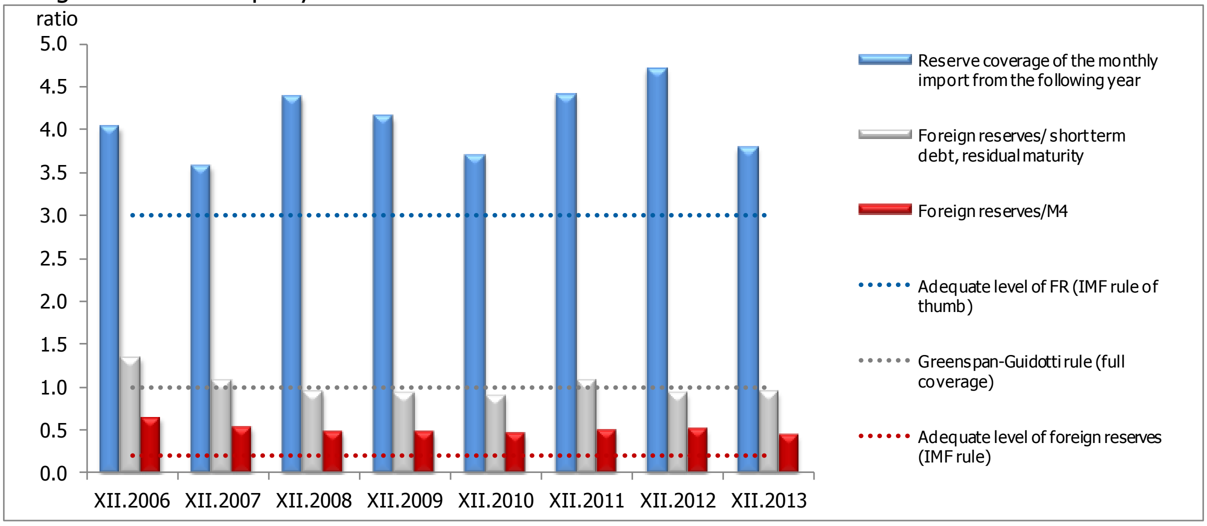

Chart 16
Gross foreign reserves,% of GDP[12]




Source: NBRM and SSO.

[12] Estimated data for 2013.

Chart 17
Foreign reserves adequacy indicators




Source: NBRM.

In addition to meeting the main objective, the monetary changes in 2013, aimed to encourage banks to further support the real sector. However, the presence of certain non-monetary factors in the banking sector for providing adequate credit support to the economy did not allow full transmission of the undertaken monetary measures. In fact, despite the high capitalization and liquidity of banks and stable indicators of their performance, the banks' lending capacity was not fully utilized. Banks invested the liquidity released through the reserve requirement[13] and the additionally created liquidity in the banking sector through the autonomous factors in the deposit facility with the National Bank. Also, the due amount based on repo operations was paid back. In 2013, the level of the main monetary instrument was stable[14]. Thus, monetary instruments in 2013, on a net basis, contributed toward withdrawing liquidity. Under these conditions and amid still present uncertainty and risks from the global environment, within the total banks' assets the highest growth was recorded in the share of highly liquid instruments (monetary instruments and government securities), with registered growth also in the share of the loans to the private sector, but at a more moderate pace. The reason for such a precautionary credit policy of banks may be located in the further deterioration of the loan portfolio quality mainly in the corporate sector, which however, was more moderate, amid still present uncertainty about the economic recovery of the real sector. Hence, the credit activity was the highest in the household segment, as banks probably more rapidly adjusted their perceptions of the degree of risk in this segment, given the still relatively lower indebtedness of the households and favorable developments in the labor market. Lending conditions for the corporate sector in 2013 were further tightened, on average, although they were relaxed at the end of the year, after a longer period. On the other hand, banks continued to relax the lending conditions for the households. Also, there was a different intensity of credit demand in these two sectors during the year. In 2013, the growth in household demand accelerated, on average, compared with the previous year, while the growth in corporate demand was slower compared to the increase in the previous year. Conservative strategies of major international groups that operate in the domestic financial market also restricted the credit growth. Hence, improving the effectiveness of monetary

[13] In 2013, the reserve requirement in Denars and in Euros fell by Denar 1,065 million and Denar 799 million, respectively. However, given the increase in total banks' liabilities included in the base for reserve requirement, the reduction of the reserve requirement primarily reflects the changes in this instrument.

[14] During 2013, at the CB bills auctions the National Bank mostly determined the supply of CB bills at the level of the due amount, with the exception of two auctions when the amounts offered were different from the due amount. In such circumstances, through CB bills of the National Bank liquid assets totaling 500 million on annual basis, were created.

transmission in the next period will largely be determined by the normalization of the banks' expectations and by the exhaustion of the effect of other currently present limiting factors.

Chart 18
Liquidity ratios[15]

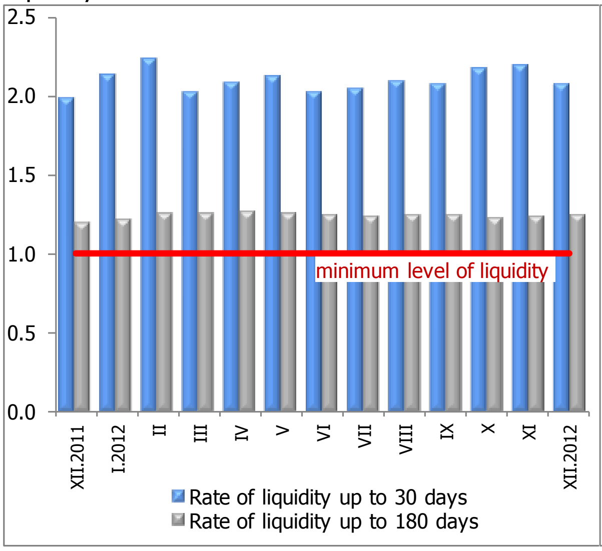
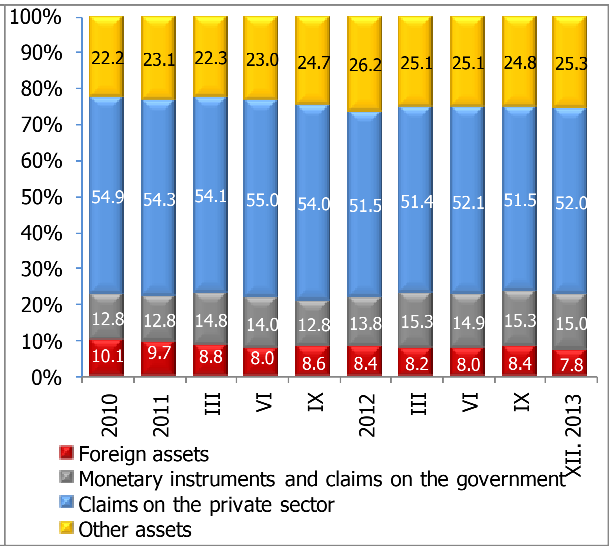
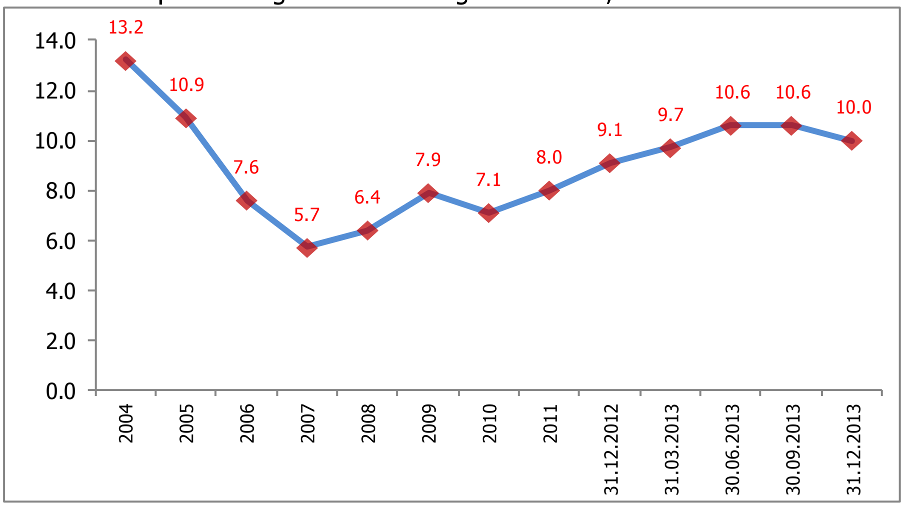



Chart 19
Banks' assets structure




Source: NBRM.

Chart 20
Share of non-performing loans in total gross loans[16], in%




Source: NBRM.

[15] Liquidity ratios are calculated as the ratio between assets and liabilities that mature in the next 30, i.e. 180 days.
[16] The indicator relates to loans to the non-financial sector.

# II. Macroeconomic developments in 2013

## 2.1. International economic environment

In 2013, the global economic activity accelerated by 3%, which is minimally slower growth compared with 2012. Thus, the trend of gradual, however uneven recovery of individual economic regions, was maintained. The economic growth in developed countries was driven by the accommodative monetary policy, reduced fiscal drag (negative effects of the fiscal consolidation on consumption), improved balance sheets of households and growing confidence of economic agents. Within the advanced economies, GDP of the USA registered the highest growth rate, while the economy of the Euro area emerged from the recession, amid improved conditions in the countries of the core and stabilization of the countries affected by the crisis. Growth of the emerging economies and developing countries remained solid. However, it slowed down moderately, due to structural problems, political turmoil, uncertainty regarding the macroeconomic policies and restored volatility on the financial markets, amid capital outflows from this group of countries. Similar was the dynamics of the world trade, whose annual growth remained at last year's level and amounted to 2.7%.

Chart 21
Global economic growth (in %)

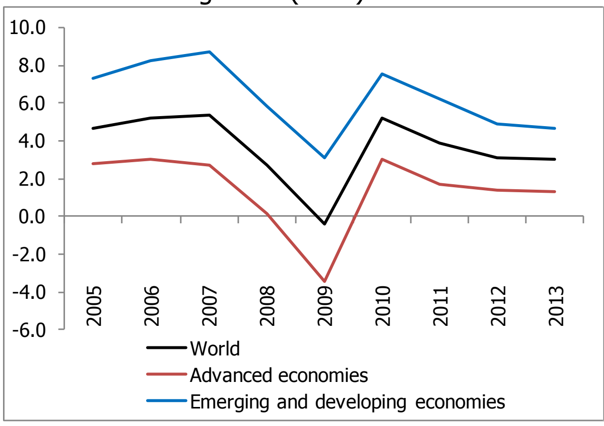
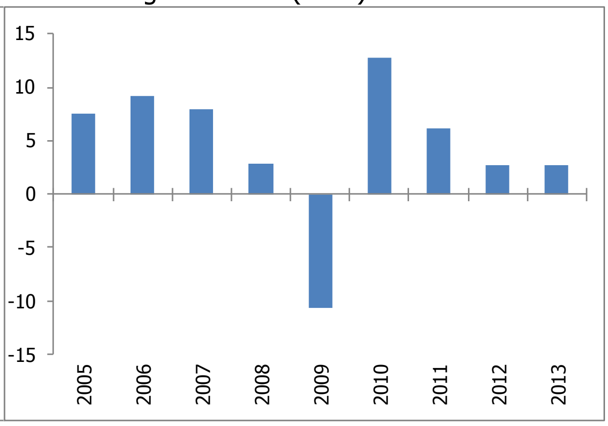



Chart 22
Growth of global trade (in %)




Source: IMF World Economic Outlook Database, October 2013, IMF World Economic Outlook Update, January 2014.

Foreign effective demand for Macedonian products in 2013 dropped by 0.2%, which was lower decline compared to that registered in the previous year, and resulted from the negative economic growth with most of our trading partners[17]. Following the negative growth rates in the first two quarters, foreign effective demand was gradually recovering in the second half of the year, which contributed to mitigation of the annual decline. The economies of Greece and Italy had the largest negative contribution to the annual decline, which was partially offset by the positive contribution by Serbia and Germany.

[17] Foreign effective demand is calculated as the sum of the weighted indices of the gross domestic product of the most important trading partners of the Republic of Macedonia. The calculation of the index includes Germany, Greece, Italy, the Netherlands, Belgium, Spain, Serbia, Croatia, Slovenia and Bulgaria. The weights are calculated on the basis of the share of these countries in the Macedonian export.

Chart 23
Foreign effective demand
(index, 2005=100)

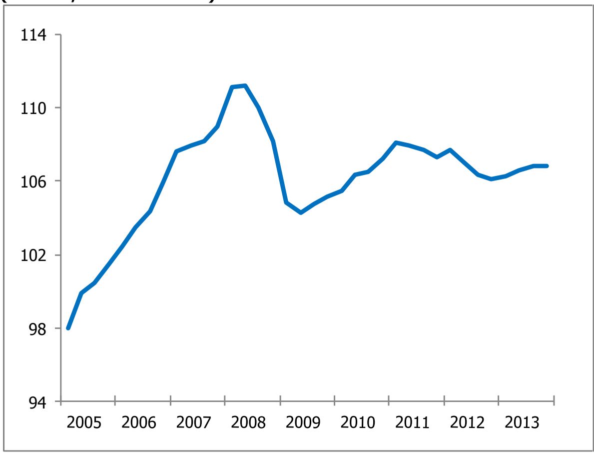
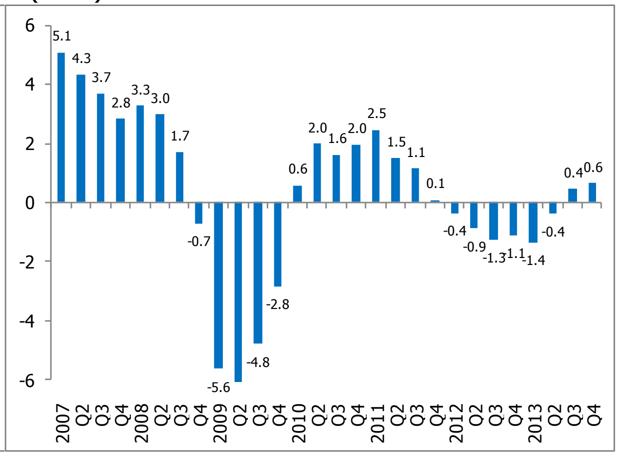



Chart 24
Annual growth rates of foreign effective demand
(in %)



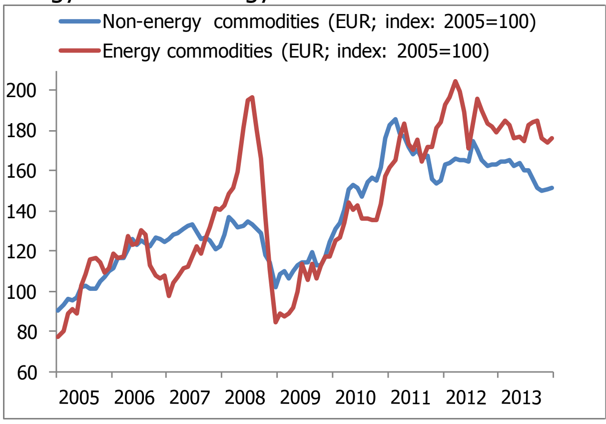

Source: NBRM calculations.

Global inflation slowed down further, and in 2013 it was 3.8%, compared to 4% last year. Such movements were observed amid relatively stable prices of primary products, incomplete utilization of the production potential and stable inflation expectations. Thus, on average, developed countries registered an inflation rate of 1.4%, while emerging economies and developing countries had a rate of 6.2%.

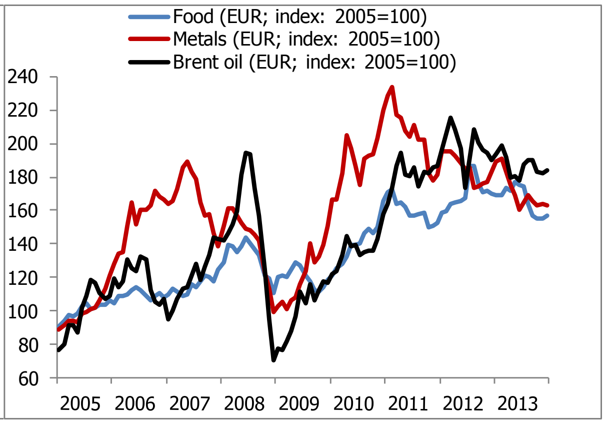
During 2013, world prices of primary products, expressed in euros, registered negative growth rates due to the combined effect of the price decline in both the energy and the non-energy component. These movements are mainly linked to the weak global demand amid modest growth of the world economy, and slowdown in the economic activity in emerging countries. Oil prices registered an annual decline for the first time since 2009, despite the temporary upward pressures caused by the escalation of the geopolitical tensions in Iran and Syria. On the supply side, the increased oil production in the USA and Canada influenced the price drop. Regarding the OPEC countries, the significant reduction in the supply by Iraq and Libya was to a greater extent offset by the increased production in Saudi Arabia, with simultaneous increase in the reserve oil capacity in these countries. Hence, the price of crude oil "Brent" averaged Euro 82 per barrel, representing a decline of 5.8% compared with 2012. Annual decline in metal prices was registered also in 2013, however slower than in the previous year, equaling 7.2%, which primarily stems from the decline in the prices of nickel, aluminum, copper and zinc. The increase in inventories of metal ore, and the slowdown in the construction sector in China are considered essential factors for such an outturn. In 2013, the food prices index fell by 2.1% compared with the previous year. This decline stems from the fall in the prices for wheat products, especially corn, due to the record yields from last year's harvest. The depreciation of the US Dollar of 3.4% against the Euro also contributed to the fall in the prices of primary products in Euros, with uncertainty regarding the Fed's tapering and the economic recovery of the Euro area.

Chart 25

Monthly movement of the prices of primary energy and non-energy commodities




Monthly movement of the prices of crude oil, metals and food




Source: IMF's database on primary commodity prices.

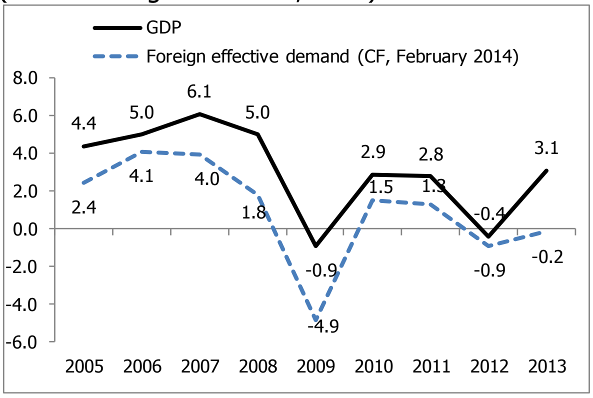
Central banks of advanced countries continued to conduct stimulating monetary policy in 2013. Besides keeping the policy rates at levels close to zero, common for them was the use of forward guidance, in order to contribute to the maintaining of the expectations that interest rates will remain low for a longer period of time. Thus, following the example of the Fed from 2012, in the third quarter, also the Bank of England linked the change in its interest rate policy with the situation in the economy, i.e. it announced it would not raise the key interest rate until the unemployment rate dropped below 7%. The Bank of Japan announced the introduction of a new operational framework, called "Quantitative and Qualitative Monetary Easing", that consisted mainly of purchasing Japanese government bonds. Given that this measure aims to help overcome deflationary pressures, the Bank stressed that it will continue to implement it until the inflation rate reaches 2%. In July 2013, the European Central Bank started to publish the forward guidance, but unlike other central banks, the European Central Bank did not establish a specific target for unemployment. In terms of the interest rate policy, the European Central Bank reduced the interest rate on the main refinancing operations on two occasions (May and November), whereby it was reduced to the historically lowest level of 0.25%. The interest rate on overnight credits was also reduced, and it reached 0.75%. In December, after several delays, and in line with the improved economic performance and prospects of the US economy, the Fed began with the tapering strategy, when it was decided that the monthly purchase of mortgage and long-term government bonds will be reduced by US Dollar 5 billion USD (down to US Dollar 35 billion, i.e. US Dollar 40 billion, respectively), and the further dynamics of purchase of the securities will depend on the future economic prospects. Announcements of applying this measure of the Fed adversely affected the financial markets of emerging economies, which came up with a significant tightening of the financing conditions, increased risk of capital outflows and downward pressure on their currencies.

## 2.2. Macroeconomic developments in the Republic of Macedonia

### 2.2.1. GDP and inflation

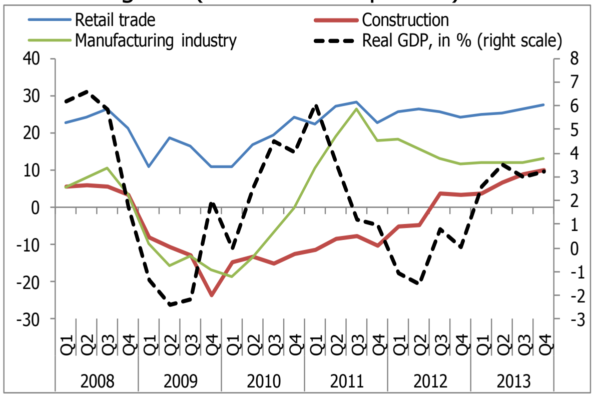
After the minimal decline registered in the previous year, during 2013, the domestic economy returned to the zone of positive growth rates. Estimated data for the gross domestic product for 2013 pointed to solid economic growth of 3.1%. Such economic performance, under circumstances of slow improvement of the external economic environment, is explained by factors that were inherent to the Macedonian economy at that time. The presence of the new production facilities in the technological-industrial development zones and the constant increase in their utilization creates positive second-round effects on the export sector and industry. In addition, further support of the economy through public and private investment, particularly in the construction sector, represents an important factor for the economic growth in 2013. In such conditions, shifts in the labor market were favorable, which also provided additional stimulus for growth of the domestic economic activity.

Chart 26
GDP and foreign effective demand[18]
(annual real growth rates, in %)




Source: State Statistical Office and Consensus Forecast, February 2014.

Chart 27
Perceptions for the current economic activity of business agents (balance of responses)[19]

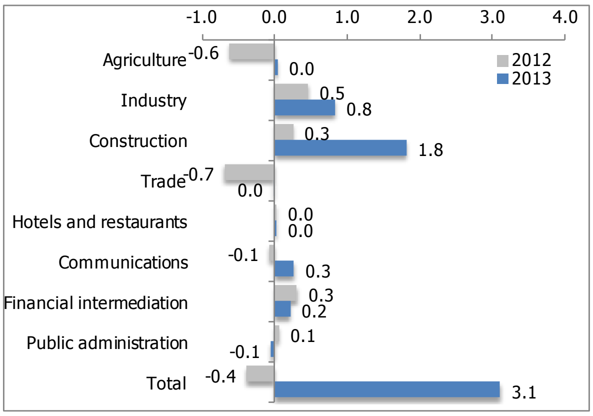



Source: State Statistical Office.

In 2013, almost all sectors in the economy made a positive or neutral contribution to the total economic growth. However, public and private investment in construction contributed to a strong double-digit growth in this sector, with its individual contribution to the overall real GDP growth being the highest (construction contributes to more than half of total growth). According to the structural analysis, civil engineering (transport infrastructure, in whole) had the largest contribution to the growth of construction activity, and the remaining growth was a result of the positive developments in the housing and non-housing construction, which could be related to government and foreign private investment. The gradual recovery of the economies in the Euro area has led to increased utilization of domestic and foreign export-oriented facilities, and thus to an increase in the value added of industry. The largest contribution to growth was that of the manufacturing industry, where the growth of manufacturing of clothing, machinery and equipment, and textiles contributed greatly to the growth of the industry. The growth of industrial production positively influenced the developments in the transport sector, which is the third component of GDP with the largest positive contribution to the growth of the real economic activity. Other services (except domestic trade which registers stagnation) and the activity in agriculture gave an additional positive stimulus for the growth of the domestic economy.

[18] GDP data for 2012 are preliminary, and data for 2013 are estimated.
[19] The balance represents the difference between the weighted positive and negative responses, expressed as a percentage. The balance shows the movement of the observed economic indicator rather than its real size.

Chart 28
Contributions to the annual GDP growth
(in percentage points)




Source: State Statistical Office and NBRM calculations.

Chart 29
Completed construction works by construction type (contributions to the annual change in percentage points)

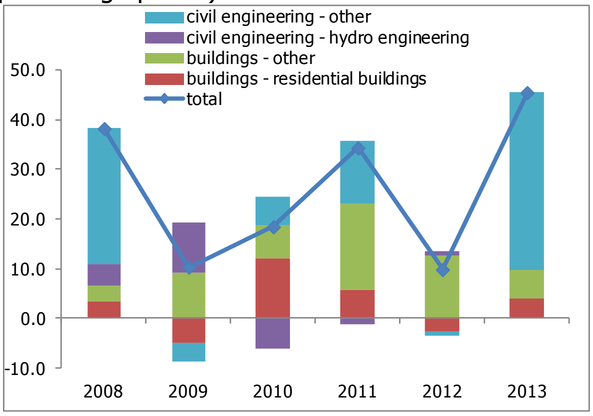
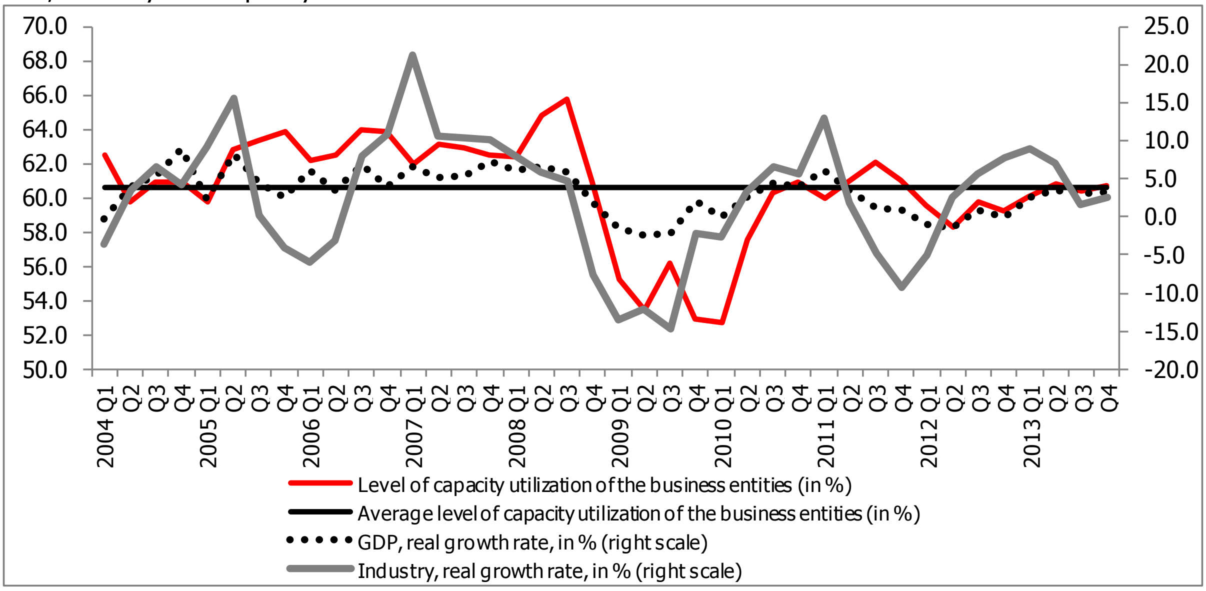



Chart 30
GDP, industry and capacity utilization[20]



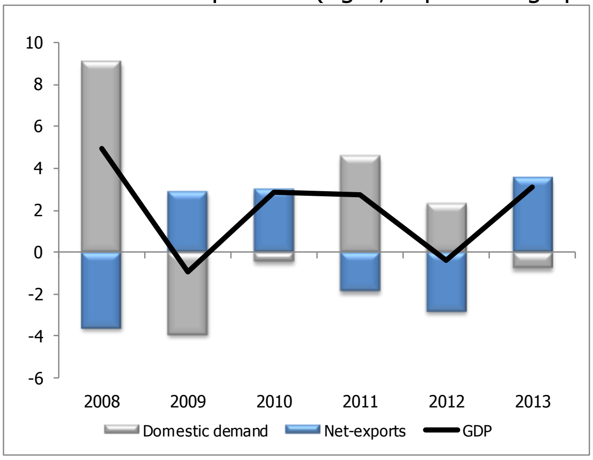

Source: State Statistical Office and NBRM calculations.

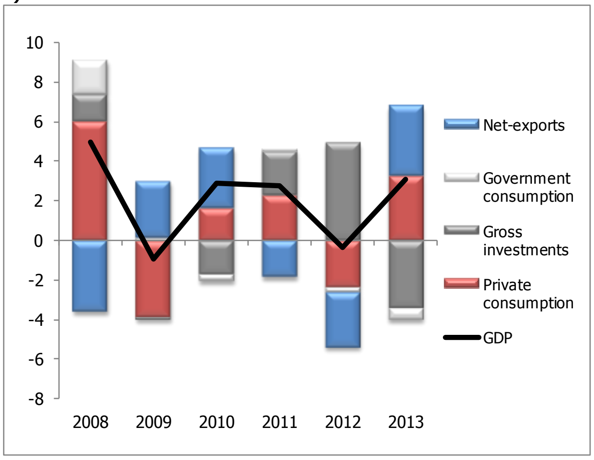
Analyzed from the demand side, in 2013 the economic growth was due to the positive contribution of net exports, while total domestic demand contributed negatively to the change in GDP. Further structural changes in the economy as a result of the foreign investments in the free economic zones, as well as the moderate and gradual recovery of foreign demand had a positive effect on the export sector. At the same time, given the decline in the imports of energy and further moderate domestic demand, no import pressures were registered and the total import demand was lower than the previous year. The negative contribution of domestic demand to the economic activity was mainly due to the decline in gross investment. Amid favorable changes observed in almost all high frequency indicative categories of investment demand, this drop in investments can be explained solely by lower inventories. Public consumption made a little negative contribution to the decline in the domestic demand. Its decline was mainly due to the lower expenditures for wages and for goods and services in real terms. Amid favorable developments in the labor market and increased lending to the households, household consumption grew and

[20] GDP data for 2012 are preliminary and data for 2013 are estimated.

was the only component of domestic demand, which in 2013 had a positive contribution to the overall GDP growth.

Chart 31
Contribution of domestic demand and net exports to GDP growth (left, in percentage points) and of the individual components (right, in percentage points)

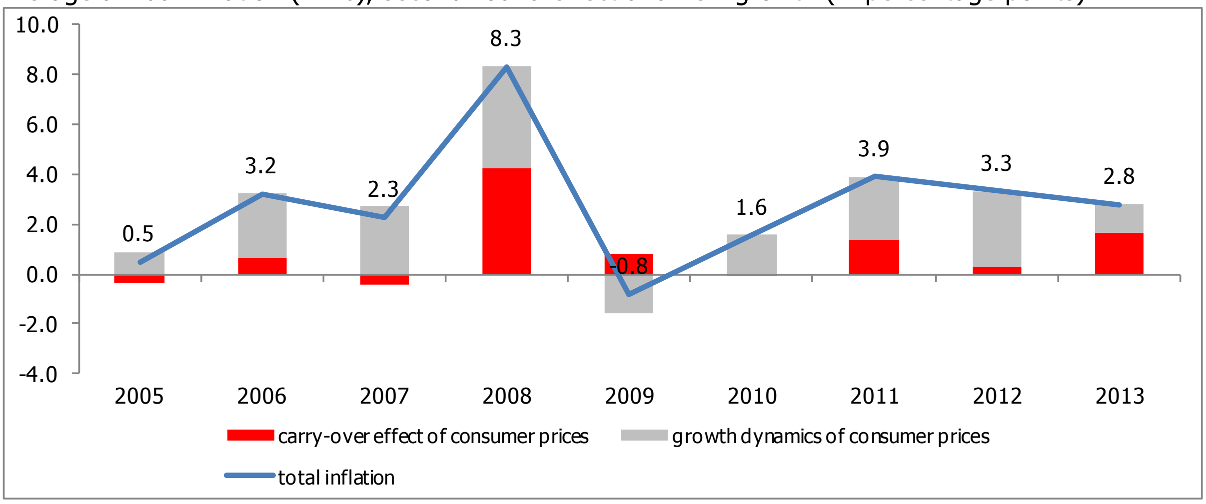



Source: SSO and NBRM calculations.

The average annual inflation in 2013 was 2.8%, which is a slowdown compared to 2012 when it was 3.3%. The slower inflation, overall, stemmed from the energy component, given the reduction of part of the regulated prices and a decline in the prices of petroleum fuels, in accordance with the favorable prices of these products on the world markets. In the first half of the year, inflation was 3.6% on average, annually. In the second half of the year, inflation slowed down and reduced to 2% on average, as a result of the influence of all the key price components.

Chart 32
Average annual inflation (in %), second-round effect and new growth (in percentage points)




Source: SSO and NBRM calculations.

Regarding the structure, the growth of domestic prices over 2013, was entirely a result of the soaring food prices and the long-term component, while the contribution of the energy component was almost neutral. The growth in the domestic food prices by 3.6% (contribution of 1.4 percentage points to overall inflation) in 2013, was caused by several factors. First, in 2013, there was a second-round effect of the increase in the food prices from the last year. In addition, adverse weather conditions[21] affected the supply of certain food products, leading to increased prices of the fresh food component. The upward shift in the domestic food prices corresponded also with the growth in the effective foreign food prices[22]. Notably, despite the reduction in the world food prices, the index of effective foreign food prices registered an annual increase of 4.2%. The long-term price component (core inflation without food and energy) in 2013 had a significant contribution to the growth of the general price level. This component registered an average annual growth of 3.2% (contributing with 1.4 percentage points to the overall inflation). In the absence of pressures from the demand side, the influence of the one-off factors (mainly from the higher prices of footwear) and the second-round effects of the previous growth in food and energy prices on other prices in the economy, could be considered to be the reasons for such changes. In terms of structure, the prices of clothing and footwear, hygiene and health, the prices of food and beverages in restaurants, and the prices of tobacco and alcoholic beverages contributed to the growth of core inflation[23]. After the sharp rise in the previous year, in 2013, the energy component reported a marginal decline of 0.2%. The higher level of electricity prices[24] on average in 2013, was completely offset by the reduced cost of heating[25] and domestic prices of oil derivatives, in accordance with the fall in the price of crude oil on the world markets.

Chart 33
Domestic inflation and foreign effective inflation[26]
(annual growth rates, in %)

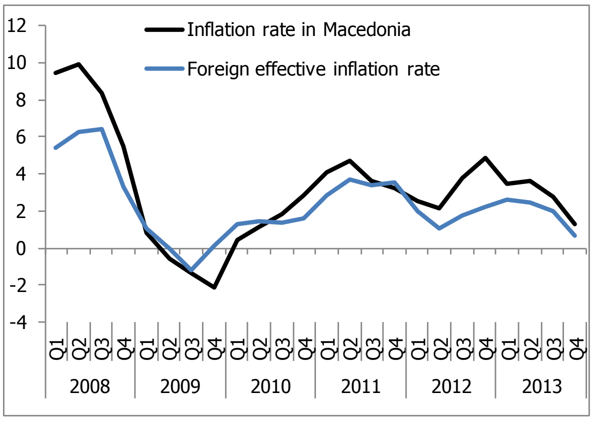
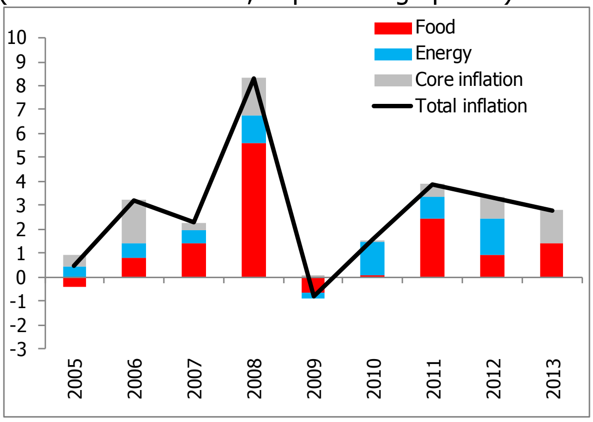



Chart 34
Volatile (food and energy) and long-term component of inflation
(annual contributions, in percentage points)




Source: State Statistical Office, EUROSTAT and NBRM calculations.

[21] Refers to the damage from the February flooding on the yield of early vegetable production in the southeastern part of the country and the floods in Europe.
[22] Effective foreign food prices are obtained as a weighted sum of food prices in the countries that are major trade partners of the Republic of Macedonia.
[23] As a result of higher excise taxes on cigarettes and alcoholic beverages from July 2013. With the amendments to the Law on Excise, the excise tax on beer increased from Denar 3 to Denar 4 per liter per alcohol degree and the excise tax on pure alcohol increased from Denar 300 to Denar 340 per liter. The excise duty on cigarettes, cigars and cigarillos was increased in 2013 and it is planned to be gradually increased over the next 10 years. Rates of minimum and specific excise duty on cigarettes are increased by Denar 0.15 per piece, each year until 2015, and by Denars 0.20 per piece each year until the end of 2023.
[24] In 2013, the Energy Regulatory Commission changed the prices on two occasions. In July 2013, the electricity price was reduced by 4.5%, but in August the price increased by 1.5% when ERC granted the appeal of EVN. Thus, the effective reduction of the electricity price was 3.1%. However, since in the second half of 2012 the electricity prices went up, and thus the price level throughout most of 2013 was higher, electricity price had a positive impact on the overall inflation.
[25] By a decision of the ERC, the price of central heating for households was reduced by 2.9%, which came into force on August 1, 2013.
[26] Effective foreign inflation is obtained as a weighted sum of the inflation rates in countries that are major trading partners of the Republic of Macedonia.

### 2.2.2. Labor market

In 2013, most of the labor market indicators pointed to further positive trends. The number of employees grew rapidly, and in 2013 it reached 4.3%, which is consistent with the better economic performance. Greater resilience of the domestic economy and the labor market to the still unfavorable global environment, was partly associated with the operation of the new production facilities in the free economic zones, as well as with the foreign investment in the construction sector. Other mitigating factors were the fiscal stimulus in the form of publicly funded construction work, the agricultural subsidies and the active employment programs and measures[27] that have been implemented for several years in a row, and have had a positive contribution to the local economy. Analyzed by sector, positive signals were mostly associated with agriculture, transport, storage and communications, as well as construction, as sectors that comprise a significant number of employees who directly or indirectly were in the focus of fiscal incentives and economic policies that simultaneously encouraged economic and employment growth[28]. The growth in demand also caused an increase in the labor supply. Thus, in 2013 the number of active population grew by 1.4%. The increase in the labor force, with a simultaneous decline in the number of inactive population, caused an upward shift in the activity rate, whereby it has reached the level of 57.2%, on average, for the entire 2013. However, the faster growth of labor demand relative to the growth of labor supply caused a downward movement of unemployment. Consequently, in 2013, the unemployment rate averaged 29%, and reached the historically lowest level. An increase was registered also in the employment rate, which in 2013 averaged 40.6%. Favorable developments were observed in terms of the age groups. Namely, also in 2013, unemployment tended to reduce in the most vulnerable age groups, i.e. those aged between 15 and 24 and between 50 and 64 years of age. This is to a significant extent associated with the profile of the active measures on the labor market in terms of their focus on job creation while increasing social inclusion.

Chart 35
Selected labor market indicators

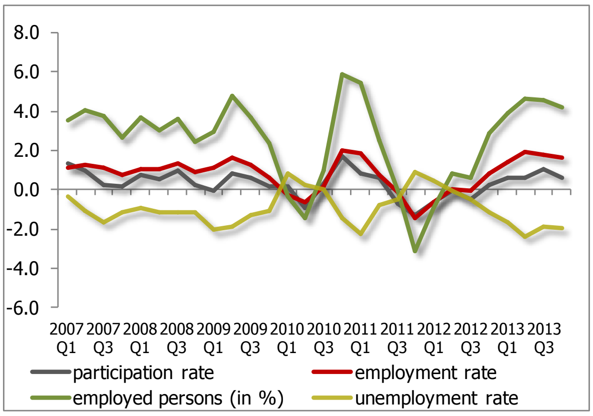
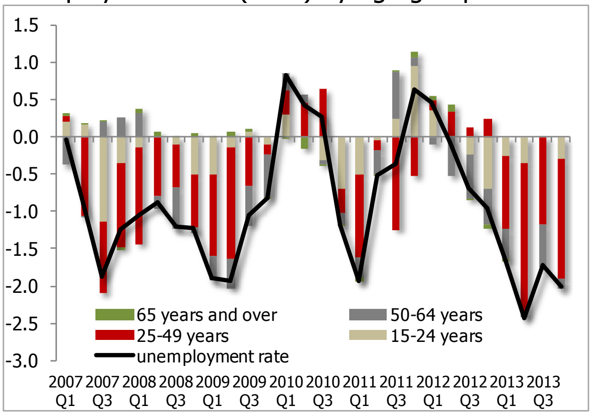



Chart 36
Unemployment rate (in %) by age group




Source: State Statistical Office.

In terms of labor cost, in 2013 a moderate strengthening of the nominal growth of average wages paid, and further slowing of their real decline, was registered. Thus, the

[27] Also in 2013, the Government of the Republic of Macedonia, through the Ministry of Labor and Social Affairs and the Employment Agency, conducted active measures and programs designed to increase employment, such as self-employment programs, financial support to legal entities for opening new jobs, employment subsidies, internship programs and many other measures.

[28] For illustration, most employees in agriculture are employed for their own account - subcategory in which in 2013 the number of employees increased by 25%. This outturn is associated mostly with the policies of subsidizing agriculture, but also with the policies in favor of more dynamic development of entrepreneurship, including the simplification of the procedures for starting own business. At the same time, employment growth in "transport, storage and communications" is generally explained as a positive outcome of the increased construction and industrial activity, having in mind the complementarities of these activities.

nominal net and gross wages[29] registered an annual growth of 1.2%, with an upward correction observed in all sectors of activity. Amid average inflation of 2.8%, net and gross wages registered a real decline of 1.6%. In 2013, the indicators of competitiveness of the economy in terms of labor[30] showed further deterioration, and thus further moving away from their average level achieved in 2008 as a reference pre-crisis period. Thus, amid stronger employment growth compared with the growth of the economic activity, labor productivity declined by 1.2%. However, given the expected growth of the activity of the new facilities (primarily new foreign investors) productivity ratio for the domestic economy is expected to improve in the next period. The decline in productivity, amid simultaneous increase in gross wages, caused an annual growth in unit labor costs by 2.4%.

Chart 37
Average gross and net wages
(annual changes, in %)

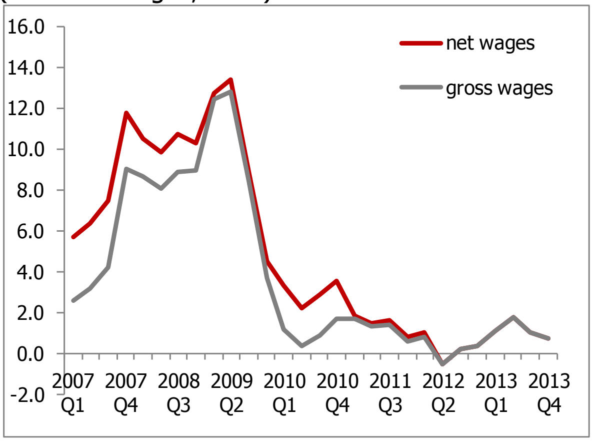
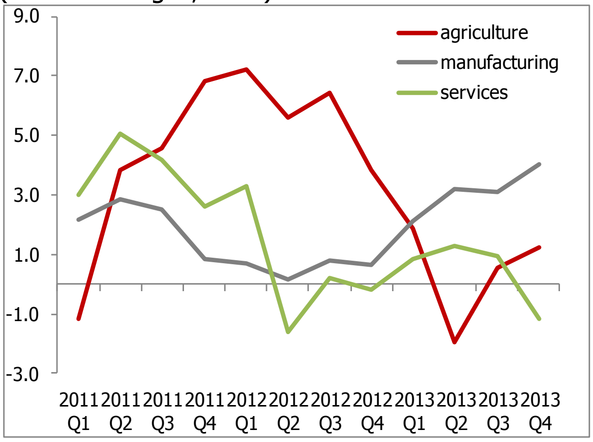



Chart 38
Average net wages, by sector
(annual changes, in %)




Source: State Statistical Office and NBRM calculations.

Chart 39
Labor productivity
(annual changes, in %)

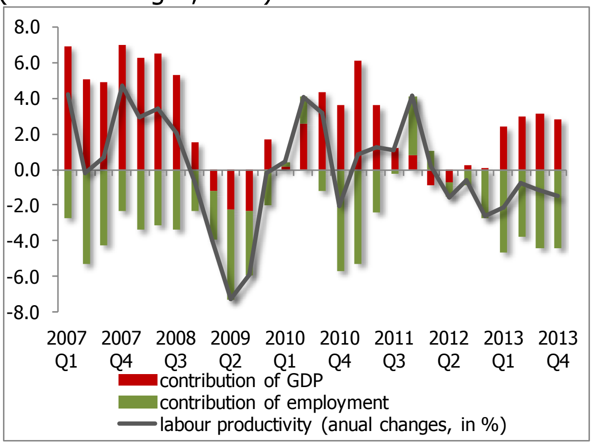
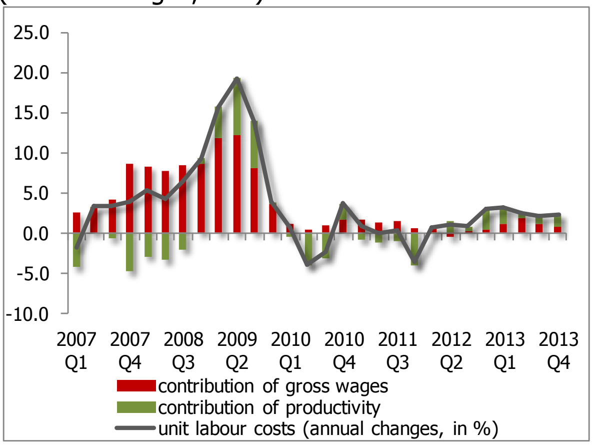



Chart 40
Unit labor costs
(annual changes, in%)




Source: State Statistical Office and NBRM calculations.

### 2.2.3. Public finances

Fiscal policy supported the recovery of the domestic economy also in 2013. Budget deficit has increased, and most of the deficit (about 60%) was realized in the first quarter of the year, largely due to the full repayment of the arrears from the previous year. During the

[29] The total gross wages paid include: net wages paid for the reporting month, paid income tax and paid contributions (pension and disability insurance, health insurance, employment, occupational disease and water supply). The data relate to wages paid.
[30] Productivity and unit labor costs for the overall economy are calculated on the basis of GDP data, for the total number of employees, according to the Labor Survey of the State Statistical Office and the data on average gross wages.

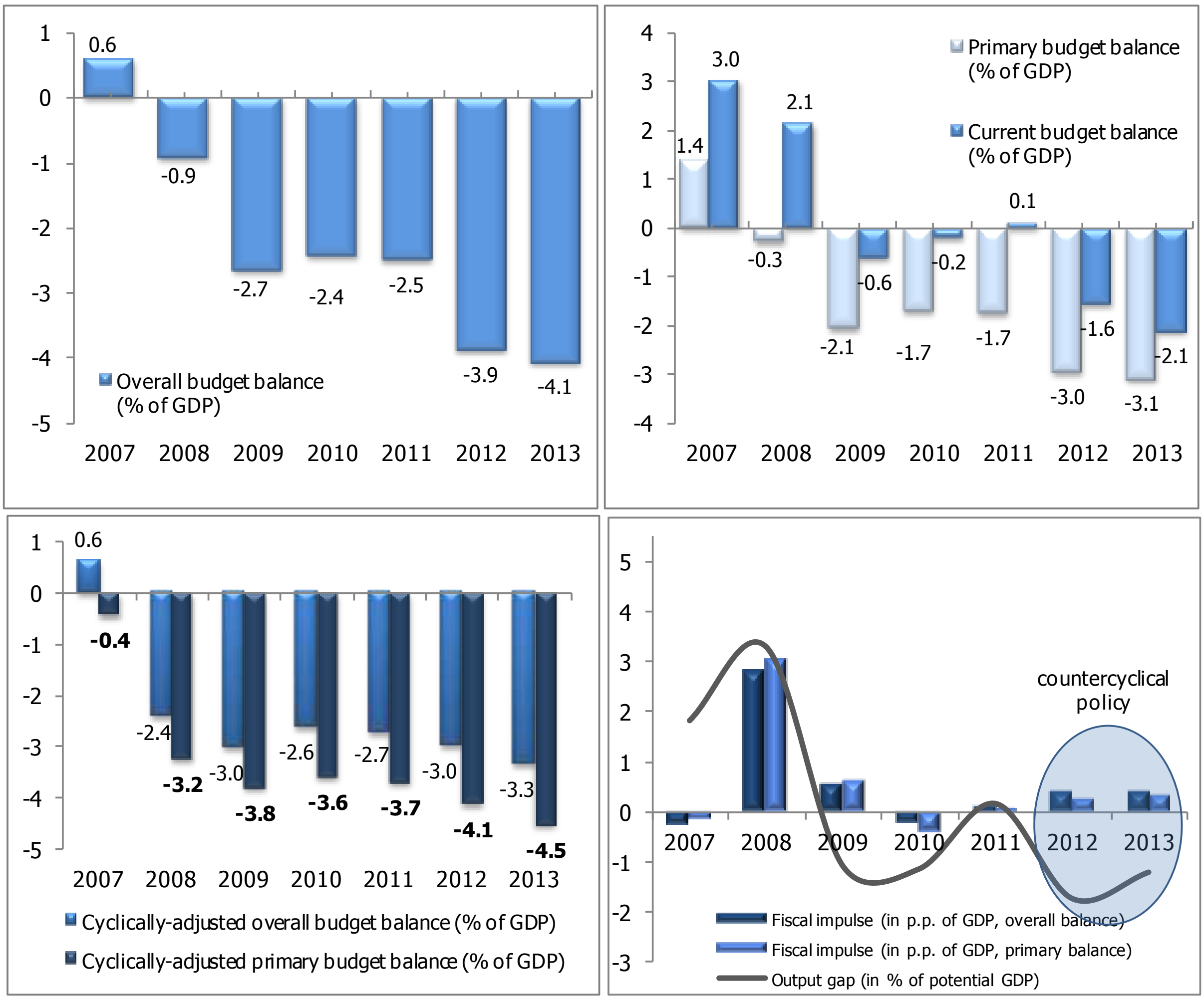
year there was no significant deviation between planned and actual revenues and expenditures. However, the need for providing the social component of the budget called for adoption of a amendments to the Budget[31] in November, whereby total budget revenues were upwardly adjusted by 0.9% and total budget expenditures by 2%, compared to the original plan and the budget deficit target was raised to 3.9% of GDP. This amendment implied a change in the path planned with the initial budget, in which moderate consolidation of public finances was envisaged, i.e. reduction of the deficit down to 3.5% from 3.9% of GDP in 2012. Given the supplementary budget, in 2013 the nominal budget deficit was fully realized, although as a relative indicator it was higher than planned, amounting to 4.1% of GDP. This caused a minimal increase also in the primary budget balance[32], which reached -3.1% of GDP, compared to -3% in 2012. Current budget balance[33] deteriorated also during 2013, but more slowly, with the higher current expenditures causing a current deficit of 2.1% of GDP, versus 1.6% in the previous year. The deficit and the need for its financing resulted in further growth of the central government debt, whose share in GDP in 2013 reached 35.8%.

[31] Amendments to the Budget of the Republic of Macedonia for 2013, "Official Gazette of the Republic of Macedonia" no. 152/2013 of November 5, 2013.

[32] Primary budget balance is the difference between total budget revenues and total budget expenses, less the repayment of current loan (interest) liabilities. This fiscal indicator is considered more appropriate for the analysis of the current policy course, due to the fact that it does not include fiscal costs related to past conduct of fiscal policy relative to the public debt.

[33] Current budget balance is the difference between current revenues (tax revenues and non-tax revenues) and current budget expenses (for wages and fees, goods and services, transfers and interests).

Chart 41
Fiscal indicators[34]




Source: Ministry of Finance of the Republic of Macedonia and NBRM calculations.

The analysis of the discretionary changes in the fiscal policy suggested further countercyclical policy. The total structural deficit increased to 4.5% (from 4.1% in 2012), amid simultaneous increase also in the structural primary deficit[35] (from 3% in 2012 to 3.3% in 2013). Consequently, as in 2012, a positive fiscal impetus was given, which, according to the structural primary balance was slightly higher than in 2012. Moreover, if the analysis includes the output gap, which has been negative for two years in a row, it can be estimated that the fiscal policy was countercyclical also in 2013.

[34] Calculations of the current budget balance in historical framework exclude the dividend of "Telecom" from the non-tax revenues and include it in the capital revenues (according to the methodological changes in 2011).
The fiscal incentive is the difference between the cyclically adjusted balance in the previous and in the current year.
[35] The total structural deficit is obtained when the cyclical budget component is removed from the actual budget deficit. It is calculated as the difference between the actual budget revenues adjusted for the effect of the deviation of the potential from the actual GDP with elasticity of 1 and actual budget expenditures adjusted for the effect of the deviation of the potential from the actual GDP with elasticity of 0. The structural primary deficit is equal to the total structural deficit reduced by the effect of the interest expenses.

Chart 42
Budget balance financing structure (in millions of denars)[36]

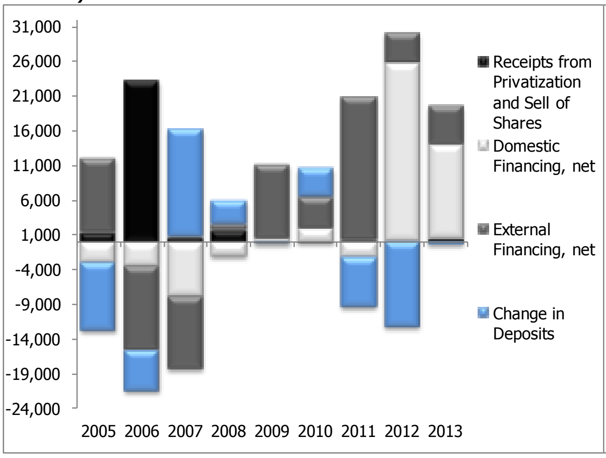
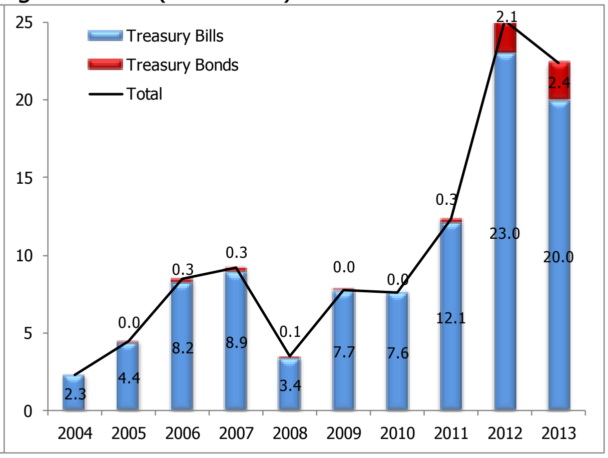



Chart 43
Government securities on primary market on gross-basis (% of GDP)

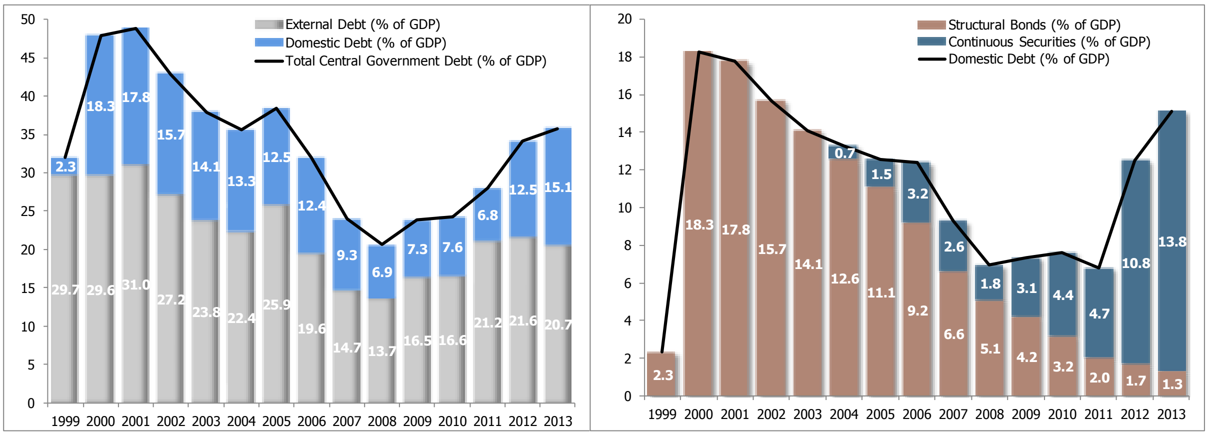



Source: Ministry of Finance of the Republic of Macedonia and the National Bank.

In accordance with the amendments to the Budget, the financing of the budget deficit on a net basis in 2013, was mostly done through auctions of government securities, and the rest of the required net inflows was provided from external sources. In the beginning of the year high inflows were registered, based on external borrowing[37], but due to the full repayment of the second Eurobond (amounting to Euro 175 million), net inflows based on foreign borrowing had lower participation in financing. During the year, the Government was active also on the domestic capital market, and it used more resources than planned through this segment, at the expense of the use of deposits, which did not materialize[38]. In 2013, the total realization on the primary government securities market amounted to 22.4% of GDP, representing a slight decrease of 2.7 percentage points compared with 2012, amid historically low interest rates on government securities[39]. In accordance with the determination to extend the maturity of the government securities portfolio by issuing longer-term securities, also in 2013 there was a trend of increased borrowing through government bonds versus the moderate reduction of the borrowing through Treasury bills.

[36] Difference between total inflows on the basis of continued and structural securities (Treasury bills and bonds) and total outflows based on domestic debt repayments.
[37] In line with the disbursement on the basis of the Loan facility at Deutsche Bank made under the Loan Agreement secured by policy-based guarantee by the World Bank (amounting to Euro 250 million) and the First programmatic competitiveness Development Policy Loan from the World Bank (in the amount of US Dollar 50 million).
[38] In 2013, the Government accumulated deposits in the amount of Denar 327 million, against the plan for their use for deficit financing in the amount of Denar 5,497 million.
[39] The average weighted interest rate on Treasury bills in 2013 was reduced to 3.5% (4.1% in 2012), while the average interest rate on government bonds was 4.6% (5.5% in 2012).
The negative change in government deposits implies that they have been deposited on the account with the National Bank.

Chart 44
Structure of the central Government debt and of the domestic debt




Source: Ministry of Finance of the Republic of Macedonia and NBRM calculations.

In 2013, the debt of the central government[40] increased by 8.4%, and in absolute terms it amounted to Euro 2.757 million. The annual growth of the debt was entirely due to the increased domestic borrowing (by 25%), while external debt decreased (1.3%), which was solely due to the exclusion of the loans of the public enterprise for State Roads from the debt of the central government after its status change from a state fund to a public company in early 2013. The share of the central government debt in GDP rose by 1.7 percentage points, reaching 35.8%, versus 34.1% in 2012. Analyzing the structure of the debt under the principle of residency, the share of the domestic debt in GDP continued to increase, reaching 15.1%, while the share of the external debt registered a slight decline, although still the largest part of the total debt refers to the external debt. Orientation of the country toward the domestic financial market contributes to its deepening, and simultaneously reduces the risks associated with external borrowing. At the same time, an emphasis should be put on the tendency to extend the maturity of the existing portfolio of government securities, which contributes to reduce the need for refinancing and lowering the liquidity risk.

### 2.2.4. Balance of payments, IIP and external debt

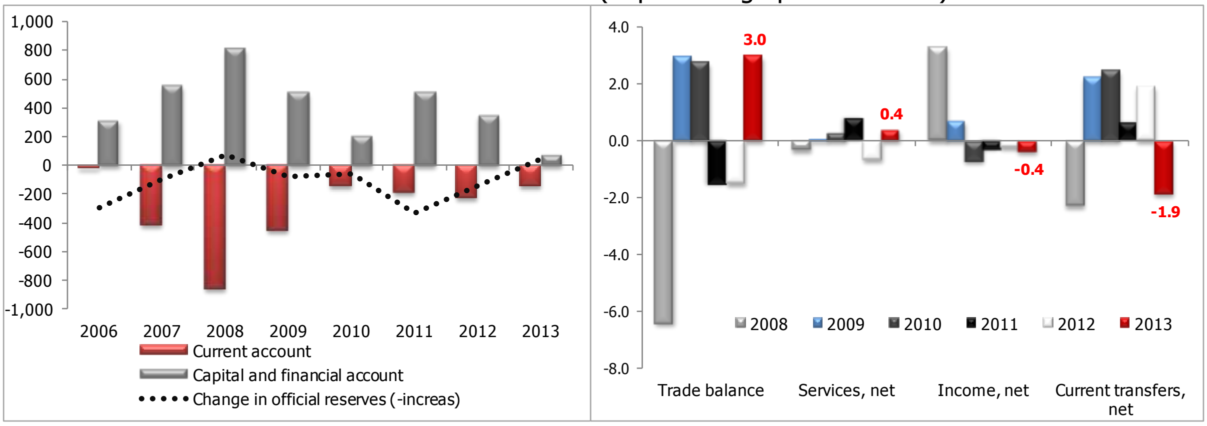
The developments in the external sector during 2013 were again under considerable influence of the still weak conditions in the Euro area and the unfavorable changes in the prices of some of the key export products on the world markets. On the other hand, structural changes in the domestic economy had a positive influence on the external position and they increased the resilience of the exports amid the still unfavorable external environment. Observed through the prism of individual components of the balance of payments, in 2013 the current account deficit registered an annual decrease of 1.1 percentage point of GDP, and in 2013 it was reduced to 1.9% of GDP. The narrowing of the deficit was caused by the smaller negative gap in the trade of goods and services, amid solid export performance, and simultaneous significant reduction of the import demand for energy products and of their prices. Improved investment sentiment in the global economy and stabilized financial markets increased the inflows of foreign direct investment and boosted the external borrowing of the economy, but under circumstances when short-term financial flows experienced substantial net outflows. Against such background, the net

[40] The debt analysis is not fully consistent since until 2012, data referred to the debt of the central government and funds, and starting from 2013 this definition excludes the Debt of the Agency for State Roads. In fact, in January 2013, the Agency for State Roads was transformed into a public company, and therefore its direct debt and the debt assumed by the Government for part of the loans used by the Agency in the past are excluded from the external debt of the central government and are shown as part of the public external debt of the "public companies" sector.

inflows in the capital and financial account were lower on an annual basis and insufficient to fully finance the current account deficit.

Chart 45
Current and capital and financial account (in millions of euros)

Contribution of individual components in the annual change in the current account (in percentage points of GDP)



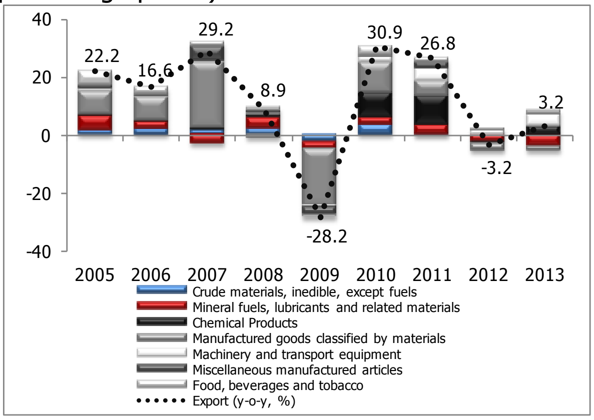

Source: NBRM.

The improved performance in the current account in 2013 was solely due to the improved balance of goods and services, amid reduced net inflows in current transfers and higher net outflows in income. The reduction in the trade deficit by 3 percentage points of GDP was mainly caused by a narrowing of the energy deficit, although the non-energy balance had the same, however significantly milder effect. The individual components of foreign trade registered divergent movements. Exports, driven by the enhanced activity of the new capacities in the economy with foreign ownership, registered an annual growth of 3.2%, while the reduced demand for energy products and the annual decline in energy prices reduced the import component, causing an annual decline of 1.5%[41]. Divergent movements in exports and imports caused stagnation of total foreign trade on annual basis. The analysis according to external statistics[42] indicates that the exports of the companies from the industrial development zones were the most important driver of Macedonian exports in 2013, increasing their resilience, amid still unfavorable global conditions that caused a decrease in the exports of the metal industry. Increased exports of new companies were sufficient also for offsetting the significant decline in the exported petroleum products, caused by the simultaneous reduction of the exported quantities and lower export prices.

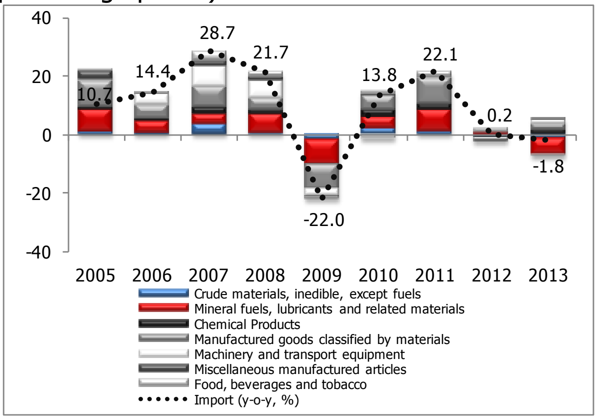
[41] The data is in line with the balance of payments statistics, while foreign trade statistics indicates an annual decline of 1.8%.
[42] According to the foreign trade methodology, data on the export of goods are published on a f.o.b. basis, and on the import of goods, on a c.i.f. basis.

Chart 46

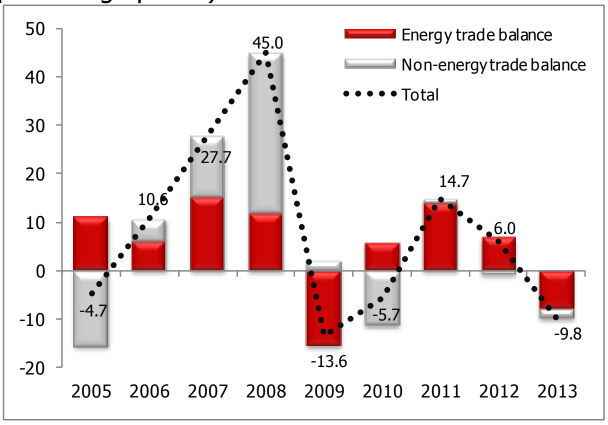
Contributions to the annual export growth (in percentage points)




Contributions to the annual import growth (in percentage points)




Contribution of the energy and non-energy balance to the annual change in the trade balance (in percentage points)



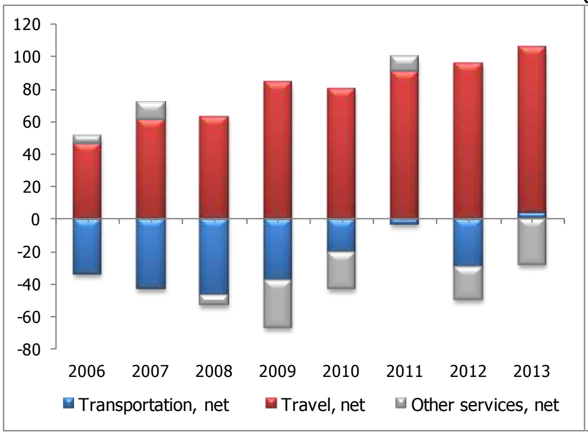

Source: SSO and NBRM calculations.

The annual decline in imports was mainly caused by the lower imports of energy products, due to the favorable movements in their prices[43], but also by the reduced domestic needs and lower export demand[44]. The movement of other import components was mainly related to export performance. Thus, imports of raw materials for the metal industry continued to decline during 2013, amid further growth of imported raw materials of new export capacities, which corresponded with the change in the export structure and all the more substantial part of the products of the automotive industry in total exports. The intensification of foreign direct investment and the stimulus from the publicly financed investment projects caused an annual increase also of investment imports.

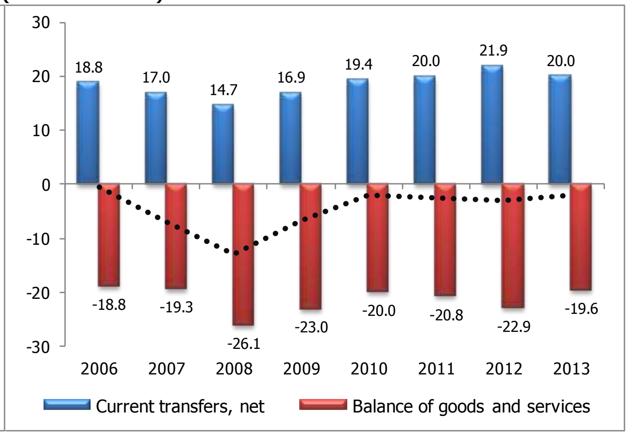
[43] Prices of crude oil and Russian gas price dropped after the series of price jumps from the past years of recovery.

[44] Smaller domestic needs are partly associated with the warm winter versus last winter, when conditions were tougher and demand for energy products was higher. Furthermore, the reduced energy needs were a result also of the decreased production of the industrial facilities. Such was the effect also of the lower energy imports intended for further processing and export.

Chart 47
Services balance, by component
(in millions of euros)




Balance of goods and services and current transfers
(in % of GDP)

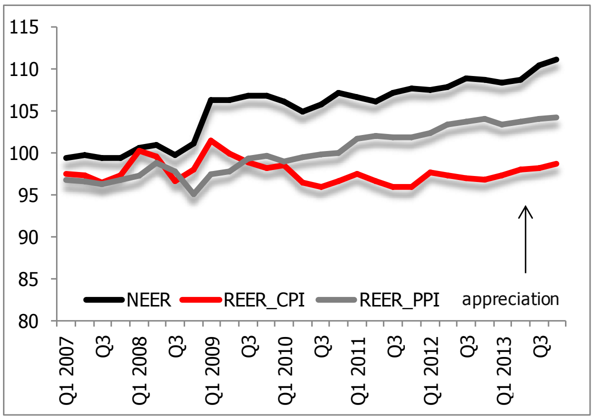



Source: NBRM.

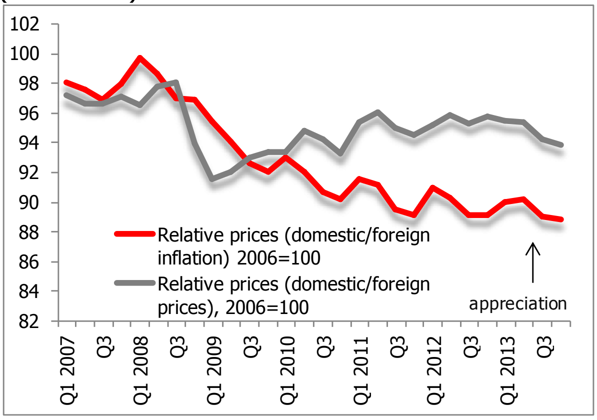
After the decline in the previous year, the trade surplus of services in 2013 increased on a net basis by 0.4 percentage points of GDP, influenced by the continuous growth of the net inflows from tourist services. Positive developments in the trade of goods reflected also in the balance of transport services, which registered a surplus for the first time. Only other services registered divergent movements and widening of the deficit compared with the previous year. Foreign companies' expectations for achieving better financial results contributed to higher reinvested earnings in 2013. Higher outflows in the income from investments and reduced inflows from employees' compensations caused widening of the income deficit by 0.4 percentage points of GDP compared to 2012. At the same time, net inflows from current transfers, as the largest source of funding of the trade deficit, decreased in 2013. Despite the decline of 1.9 percentage points of GDP, net inflows from current transfers were sufficient to fully cover the deficit in the trade in goods and services. Unlike 2012, when the estimated private cash transfers based on purchase of cash foreign currency on the currency exchange market were the driving force behind the growth of current transfers, in 2013 this category largely contributed towards the annual decline. Given the high base effect from the last year, the supply of foreign currency decreased, as a result of the reduced supply of the Euro currency. Changes in the supply were especially evident in the first half of the year, in large part due to the high base effect from this period in 2012, when due to the lack of confidence in the common currency of the Euro area, high denarization was registered, through conversion of Euros into domestic currency on the currency exchange market and high annual growth of the net purchase. The increased demand for Euros on the currency exchange market also contributed to the reduced net purchase on the currency exchange market in 2013.

Chart 48

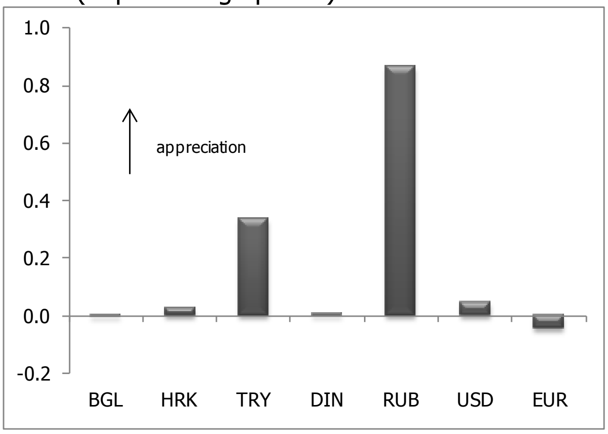
NEER and REER (CPI and PPI based, 2006=100)




Relative prices (2006=100)




Contribution to the annual change of NEER of the Denar (in percentage points)



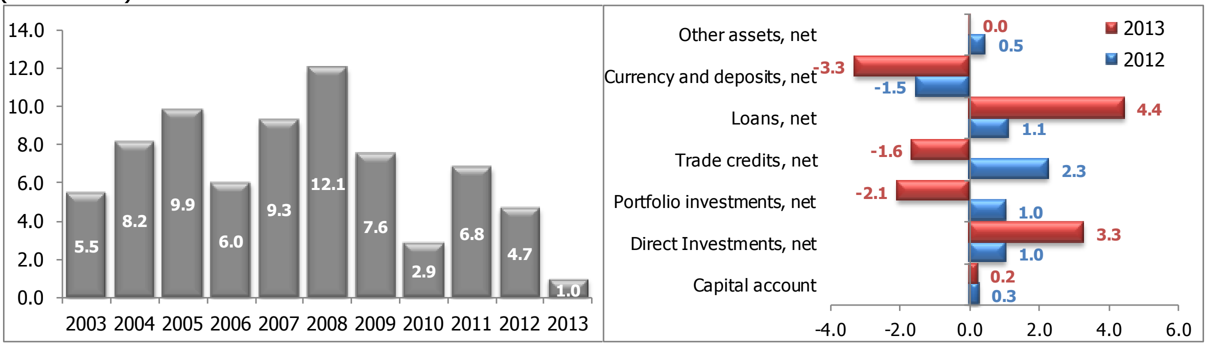

Source: NBRM.

Indicators of price competitiveness of the Macedonian economy pointed to a negligible appreciation of the Denar in 2013. The CPI-deflated real effective exchange rate rose by 0.9%, while the PPI-deflated REER recorded an annual appreciation of 0.4%. The change was entirely caused by the movement of the nominal effective Denar exchange rate, as a result of the appreciation of the domestic currency against the Russian Ruble and Turkish Lira[45], with favorable slower movements of domestic relative to foreign prices.

[45] The announcements for Fed's tapering caused sudden capital outflows in most emerging economies, devaluing their national currencies against the US Dollar. The devaluation was particularly emphasized in the Argentine Peso, Russian Ruble, Turkish Lira and South African Rand.

Chart 49
Capital and financial account, excluding official reserves
(% of GDP)

Capital and financial account component
(% of GDP)



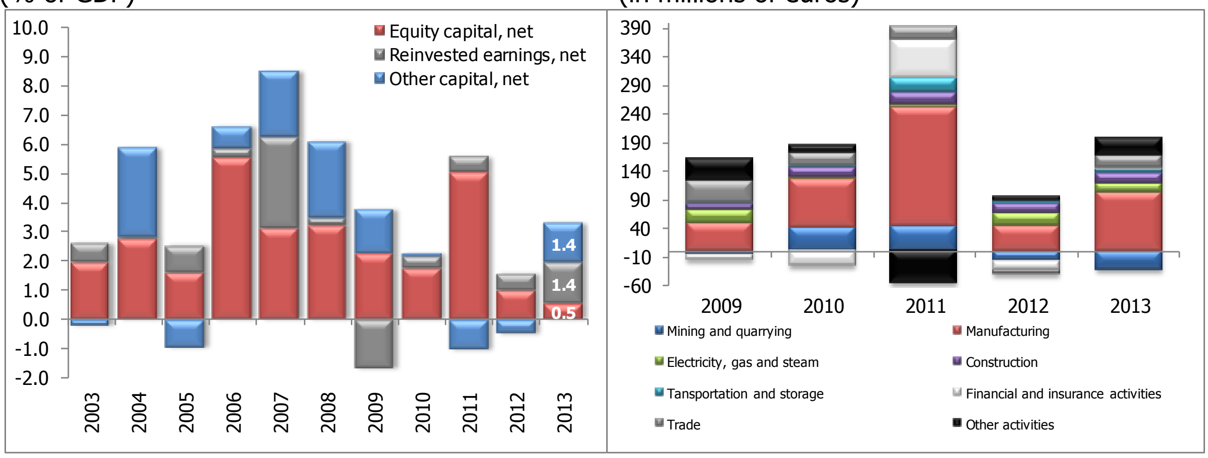

Source: NBRM.

Source: NBRM.

In 2013, the capital and financial account registered net inflows of 1% of GDP, which were lower by 3.7 percentage points of GDP, on an annual basis. In 2013, direct investments and net external financing of the Government and the private sector were the major sources of creating new capital inflows. Foreign direct investments in 2013 amounted to 3.3% of GDP, and were mainly in the form of reinvested earnings and intercompany debt. The permanent form of investment, i.e. equity was of little importance in the inflows of direct investment, in 2013. Analyzed on a gross basis, the intercompany debt registered more intensive borrowing from parent companies, and significantly lesser lending to parent companies by the subsidiaries operating in the domestic economy. In terms of activities, the direct investments of foreign investors are mainly in production, and are mostly related to additional investments of existing investors in the automotive industry. Compared to 2012, direct investments registered significantly higher net inflows (by 2.2 percentage points of GDP) as a result of the net inflows in the intercompany debt (as opposed to the net outflows in the previous year) and increased reinvested earnings.

Chart 50
Direct investments structure, net
(% of GDP)

Direct investments, by activity
(in millions of euros)




Source: NBRM.

Source: NBRM.

Government external financing in 2013 was also a significant source of creating capital inflows, amounting to 1.9% of GDP on a net basis. The Government borrowed from foreign creditors (in January, the Government used a Loan facility at Deutsche Bank made under the Loan Agreement secured by policy-based guarantee by the World Bank and the

First programmatic competitiveness Development Policy Loan from the World Bank[46]), but it simultaneously repaid the Eurobond issued in 2009[47]. Net borrowing of the private sector abroad was almost equally distributed between banks and other sectors in the economy. On an annual basis, net loans experienced fast growth (of 3.6 percentage points of GDP), which was mostly a result of increased Government borrowing abroad. These positive developments were largely offset by the volatile short-term trends in the financial account, i.e. the high outflows registered in currency and deposits and trade credits. Increased outflows in currency and deposits resulted from the continued trend of withdrawals of households' foreign currency deposits from the banking system in cash, which were later partially converted into Denars on the currency exchange market, but also from the increase in banks' foreign assets placed on their accounts abroad. Substantial outflows in trade credits were expected to some extent, having in mind the fast growth in this category last year. The very nature of this category, as short-term loans related to foreign trade, explains the high repayment of trade credits after their accumulation in the previous year. Significant outflows were recorded also in the category of portfolio investments, due to the payment of the Eurobond issued by the Government in 2009, unlike last year, when net inflows were registered (mainly from the sale of the Eurobonds issued by the Republic of Macedonia held by domestic financial entities, mostly private pension funds - sales from residents to non-residents).

At the end of 2013, the negative international investment position of the Republic of Macedonia against the rest of the world amounted to Euro 3,543.6 million, or 59.5% of GDP. Compared with the previous year, net external liabilities increased by 3.4 percentage points of GDP, amid reduced international assets and simultaneous growth of international liabilities. The annual decline in assets was mainly explained by the changes in the gross foreign reserves, and the declining claims of the monetary authority, based on short-term lending (repo transactions). The increase in liabilities on an annual basis mainly stems from the higher liabilities to direct foreign investors and government long-term external borrowing. Regarding the sectors, the analysis of net debt position of the country with the rest of the world in 2013, speaking in terms of the share in GDP, indicates more negative position with the monetary authority and the other sectors in the economy. Increased liabilities to direct investors, i.e. increased direct investments in the country contributed to the growth of net international liabilities of other sectors in the economy, which given their importance for the economic activity, is a positive feature. The lower net assets of the monetary authority are related to the reduced foreign reserves. On the other hand, a slight improvement of the IIP was recorded through the reduced government liabilities and the slight positive change in the banks' investment position[48].

[46] Under the Law on the borrowing of the Republic of Macedonia based on the Loan facility at Deutsche Bank made under the Loan Agreement secured by policy-based guarantee by the International Bank for Reconstruction and Development - World Bank ("Official Gazette of RM" no. 171 of December 28, 2012) the loan amounts to Euro 250 million, while the borrowing from the World Bank totals Euro 38.7 million (Law on the borrowing of the Republic of Macedonia from the International Bank for Reconstruction and Development - World Bank under the First programmatic competitiveness Development Policy Loan from the World Bank, "Official Gazette of RM" no. 171 of December 28, 2012).

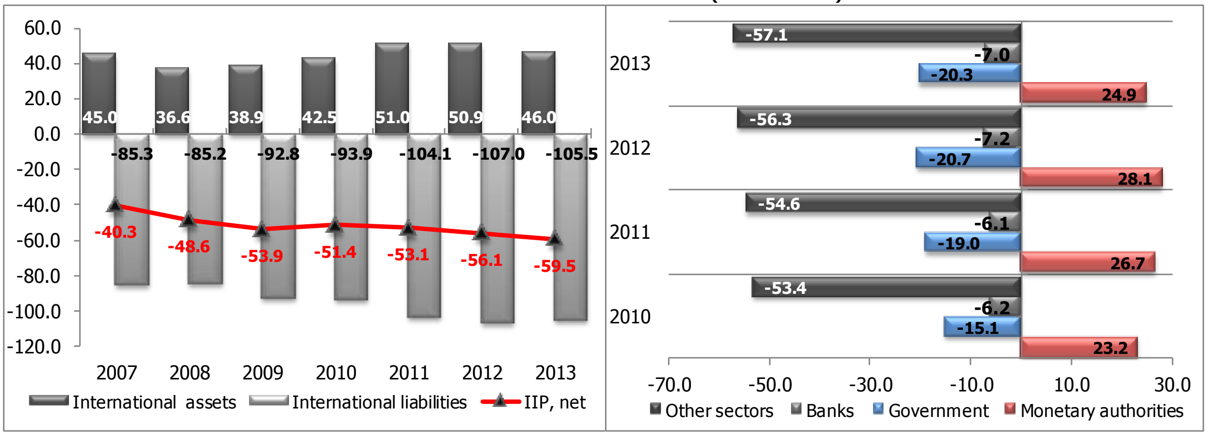
[47] The Government repaid the nominal amount of the Eurobond of Euro 175 million, but at the time of maturity, certain portion of the Eurobond was owned by domestic investors, mostly domestic pension funds, so that the amount of funds siphoned out of the country was Euro 131.7 million.

[48] The analysis of the IIP by sectors, in absolute terms, shows deterioration in all institutional sectors in the economy.

Chart 51

International Investment Position (% of GDP)

International investment position, by institutional sectors (% of GDP)




Source: NBRM.

At the end of 2013, the gross debt reached Euro 5,210.1 million, or 67.7% of GDP, which in relative terms represents an annual decrease of 1.7 percentage points of GDP. However, if the analysis excludes the repo transactions of the monetary authority, the annual change in the gross debt to GDP ratio indicates an increase of 0.4 percentage points of GDP. Main generator of the annual growth of the gross debt (excluding repo transactions) is the higher public sector debt, while the external debt of the private sector did not register significant changes on annual basis. Changes in the public debt are due to the government external borrowing in the first quarter of the year by using long-term financial loans[49], causing a rise in the external debt despite the Eurobond repayment in January 2013. Public enterprises and public banks[50] had an additional contribution to the growth in the public debt. Higher debt of public enterprises was mostly due to the transformation of the Agency for State Roads into a Public Enterprise for State Roads[51], which respectively increased the foreign debt of "other sectors" simultaneously reducing the external debt of the government sector. The external debt of the private sector registered an increase in the long-term liabilities, especially liabilities to foreign direct investors, while short-term debt decreased due to the reduced liabilities based on trade credits and currency and deposits.

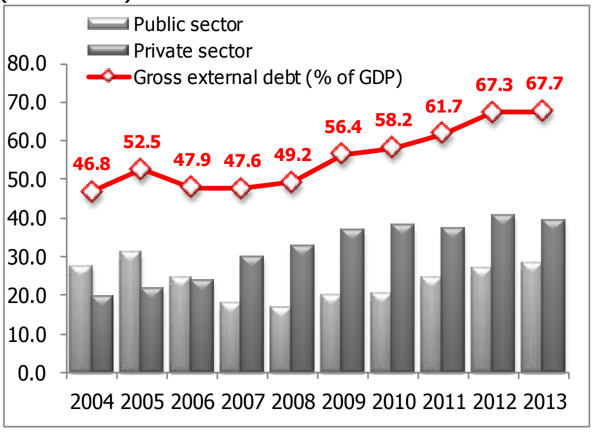
[49] In January, the Government was granted a loan from the World Bank aimed at fostering competitiveness and another loan from the Deutsche Bank secured by policy-based guarantee by the World Bank. The total amount of disbursements based on these two loans amounted to Euro 280 million.

[50] The higher debt of the sector "public banks" is due to the borrowing of the Macedonian Bank for Development Promotion from the EIB, through withdrawal of funds from the third credit line for support of SMEs in the amount of Euro 58 million.

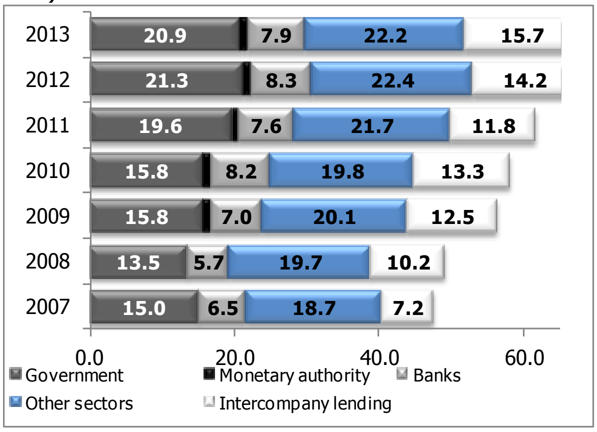
[51] In January 2013 by a decision of the Government ("Official Gazette of RM" no. 1/2013) the Agency for State Roads was transformed into a Public Enterprise for State Roads. With the restructuring, the public enterprise took part of the credit liabilities of the Government, which reduced the debt of the government sector by Euro 82 million while simultaneously increasing the liabilities of other sectors, i.e. liabilities of public companies based on long-term loans for the same amount.

Chart 52

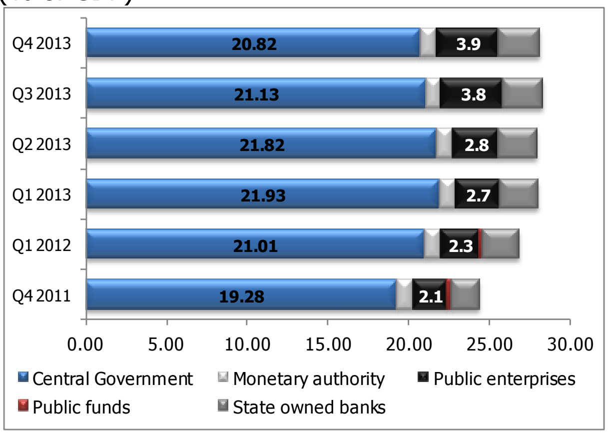
Gross external debt
(% of GDP)




Gross external debt, by institutional sectors (% of GDP)




Public debt structure
(% of GDP)




Source: NBRM.

Indicators of external indebtedness of the domestic economy generally show that the gross external debt remains in the safe zone. Analysis of the solvency indicators[52] confirms that according to the level of the gross external debt, the Republic of Macedonia belongs to the group of low indebted countries, with the exception of the external debt to GDP ratio, which is the only indicator pointing to high indebtedness of the economy. Considering the dynamics, most indicators suggest improvement or a slight increase on an annual basis, with the exception of the debt repayment to exports of goods and services and other inflows ratio[53]. External debt liquidity indicators generally point to favorable position, i.e. the coverage of the short-term debt (residual maturity) with foreign reserves is close to the required full coverage. On an annual basis this indicator shows no significant change.

[52] These indicators are analyzed according to the methodology of the World Bank.
[53] The methodology of the World Bank, beside the exports of goods and services, also includes the inflows based on investment income, remittances and compensations of employees. The deterioration of this indicator is due to the repayment of the Eurobond in January 2013.

Table 1
External indebtedness indicators

| Indicators for external indebtness | Solvency | | | | Liquidity | | |
|---|---|---|---|---|---|---|---|
| | Interest payments/ Export of goods and services and other inflows | Gross debt/ Export of goods and services and other inflows | Gross debt/ GDP | Debt servicing/ Export of goods and services and other inflows | Foreign reserves/ Short-term debt | Foreign reserves/ Short-term debt, with residual maturity* | Short-term debt/ Overall debt |
| | in % | | | | ratio | ratio | in % |
| 31.12.2004 | 2.24 | 120.1 | 49.3 | 11.5 | 1.14 | 0.89 | 30.3 |
| 31.12.2005 | 2.33 | 128.5 | 56.3 | 9.7 | 1.67 | 1.04 | 26.7 |
| 31.12.2006 | 2.88 | 109.8 | 51.8 | 18.2 | 1.95 | 1.34 | 29.0 |
| 31.12.2007 | 2.38 | 102.3 | 53.2 | 16.6 | 1.35 | 1.08 | 39.8 |
| 31.12.2008 | 2.30 | 101.1 | 55.3 | 8.8 | 1.29 | 0.95 | 35.2 |
| 31.12.2009 | 2.10 | 113.3 | 58.5 | 10.2 | 1.29 | 0.94 | 32.9 |
| 31.12.2010 | 2.78 | 121.1 | 60.1 | 11.9 | 1.31 | 0.90 | 32.0 |
| 31.12.2011 | 2.70 | 128.4 | 65.2 | 14.5 | 1.53 | 1.06 | 29.4 |
| 31.12.2012 | 2.53 | 123.2 | 68.4 | 11.3 | 1.39 | 0.93 | 31.4 |
| 31.12.2013 | 2.10 | 119.6 | 69.1 | 13.7 | 1.27 | 0.91 | 30.1 |
| *Moderate indebtedness criterion* | *12 - 20%* | *165 - 275%* | *30 - 50%* | *18 - 30%* | | *1.00* | |

*The moderate indebtness criterion is accordng to the World bank's methodology of calculationg indebtness indicators, which implies 3-year moving averages of GDP and exports of goods and services in the calculation of the indicators.
In compliance with "External debt statistics: Guide for compilers and users," published by the IMF.
*According to the "Greenspan-Guidotti rule", a country should maintain full coverage of short-term debt at remaining maturity with gross foreign reserves.
Source: NBRM.

### 2.2.5. Monetary and credit aggregates

In 2013, the dynamics of the monetary and credit aggregates corresponded to the gradual recovery of the economy and further stabilization of expectations. The enlarged potential of the domestic economy, the stabilization of the expectations of the economic entities, as well as the lower risk perception of the banks, created conditions for both expanding the deposit base and accelerating the lending activity. In this regard, the taken macro prudential and monetary measures during the year, aimed at easing the banks' interest rate policy and increasing their lending activity, acted in this direction. In conditions of larger release of liquidity and moderate decline in the banks' lending interest rates, certain favorable changes in the credit supply were registered, given constant increase in the credit demand by both enterprises and households[54]. On the other hand, the gradually intensified activity in the economy contributed to the creation of additional disposable income, thus creating conditions for solid growth in the basic source of banks funding.

[54] According to the results in the Lending Survey of the National Bank in 2013.

Chart 53
Annual growth of CB bill interest rate and lending Denar interest rate of banks

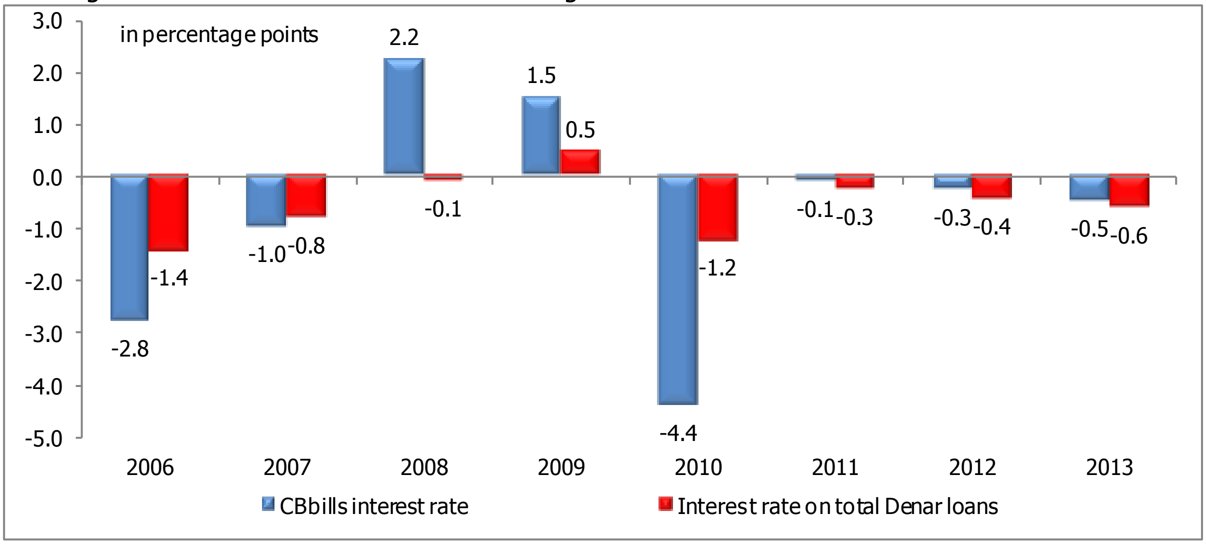
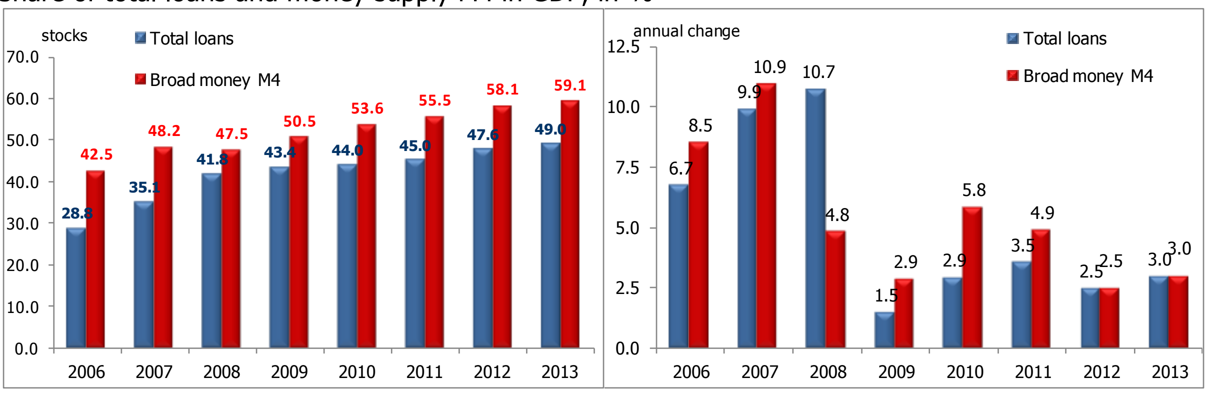



Chart 54
Share of total loans and money supply M4 in GDP, in %




Source: NBRM.

The broad money M4 continued to mount in 2013, but more intensively in comparison with the previous year, with the annual monetary growth rate in December being equal to 5.3%. Also in 2013, most of the monetary growth emanated from the increased deposit potential of the banks[55]. Namely, the gradual recovery of the real sector, as well as the positive movements on the labor market, contributed towards creating conditions for improvement in the financial position of the entities. In such conditions, the declining rate of the deposit potential of the corporate sector was significantly slower relative to the previous year[56], while the household savings continued to increase with similar dynamics as in the preceding year. The long-term deposits are, for the second consecutive year, the sole generator of the increase in the banks' deposit base, given the registered decrease in the short-term savings. Such developments underline the stable expectations of the economic agents, thus increasing the preference for long-term savings, as more profitable form of placement of disposable assets. The most liquid component of the broadest money, i.e. monetary aggregate M1 contributed positively to the monetary growth also in 2013, but moderately less compared to the previous year. The increase in the broad money M1 mostly aroused from the increase in the demand deposits, given their risen level with both the household and corporate sector, as well.

[55] It refers to the total deposits without demand deposits.
[56] In 2013, the total corporate deposits with included demand deposits, registered an increase.

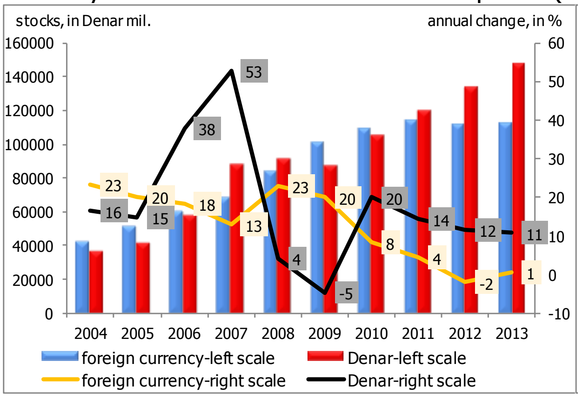
Table 2
Components of monetary aggregates

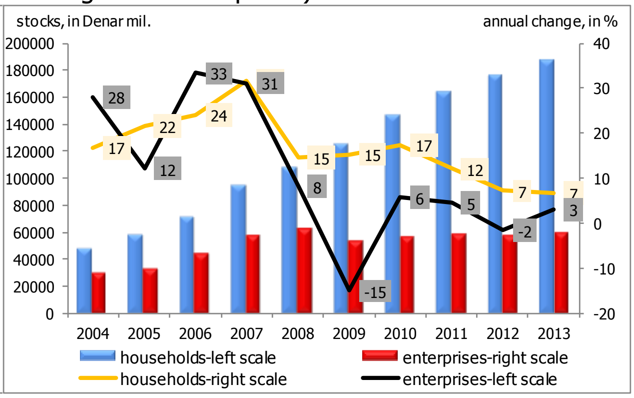
| | Balance as of | | | Annual change | | | Contribution in annual growth of M4 | | |
|---|---|---|---|---|---|---|---|---|---|
| | 31.12.2011 | 31.12.2012 | 31.12.2013 | 31.12.2011 | 31.12.2012 | 31.12.2013 | 31.12.2011 | 31.12.2012 | 31.12.2013 |
| | in millions of denars | in millions of denars | in millions of denars | in % | in % | in % | in % | in % | in % |
| Currency in circulation | 19,308 | 20,118 | 20,706 | 13.9 | 4.2 | 2.9 | 10.5 | 7.2 | 4.2 |
| Demand money | 41,993 | 45,824 | 49,299 | 3.9 | 9.1 | 7.6 | 7.1 | 34.0 | 24.7 |
| **M1** | **61,288** | **65,941** | **70,005** | **6.8** | **7.6** | **6.2** | **17.5** | **41.3** | **28.9** |
| Short-term Denar deposits | 58,293 | 57,543 | 57,112 | 13.6 | -1.3 | -0.7 | 31.2 | -6.7 | -3.1 |
| Short-term foreign currency | 97,107 | 94,228 | 90,949 | 4.5 | -3.0 | -3.5 | 18.6 | -25.5 | -23.3 |
| **M2** | **216,682** | **217,712** | **218,066** | **7.5** | **0.5** | **0.2** | **67.3** | **9.1** | **2.5** |
| Long-term Denar deposits | 21,966 | 31,688 | 41,509 | 45.3 | 44.3 | 31.0 | 30.5 | 86.3 | 69.8 |
| Long-term foreign currency | 16,372 | 16,887 | 20,788 | 3.2 | 3.1 | 23.1 | 2.2 | 4.6 | 27.7 |
| **Total deposits** | **193,738** | **200,346** | **210,358** | **10.6** | **3.4** | **5.0** | **82.5** | **58.6** | **71.1** |
| **M4** | **255,020** | **266,287** | **280,363** | **9.7** | **4.4** | **5.3** | **100** | **100** | **100** |

Source: NBRM.

The analysis of the changes in the in the currency components of the banks' deposit base indicated further stable expectations for the foreign exchange rate and more evident propensity to save in domestic currency. During the year, the annual growth dynamics of the Denar deposits was constantly positive, while their contribution to the deposit growth, the highest. In terms of foreign currency deposits, annual downward trend in the first eight months of the year was registered, which was especially evident from April as a result of the payment of dividend to the Government and the foreign investor (assets withdrawal from the corporate foreign currency accounts). In the following four months of 2013, the foreign currency deposits began to mount on annual basis, but moderately, thus contributing slightly to the increase in the total deposits. Having in mind such a dynamics of the Denar and foreign currency deposits, in 2013, the process of decrease in the level of euorization continued (measured through the share of the foreign currency in the total deposits[57]), and as a result, in 2013 it equaled 44.4%, on average (compared to 46.7% in 2012 and 50.9% in 2011).

Chart 55
Currency and sector structure of total deposits (including demand deposits)




[57] With the demand deposits being included.

Chart 56
Contribution to the annual growth of M4 (in p.p.)

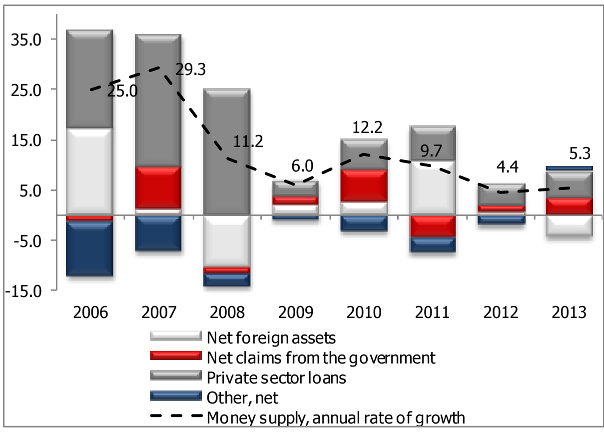
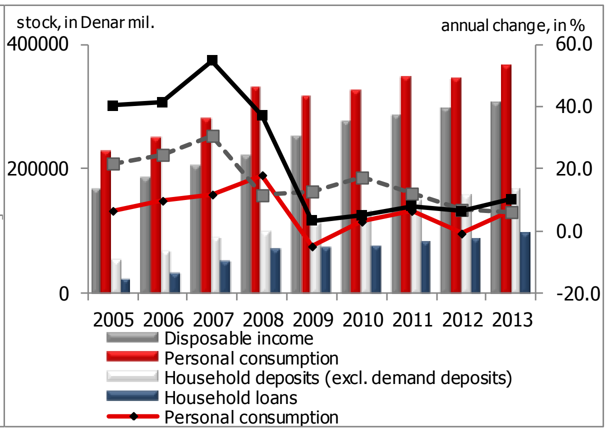


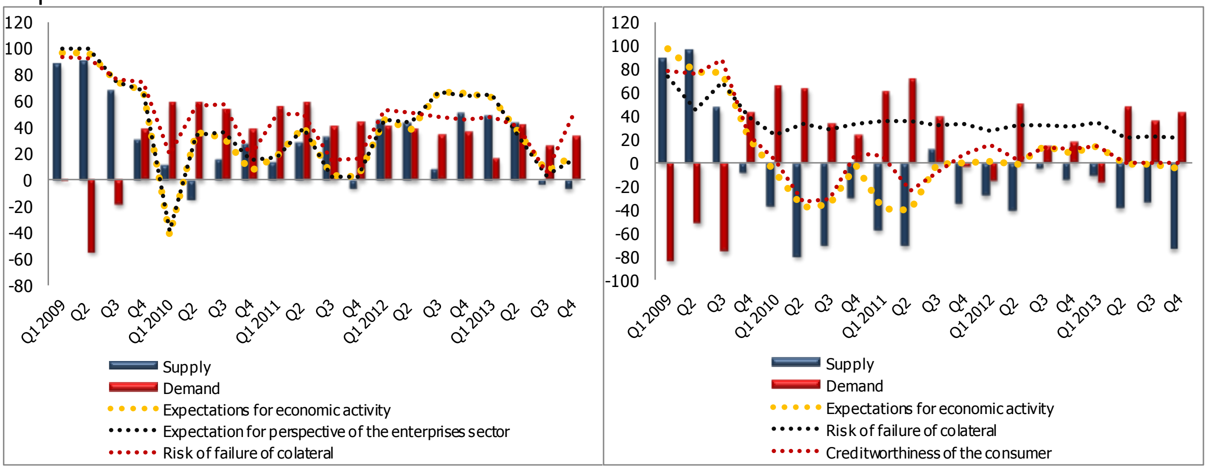

Chart 57
Developments of major household inflows and outflows[58]




Source: NBRM.

In conditions of favorable developments in the economy and intensified increase in the banks' deposit potential, in 2013 the banks' lending activity continued to mount with moderate acceleration. Thus the total credits registered annual increase of 6.4%, while the new credit flows in the economy exceeded the credit amount that was placed in the previous year. The reason for this lies not only in the intensified economic activity, but in the performed monetary easing, as well, given simultaneously adequate liquidity and capitalization level of the domestic banking sector. In such conditions, the banks' risk perceptions improved relative to the previous year, which is perceived through the banks' responses in the lending surveys.

Chart 58
Supply, demand of credits and banks' risk perception (net percentage)[59]
Corporate sector
Household sector




Source: Lending Survey, NBRM.

Regarding the corporate sector, the constant trend of tightening of lending terms was discontinued at the end of 2013, when the banks indicated net relaxation of the terms for corporate lending. During the year, regarding the household sector, the banks continued

[58] Disposable income encompasses the private transfers, pensions and wages of the households.
[59] Explanation: the supply refers to the change in the lending terms (if the net percentage is positive, then the lending terms are tightened, while if it is negative, they are relaxed); the credit demand (if the net percentage is positive, the demand is higher, if it is negative, the demand is lower), the risk factors influencing the lending terms, if the net percentage is positive, then they contribute to tighten the lending terms, while if it is negative, they act towards eased lending terms. The chart pertaining to households presents the average of the net percentage of the risk factors influencing the lending terms when extend the housing loans and those having influence on the consumer loans. For more details on the lending surveys, please see the web site of the National Bank.

to ease the lending terms on a net basis. From the aspect of the demand from both sectors, larger demand for loans by companies and households was registered, although with different dynamics throughout the year. According to the surveys, the demand for corporate loans was mainly stirred by the need for investments in inventories and working capital, fixed assets, as well as debt restructuring, with the households registering a need for investments in durable goods.

Chart 59
Annual loan growth

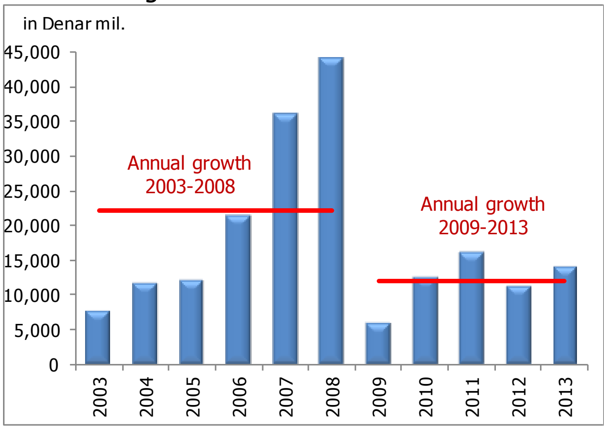
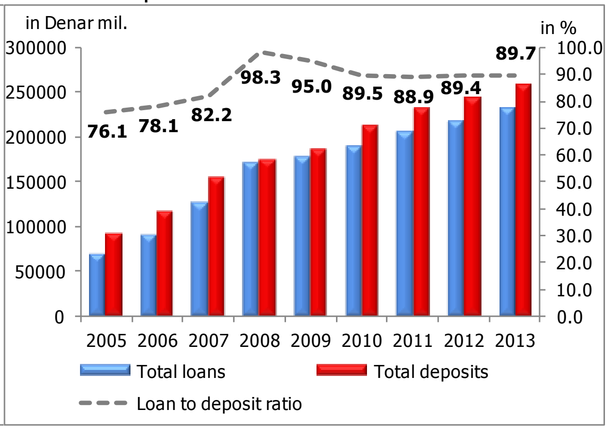



Chart 60
Loan to deposit ratio

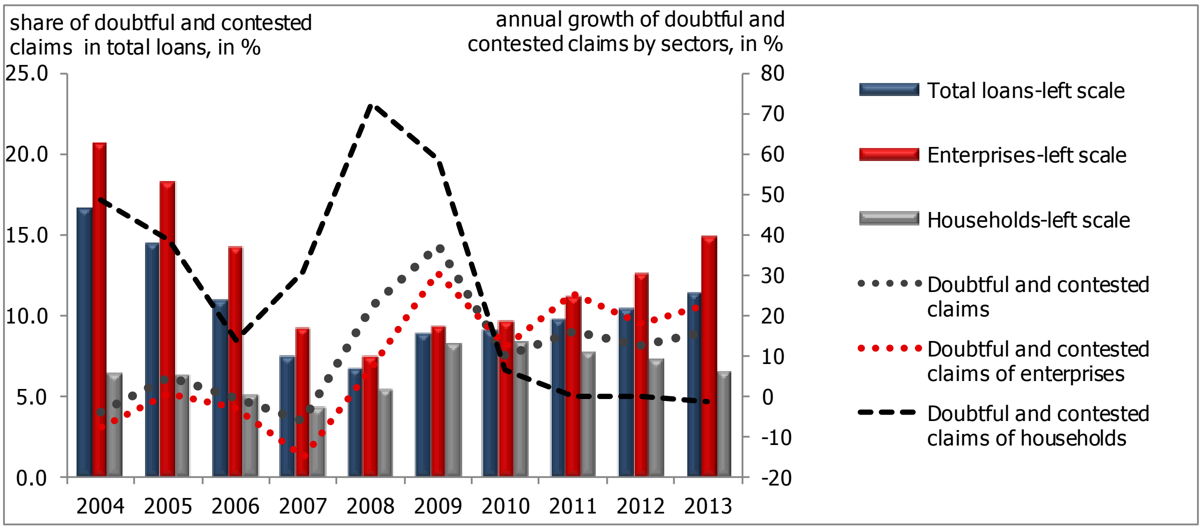



Source: NBRM.

In 2013, as well, despite the improved credit activity, there were unfavorable risks on the credit market, which are connected, once again, with the conservative strategies of larger bank groups present in the Macedonian banking system, as well as the uncertainty related to the recovery dynamics of the domestic economy. Such a restraint of the banks regarding the loan distribution referred especially to lending to the corporate sector, the contribution of which in the credit growth plunged in 2013. Thus unlike the previous year when the loans were almost equally distributed to both the household and the corporate sector, in 2013 the share of the household loans in the annual credit growth equaled 63%. Namely, despite the favorable economic developments during the year, the banks were more cautious in terms of corporate lending, having in mind the still present risks in the economy. This can partially be explained through the risk dispersion, having in mind that the corporate loans are extended in larger individual amounts than the household loans, thus elevating the risk for the bank. The ground for the banks' carefulness towards this sector can also be found in the higher increase in the doubtful and contested claims with the corporate sector (of 22.8%, annually), which explains about 77% of the total doubtful and contested claims, emphasizing the present credit risk. The developments on the credit market show that despite the stabilization in the risk perceptions and improved expectations for the following period, in order to speed-up the credit activity, the uncertainty level should decrease more, while the economic recuperation process should continue.[60]

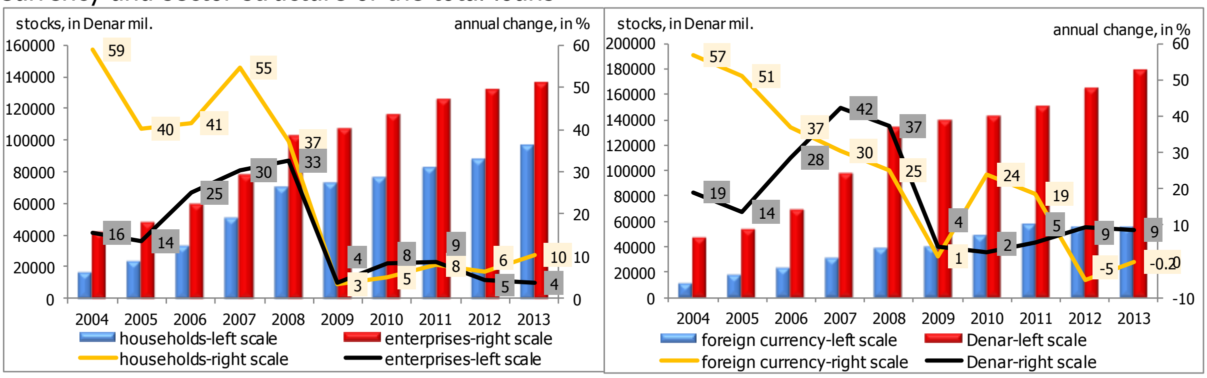
[60] The researches on this topic showed that the economic growth and the credit activity after certain financial crisis do not recuperate with the same dynamics. Thus according to the BIS research (Credit and growth after financial crisis, working paper No 145, July 2013), which covers 39 financial crisis emerged after a credit expansion, it has been determined that the changes in the loans in the first two years of the recovery do not associated with the economic growth, and in the third and fourth year there is small, but still weak connection between these developments. According to the research of the European Central Bank (*Money and credit growth after economic and financial crisis-a historical global perspective*, article, Monthly Bulletin, February 2012), which refers to the movements of the monetary and credit flows during various recessions of the OECD countries, it was determined that the money supply growth corresponds to the economic cycle, while the credit growth mainly lags behind the recovery of the economic activity.

Chart 61
Doubtful and contested claim, by sector




Source: NBRM.

Chart 62
Currency and sector structure of the total loans




Source: NBRM.

## III. Macroeconomic environment and monetary policy in 2014 and 2015

In accordance with the statutory provisions, the maintenance of the price stability as the basic monetary objective will continue to be the main goal of the monetary policy of the National Bank also in the following period. The National Bank will pursue its efforts towards maintenance of stable and competitive banking sector and support to the general economic policies without jeopardizing the achievement of the primary goal. In terms of monetary strategy, the National Bank is committed to applying strategy of maintaining stable nominal exchange rate against the Euro. The role of the exchange rate as a nominal anchor derives from the characteristics of the domestic economy, as a small and open economy that is highly dependent on the import of primary commodities. In such conditions, the importance of the exchange rate for price stability maintenance and economic agents' expectations for stable inflation becomes even larger. In order to attain its objectives, the National Bank will continue implementing appropriate monetary instruments. The operational framework of the monetary policy, as before, will be set on a flexible basis and for the purpose of effective management of liquidity in the banking system and maintenance of balance on the foreign exchange market. Accordingly, the monetary policy will continue to contribute to the overall macroeconomic stability as a key factor in creating a favorable environment for sustainable economic growth.

It is expected that the monetary policy conduct in the next two years will take place in a relatively stable environment, in the absence of significant internal and external imbalance. The latest projections of the National Bank from October 2013 envisage further acceleration of the economy boost, primarily due to the exports and the investments. It is expected that the external sector developments will be favorable in the next two years, despite the assessments for moderate expansion of the current account deficit in line with the strengthening of economic activity. The capital inflows will increase and their level will enable funding of the current account deficit and increase in the foreign reserves, which are expected to remain on a comfortable level. Inflation will be moderate and move within controlled frames about the historical average of approximately 2%.

The materialization of the projected macroeconomic framework is followed by risks, which mainly come from the external environment. Namely, despite mostly positive prospects for global economic growth, there are expectations for slow recovery, which primarily relates to the euro area, as our largest trading partner. The still present uncertainty on financial markets, the possibly weaker performance in domestic and export demand, as well as slow and inadequate implementation of structural reforms in some member states are emerging as key sources of vulnerability for the economic activity in the euro area. From the beginning of 2014, in conditions of significant slowdown of the inflation rate, the risks of downward adjustment of the inflation expectations and emergence of deflation in advanced economies also increased, which can limit the economic growth. In addition, the uncertainty regarding the economic prospects of emerging economies and developing countries has also risen. The initiated lessening of the monetary stimulus by the FED and certain political developments[61] led to turbulence on financial markets and volatility of capital flows in emerging economies and developing countries, which in combination with the accumulated internal imbalance, increases the vulnerability of this group of countries. In such conditions, the uncertainty related to the future developments in the global economy remains high, creating incertitude and risk in terms of expectations for external borrowing

[61] It mainly refers to the riots in Turkey, Brazil and Thailand, as well as the expectations of the investors for larger political instability in the forthcoming period due to the scheduled elections in Turkey and Brazil.

and other capital inflows and domestic export activity. Having in mind the high dependence of the economy on imported energy, the risk of future energy price movements is not excluded. Namely, despite the general estimations for fall in the world price of oil in the next period, its high sensitivity to economic and geopolitical events does not exclude the possibility of unforeseen shocks in the dynamics of the price of this source of energy. Such risk, for example, is the geopolitical turbulence in Ukraine, which may impact the prices of both energy and food products (cereal products) and cause instability on these markets. Any materialization of the aforementioned risks will mean change in the environment for the monetary policy conduct, in comparison with the main expectations.

Domestic inflation will gradually slow down in the next period and it will come closer to the historical average. Inflation projection for 2014 indicates an average annual inflation of 2.3%, which would contribute to slower growth of the domestic prices, compared to 2013. The price growth in 2014 reflects the transmission effect of the previous year, as well as the expected movements of part of the import prices and the recovery of domestic demand. According to the expectations, the inflation will slow down also in 2015, when it will approach the historical average and equal 2%. The risks related to the projected path of inflation are mostly downward. Namely, from the October projection, there is stronger deceleration in the rate of inflation than expected, leading to lower inflation in December 2013 than projected. Besides changes in the initial conditions, the new projections for the movement of world food and energy prices are significantly lower than the assumptions included in the projection, indicating a possible downward adjustments to the projected rate of inflation.

The favorable economic trends, which were characteristic for 2013, will continue in the following two-year period with gradual acceleration in the rate of economic growth. The growth generator in the next period is supposed to be the export sector, as a combined effect of the larger use of foreign investors' capacities, new foreign investment, and the recovery of other exporters, in conditions of more stimulating external environment. The investment cycle should intensify in the next period, largely supported by strong fiscal impulse and foreign private capital. Namely, in 2014-2015, it is expected that the current public investments will continue, and as there are expectations for new infrastructure projects. It is estimated that these developments in the export sector and the strengthening of investment activity will create positive transmission effects on both the labor market and the expectations, and thus be a factor for further increase in the household consumption. The increase in the domestic demand should be supported additionally by liquid and solvent banking sector, through moderate intensification of the credit growth. The sound domestic and export activity will cause intensified import activity and as a result, the contribution of net export demand will be in the negative zone. Hence, it is expected that the GDP growth in 2014 will equal 3.7%, while in 2015 it would speed up even more and reach 4.4%. Given the high openness of the economy, the risks to the projected growth continued to result from the global environment and developments in the external environment.

In conditions of solid liquidity and solvency of banks, it is expected that the economic recovery, the stabilized environment, the increase in the deposit banks' deposit potential, as well as the measures already taken by the monetary authority will contribute to greater financial support for the domestic economy through the banking sector. The increase in the total loans in 2014 is projected at 6.4%, while by the end of 2015, the credit growth would accelerate and it would reach 8.5%. The end of 2013 was marked by significant intensification of the lending activity, which may be a positive signal for developments on the credit market in the following period. However, the downward risks remain amid variable global environment and still present deleverage process of the European banks. Namely, despite the domestic favorable economic performance, the still uncertain global environment and the fragile recovery of the euro area may affect the perceptions of the domestic banks, contributing towards prudent determining of the volume of the supply of loans also in the following period. The conservative strategies of the major bank groups present on the domestic markets through their daughter banks and the further development of the loan portfolio quality are additional factors that could limit the achievement of projected credit growth.

Projections for 2014 and 2015 show that the external position can provide further increase in the foreign reserves and their maintenance at appropriate level. In 2014, current account deficit of 4.6% of GDP is expected, which means its widening compared to 2013. This projection of the balance of payments reflects the estimations for higher import pressure in 2014, stemming from the increase in the import-dependant exports and investments, and it will further be strengthened by the expected growth in private consumption. In addition, in 2015, widening of the current account deficit by 5.7% of GDP is expected, mainly due to the fall in private transfers. In fact, after their strong growth in the preceding period, especially during the high non-confidence in euro currency, stabilization of the level and decrease in the relative share of the private transfers in GDP on a medium run is expected. Regarding the trade deficit, no major changes are expected, in conditions when the increasing import pressures should largely be neutralized by growth in the exports of the foreign companies. The current path of the current account deficit and its structure do not signalize major imbalances in the economy, i.e. indicate absence of major import pressures from unproductive consumption. Despite the moderate deterioration on the current account, it is estimated that its negative balance will be fully financed by capital inflows, mainly coming from foreign direct investment and external borrowings for infrastructure projects. It is expected that the foreign direct investments will gradually increase in the next two years and reach 4% and 4.5% of GDP, respectively. Also the improvement in the global environment, the stabilization of global financial markets and the improvement in the conditions in the domestic economy will act in this direction, thus causing more positive perceptions among investors. The new available information in the period following the October projections show better balance of payments position in 2013 than anticipated, which is a positive risk for the movements in the balance of payments in the next period, i.e. it could reflect through downward correction of the projected current account deficit.

In the following two years, prudent fiscal policy is expected, with gradual consolidation of the budget deficit and relatively stable level of public debt[62]. The fiscal policy is important factor that influence the monetary policy setup, while the adequate coordination of these policies is crucial for creation and maintenance of the macroeconomic stability. After the risen level in 2013, the budget deficit is expected to fall gradually and it would range about 3% of GDP on a medium run. Hence, in 2014, it would equal 3.5% of the GDP, while 3.2% of GDP in 2015. The primary budget deficit should also follow this course[63], which would equal 2.6% and 2.2% of GDP in 2014 and 2015, respectively. The public investments remain to be the priority goal of the fiscal policy. Namely, in the following period, realization of grand investment projects in road and railway infrastructure, as well as in public utilities infrastructure and energy sector, agriculture, etc., is projected. Thus the fiscal policy will further support the economic recovery process of the domestic economy. As anticipated, the deficit is going to be funded from external and domestic sources. Within the domestic sources, it is envisaged to use part of the Government deposits with the National Bank, as well as to issue government securities with longer maturity, which will contribute towards strengthening and further development of the domestic securities market. This fiscal framework envisages moderate increase in the government debt in the following period,

[62] The projections regarding the fiscal policy have been taken from the Fiscal Strategy of the Republic of Macedonia 2014-2016, September 2013.
[63] The projections of the primary budget deficit have been taken from the Pre-Accession Economic Program 2014-2016, January 2014.

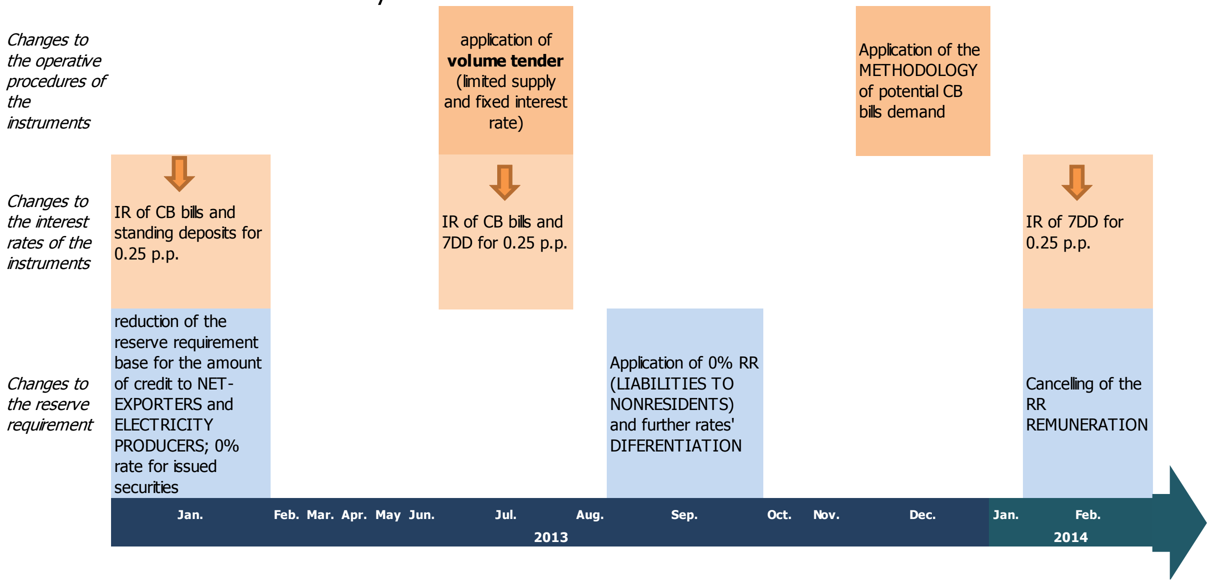
which will not jeopardize the sustainability of the public finance. Of course, the fiscal policy established in such a manner is accompanied with risks, which, as well as with the monetary policy, arise mainly from the external environment and its influence on the domestic economic activity, the consumption and investments, as well as the possibility for access to foreign financial markets.

# IV. Monetary instruments

In 2013, the monetary policy was conducted in relatively favorable environment. The absence of significant pressures on the foreign exchange market enabled stable exchange rate of the Denar, and during the year, the inflationary pressures gradually stabilized, given the registered downward trend of the core inflation. In such circumstances, the monetary policy implementation was mainly aimed at encouraging the banks' credit support as one of the conditions for faster economic growth. Thus besides the lowered key interest rate on Treasury bills, the National Bank took several macro prudential measures through changes to the reserve requirement system, which have a wider range of purposes, including:

- support the credit activity of the systemically important sectors of the domestic economy,
- stimulate the inflow of long-term foreign capital in the domestic economy, as additional source of funding of the banking system,
- support the currency and maturity restructuring of the banks' deposit base, as main source of lending activity, and
- stimulate the issuance of debt securities as an alternative source of funding of the banking and private sector, in general.

Picture 1
Time framework of the monetary measures in 2013




Source: NBRM.

## 4.1. CB bills

In conditions of reduced inflation risks and favorable movements with the foreign reserves, given slow recovery of the real sector and slowdown of the activity on the credit market, in 2013 the National Bank reduced the interest rate on the basic instrument - the CB bills in two occasions. Also, in 2013 the National Bank maintained stable level of offered CB bills, thus contributing towards channeling the excess of liquid assets from the banking system to alternative financial instruments, which, at the end, reflected as moderately intensified credit activity at the end of the year.

At the beginning of 2013, the National Bank reduced the maximal interest rate[64] on CB bills by 0.25 p.p., i.e. from 3.75% to 3.5%. During the first half of the year, the demand for CB bills was constantly on a moderately higher level by about 9.5% compared to the offered amount (the average offered amount of CB bills in the first half of the year equaled Denar 24,100 million). The banks' larger interest in placing assets in low-risk and highly liquid instruments mirrored the unfavorable risk perceptions, but also was a result of the process deleveraging of a part of the European banks[65] that are present on the domestic market. In such circumstances, the average weighted interest rate registered a downward trend and in June 2013 it equaled 3.21% (lower by 0.29 p.p. relative to the maximal interest rate).

Chart 63
CB bills auctions

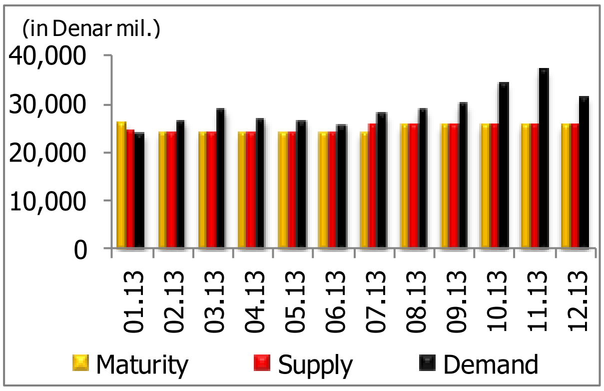
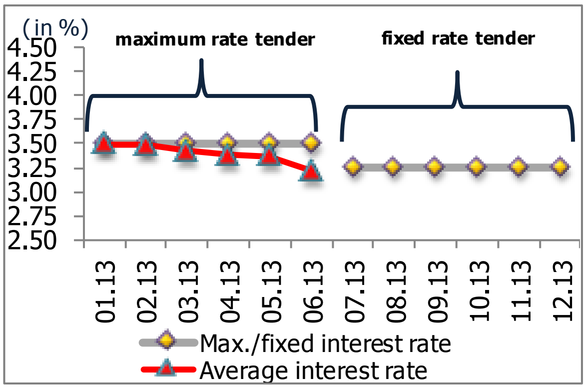



Chart 64
Interest rates on CB bills




Source: NBRM.

In order to intensify the support to lending activity, in July 2013 the National Bank once again reduced the interest rate on the CB bills from 0.25 p.p. to 3.25%, which is the historical minimum. Simultaneously, in order to stabilize the movement of the CB bills interest rate, when conducting CB bills auctions, the National Bank has introduced volume tender (restricted offered amount and fixed interest rate - 3.25%). At the CB bills auction held in July, the National Bank increased the supply moderately by Denar 1,450 million (by 6%) relative to the amount due and defined the CB bills supply at the level of Denar 25,500 million, which was maintained until the end of the year.

The implementation of the volume tender and fixed interest rate enabled maintenance of the interest rate on a stable level. However, the implementation of the restricted amount of offered CB bills, in conditions of creation of free liquid assets as a result of the macro prudential measures with the reserve requirement, given slower credit growth, resulted in banks' preference to increase the assets placed in CB bills. In such circumstances, in the third quarter of the year, the demand for CB bills started to rise significantly and it was higher by 24% in average, relative to the CB bills supply (Denar 25,500 million). Having in mind such a behavior typical when implementing this type of tender, because of the banks' efforts to increase the shares in the total amount of CB bills, in November 2013, the National Bank introduced the Methodology for determining the potential demand for CB bills[66]. The implementation of this Methodology at the latest auction

[64] In the first half of the year, at the CB bills auctions, interest rate tender was applied (restricted amount and maximum interest rate set by the National Bank), which was introduced in April. When apply this type of tender, the banks auction both the volume and the interest rate, lower than the maximum rate determined by the NBRM.
[65] In accordance with the developments on the international financial markets, these banks conducted conservative business policies, as well, which is additional limiting factor on the lending activity of the daughter banks that operate on the domestic market.
[66] According to the Methodology, the potential demand for CB bills depends on the balances on the bank accounts on the last day of the reserve requirement period, the liquidity effect of the due monetary instruments on the auction day, the effect of the due interbank claims and liabilities, as well as on the reserve requirement for the following period. However, if the demand

in 2013 resulted in significant fall in the demand for CB bills, which reduced to a moderately lower level relative to the potential demand.

Chart 65
Interest rates on the Money Market

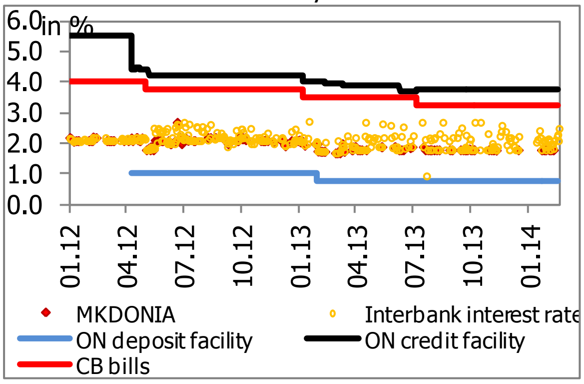
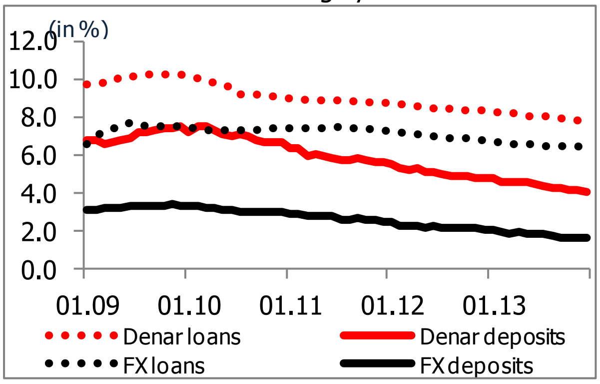



Chart 66
Interest rates of the banking system




Source: NBRM.

The decrease of the CB bills interest rate caused moderate decrease in the interest rates on the interbank money market (trading with unsecured deposits). Namely, the average interest rate MKDONIA in 2013 equaled 1.86%, which is less by 0.25 p.p. compared to the level in 2012, while the listed SKIBOR interest rates registered a decrease in the range from 0.2 p.p. on shorter maturities, to 1 p.p. on one-month maturity. The easing of the monetary conditions also resulted in a downward adjustment of both lending and deposit interest rates of the banks. In that context, and having in mind the relatively faster downward adjustment of the interest rate on the Denar deposits relative the foreign currency deposits, the space for taking further actions via the main instrument narrowed and until the end of the year, the interest rate remained on the historical minimum of 3.25%.

## 4.2. Reserve requirement

In line with the current macro prudential role of the reserve requirement on a global level, in 2012 and 2013 the National Bank has launched a cycle of changes with this instrument. Besides the primary objectives of the instrument - managing the supply of money in the economy, stabilization of the short-term interest rates on the money markets and flexible managing of the banks liquidity, the changes were aimed at making influence on certain sectors in the economy, stimulating the foreign capital inflows and making changes in the banks' balance sheets. In that regard, the changes in the reserve requirement system, besides the lending activity support, were also directed towards attaining wider macroeconomic goals, such as:

- Narrowing of the imbalance on the trade account of the Republic of Macedonia, by providing favorable conditions for lending to net exporters and domestic electricity producers, which would result in higher export-based inflows and lower outflow of foreign currency from the economy related to import of electricity. The attainment of this objective is especially important in conditions of applying a monetary strategy of targeting of the exchange rate of the domestic currency;
- Further enhancement of the initiated denarization process and reduction of the high share of foreign currency deposits in the bank liabilities, in order to diminish the systemic risk and improve the efficiency of the monetary transmission;

for CB bills of the whole banking system is higher than the potential one, the banks that auction with higher amounts than their own liquidity potential, are obliged to place the difference relative to the potential in the seven-day deposit facility.

- Widening of the scope of banking sources of financing and establishing new market segments, which will enable higher competitiveness and efficient distribution of available resources.

At the end of 2012, the National Bank introduced modifications in the reserve requirement thus creating conditions for lowering the banks' reserve requirement base by the amount of the new loans extended to the net exporters and domestic electricity producers. Also, decrease in the reserve requirement base by the amount of the banks' investments in Denar debt securities without FX clause issued by these sectors was allowed. The preliminary changes were aimed at enabling lending at lower costs and maintenance and stimulating the credit support volume in these significant economic sectors, which will finally result in increase in the export, and simultaneously, decrease in the import component of the foreign trade of the Republic of Macedonia. The second decrease of the reserve requirement base was aimed at stimulating the issuance of debt securities in domestic currency (the corporate bonds in domestic currency), as an instrument through which these sectors will mobilize fresh capital, and the banks will find new investment alternatives. Parallel to these changes, in order to widen the banks' sources of financing, and in conditions of limited access to foreign sources of funding, as well as additional stimulation of the development of the domestic capital market, a rate of 0% of the reserve requirement on liabilities in the banks' balance sheets based on issued securities in domestic currency and original maturity of minimum two years, was envisaged.

In the second half of the year, in order to further support the increase in the savings in domestic currency and the continuing trend of gradual, but stable restructuring of the currency composition of the liabilities of the banking system[67], the National Bank increased the reserve requirement rate for liabilities in foreign currency by 2 p.p., from 13% to 15%, simultaneously reducing the reserve requirement rate for liabilities in domestic currency from 10% to 8%[68].

In conditions of sluggish credit activity, counter-cyclical macro prudential measures were adopted. Namely, in order to stimulate inflow of foreign capital in the domestic economy as additional source of financing of the banking system, it was envisaged to apply a rate of 0% for the bank's liabilities to nonresidents - financial companies, with contractual maturity over one year, as well for all liabilities to non-residents with contractual maturity over two years. The rate pertaining to this category of liabilities is applied only for the long-term inflows of foreign capital, intended for credit support in the country, while for the category of short-term liabilities to nonresidents - financial companies with maturity up to one year, the rate of 13% was maintained.

In order to stimulate more active use of the advantages the macro prudential measures provided with the reserve requirement system, at the end of 2013, the National Bank adopted a decision on revoking the reserve requirement remuneration. This measure

[67] As the global economic and financial crisis intensified, in order to cease the trend of converting Denar deposits into foreign currency ones, in July 2009 the National Bank introduced differentiated reserve requirement rates from currency aspect. The reserve requirement rate on Denar deposits remained unchanged at the level of 10%, while for the foreign currency liabilities and the Denar liabilities with FX clause, the reserve requirement rates were set at the level of 13% and 20%, respectively. Simultaneously, it was envisaged to meet 23% of the reserve requirement in foreign currency, in Denars.
The implementation of the differentiated reserve requirement rates contributed towards larger propensity to save in domestic currency, so the relative share of the Denar liabilities in the banks' total liabilities increased by 12 p.p. and in April 2013 it reached 50.4%. On the other hand, the share of the foreign currency liabilities, which was dominant and equaled 55.8%, fell by 7.1 p.p., with a substantial drop also being registered with the relative share of the Denar liabilities with FX clause, from 6.7% to 0.9%.

[68] In order to maintain a stable level of reserve requirement in Denars and Euros, the part of the reserve requirement in Euro that is fulfilled in Denars, increased from 23% to 30%.

becomes effective in February 2014 and it is expected to additionally stimulate the bank efforts for increasing the credit supply.

The introduced macro prudential changes with the reserve requirement enabled more substantial release of liquid assets in the banking sector in 2013, with the reserve requirement in Denars and Euros being reduced by Denar 1,065 million and Denar 799 million, respectively. Despite the increase in the total liabilities of the banks which are included in the reserve requirement base by 4.3%[69], the decrease in the reserve requirement primarily mirrors the effect of implementation of the non-standard measures. The decrease in the reserve requirement in Euros, besides the de-euroization process, which reflected in a decrease in the foreign currency liabilities, was largely affected by the widening of the implementation scope of the rate of 0%. Regarding the reserve requirement in Denars, the effect of increase in the banks' Denar liabilities was fully compensated by applying the rate of 0% on certain liabilities (in the amount of Denar 784 million), as well as by decrease in the reserve requirement base on the basis of newly granted loans for net exporters (in the amount of Denar 511 million).

Chart 67
Change in the level of reserve requirement

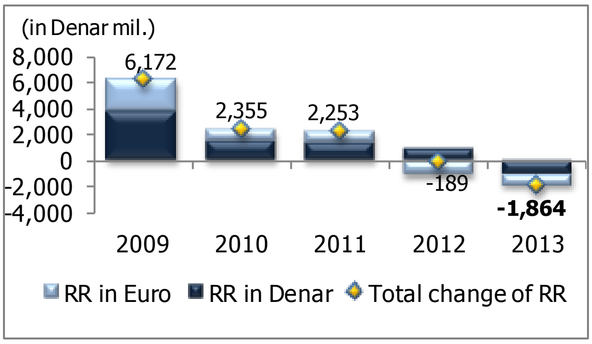
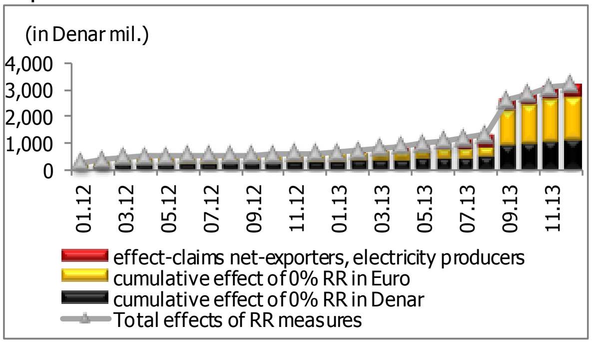



Chart 68
Liquidity effect of the measures with the reserve requirement in 2013




Source: NBRM.

**Box 1: Analysis of the effects of the taken measures with the reserve requirement in 2013**

The implementation of the measure for reducing the reserve requirement base by the amount of the new loans to the net exporters and the domestic electricity producers contributed towards granting loans to selected borrowers in the amount of Denar 6,995 million, according to the data of the banks, and contributed positively to the revival of the lending activity of the banks.

The largest share of 85% in these loans accounted for the new loans, i.e. the loans granted after January 1,2013, while only two banks granted loans at changed terms, which were concluded prior to January 1,2013. In addition, according to the purpose of the granted loans, it can be concluded that 86% of the loans are granted to net exporters. In the currency structure of the loans granted to net exporters and electricity producers, Denar and foreign currency loans have almost equal share.

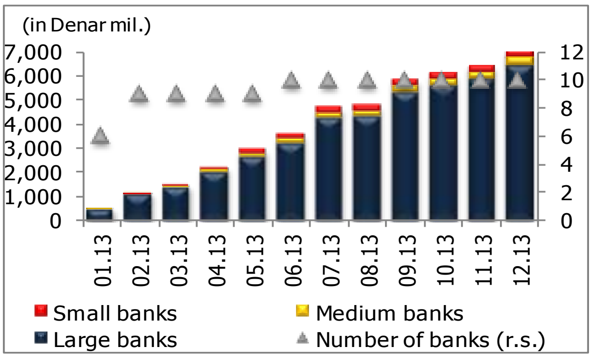
Analyzed by banks, the measure is applied mainly with the large banks, while the medium-size and small banks participate only with 9%. However, the number of banks that

[69] The bank Denar liabilities (including also the ones in Denars with FX clause), included in the base for calculation of the reserve requirement, registered an increase of 10.2%, i.e. Denar 13.8 billion in 2013. The bank liabilities in Euro currency went down moderately by 1.6%, i.e. by Denar 2 billion. If taken into consideration the total base (in Denars, with FX clause and in foreign currency, jointly), in 2013 the bank liabilities increased by Denar 11.7 billion.

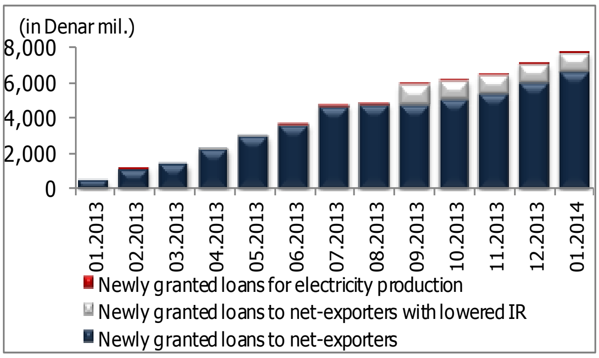
grant loans according to this measure of the National Bank, in the second half of the year, when the credit activity moderately revived, increased to 10 out of a total of 15 banks[70].

Chart 69

New loans to selected sector, by group of banks




Characteristics of the new loans to selected sectors

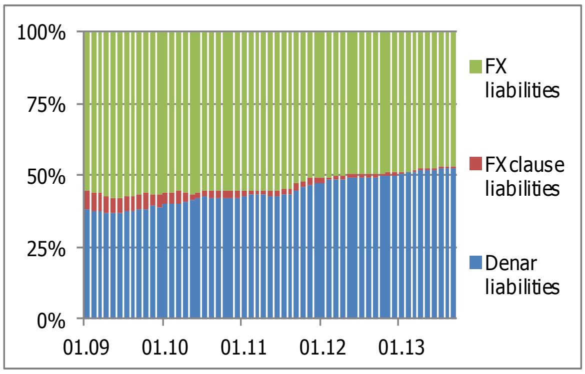



Source: NBRM.

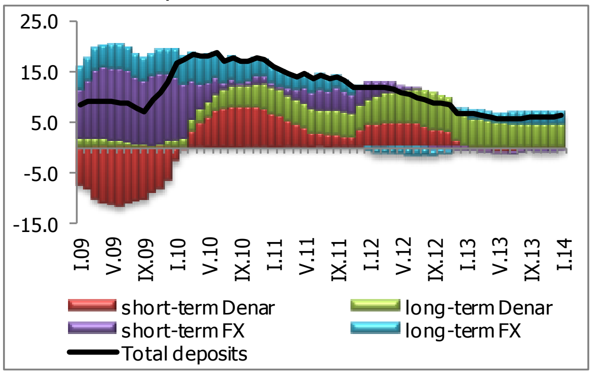
The changes with the reserve requirement rate in the second half of 2013 were additional impulse for the favorable trends in the bank liabilities' structure. Namely, since the introduction of the new reserve requirement rates, the increase in the bank liabilities remained mainly conditioned by the Denar deposits. On the other hand, the application of higher rate of reserve requirement on the foreign currency liabilities during the analyzed period, resulted in continuation of the de-euroization process, so the share of the foreign currency liabilities in the total bank liabilities decreased to 47%[71].

Chart 70

Currency structure of the bank liabilities




Contribution to the annual growth rates of the household deposits




Source: NBRM.

The implementation of 0% rate[72] of reserve requirement on part of the liabilities of the natural persons remains to have positive impact on the bank liabilities' structure. Namely, in 2013, the increase in the household deposits is fully due to the increase in the long-term deposits, with the largest increase being registered by the long-term Denar deposits. On the other hand, the applied rate of 0% for the liabilities to nonresidents contributed towards maintenance of stable level of liabilities to nonresidents, in conditions of the deleveraging process of the parent banks.

[70] Having in mind that the MBDP is not required to allocate reserve requirement, this bank is not included in the analysis.
[71] The analysis of the effects of the implementation of the differentiated reserve requirement rates uses data on the bank liabilities encompassed in the basis for calculation of the reserve requirement.
[72] Since January 2012.

## 4.3. Deposit facilities and loans with the National Bank

In 2013, the banks have actively been using the deposit facilities with the National Bank[73] when managing the short-term liquidity fluctuations. In conditions of restricted amount of CB bills, as well as higher interest of the banks for placement of the available assets in highly liquid instruments, the stock of the deposit facilities with 7-day maturity has been registering a constant increase. Thus in 2013 the average stock of the deposit facilities with 7-day maturity equaled Denar 4,071 million and it was higher by Denar 2,622 million compared to the average stock in the previous year. At the beginning of the periods for fulfilling the reserve requirement, the banks were relatively less interested in this instrument. On the other hand, the banks have been significantly more interested at the end of the reserve requirement periods, which corresponds to the assurance for fulfillment of reserve requirement, as well as the effect of the autonomous factors towards increase in the liquidity in the banking system.

Chart 71
Stock of the 7-day deposit facility

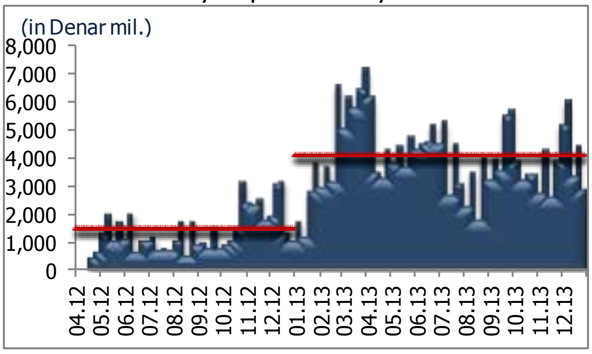
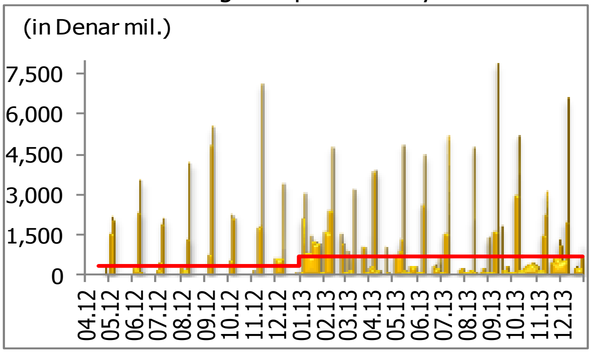



Chart 72
Stock of the overnight deposit facility




Source: NBRM.

In 2013, there was also an active use of the overnight deposit facility, and the banks placed Denar 698 million, on average, in this instrument, or more than Denar 340 million compared to the 2012 average. Relatively high interest in the overnight deposit was registered in the last several days of the reserve requirement fulfillment period because of the placement of the accumulated excess liquidity.

Unlike the use of the possibility for the banks to place overnight deposits with the National Bank (the banks were not interested to place the excess liquid assets only in 25 days of the year), the relatively high liquidity in the banking system conditioned small interest for using the overnight deposit facilities (during the year, they were used only in two occasions, in the total amount of Denar 2,500 million).

## 4.4. Repo operations for liquidity creation in the banking system

In 2013, the banks showed no significant interest in repo transactions auctions intended for generating liquid assets[74]. The easing of the monetary conditions through releasing liquid assets on the basis of reserve requirement, as well as the contribution of the autonomous factors to higher bank liquidity were the main factors that contributed in maintenance of relatively high liquidity. Thus, in 2013, out of the total of 52 auctions of repo

[73] The utilization of the deposit facilities was upon banks' initiative. Unlike the overnight deposit facility which is on a bank disposal every day, the 7-day deposit facilities have weekly frequency, so the banks have possibility to place their available assets in this instrument every Wednesday.
In 2013, the interest rate on the deposit facility was reduced from 2% to 1.5%, which is adequate to the decrease of the policy rate by total 0.5 p.p.. The interest rate on the overnight deposit facility in 2013 was decreased by 0.25 p.p. and it equaled 0.75%.
[74] The auctions for providing liquidity, which were created as a liquidity support and aimed at stimulating the banks' long-term placements, were conducted on a weekly basis also in 2013, every Friday with a 7-day maturity.

transactions aimed at liquid assets creation, where Denar 518 million, on average, were offered, the banks were interested in supplementing the necessary liquidity only on 9 auctions, at which Denar 288 million, on average, were approved.

# V. Foreign reserves management

The management of the foreign reserves of the Republic of Macedonia (hereinafter referred to as: foreign reserves), is one of the key functions of the National Bank, which is closely related to the monetary policy implementation and the maintenance of the credibility of the Republic of Macedonia on the international financial markets. The managing of the foreign reserves enables maintenance of their value and in broader sense, the national wealth.

## 5.1. Strategic framework in the foreign reserves management

In accordance with the legal rights and duties, the basic guidelines for the foreign reserves management by the National Bank are subordinated to the proper application of the principles of safety, liquidity and profitability of the investments. Within these frames, the main strategic framework for the foreign reserves management is comprised by the following elements:

1. Maintenance of the foreign reserves' currency structure, where the largest share accounts to the Euro, which contributes in the support of the applied monetary strategy of de facto fixed exchange rate of the Denar relative to the Euro;
2. Maintenance of solid quantity of gold within the foreign reserves, as a strategic commitment for having a financial asset with the highest level of security on disposal;
3. Maintenance of adequate level of liquidity of the foreign reserves by managing two portfolios - liquidity and investment portfolio :

- The liquidity portfolio serves for having enough funds on disposal to be able meet the daily liquidity needs for intervening on the foreign exchange market and executing transactions of the Government abroad.
- The investment portfolio serves for investment of funds on a longer run in order to realize higher return, and the largest portion of the investments are directed in liquid securities.

The risk management, as one of the key elements in the foreign reserves management is based on the system of investment restrictions and defined investment alternatives:

Image 2

| Type of risk | Exposure limiting methods |
|---|---|
| Credit risk | - investment of foreign reserves in countries with high long-term ratings and in accordance with the internal credit rating framework, based on macroeconomic, market and financial indicators;<br>- distribution of investments by setting quantitative limits on investments by country, by institution and by transactions with institutions, as well as quantitative limits on investments by types of securities; |
| Liquidity risk | - maintaining a certain amount of liquid assets in the form of short-term deposits (maximum maturity up to 14 days);<br>- placing foreign reserves in securities that meet the liquidity criteria set (narrow spread between buying and selling price, a high level of primary emission, high demand); |
| Currency risk | - quantitative limits on investment in other currencies than Euro; |
| Interest rate risk | - placing part of the investment portfolio in Euros into securities held to maturity;<br>- maintaining a relatively short target modified duration in individual investment portfolios composed of securities for trading. |

## 5.2. Basic guidelines for managing foreign reserves in 2013

In 2013, the diversification in the foreign reserves investment deepened, in line with the basic principles for foreign reserves management in conditions of lower credit risk aversion on the international financial markets and still low yields on the markets of the main economies. Thus despite the currency diversification of the investments, the foreign reserves were also distributed in wider scope of financial instruments. In 2013, the National Bank envisaged the following modifications to the main guidelines in the foreign reserves management:

- In terms of the currency structure, it was envisaged to pursue with the currency diversification and additional re-directing of small part (1.25%) of the foreign reserves in British Pounds.
- In terms of types of securities within the investment portfolios, the scope of the allowed instruments from the supranational, sub-sovereign и agency-SSA issuers widened, by introducing new instrument category - securities issued by agencies with derived (implicit) guarantee[75].

In context of the changes with the currency spectrum and instruments of allowed investments, the framework for managing risks of foreign reserves investment underwent appropriate changes, as well, as follows:

- By widening the scope of financial instruments, the securities liquidity criteria were also revised, envisaging adequate volume of issuance of the newly introduced financial instruments;
- In order to achieve optimal investment structure and adequate control over the credit risks, also the quantitative restrictions by type of security and issuer were revised, by increasing the share of securities from supranational, sub-sovereign and agency-SSA issuers;
- Parallel to the introduction of new instruments, the referent portfolios were adjusted to mirror more realistically the basic strategic framework of investment of foreign reserves.

## 5.3. Investment conditions at the international financial markets in 2013

In 2013 the developments on the international financial markets were under strong influence of the monetary policy applied by the ECB and FED, which contributed, also in this year, to the easing of the monetary conditions as a support to the intensification in the economic activity. In such circumstances, and having in mind the slower recovery of the activity in the euro area, the low credit support by the banking sector and the anticipated low price pressures in the medium run, the ECB decided to take measures for further easing of the monetary policy[76]. FED, as well, continued to implement a loose monetary policy, through both, maintenance of the interest rates on the historic minimum and constant implementation of the quantitative easing measures[77].

The solid macroeconomic indicators for the U.S. economy in the first half of the year, as well as the improved conditions on the labor market[78], created a room to initiate a process of gradual normalization of monetary policy and exit from quantitative measures by the FED. Therefore, at the end of May, the Chair of the FED announced the reduction (tapering) of the purchase of securities in the following period, and in June, he said that the

[75] The implicit guarantee refers to the issuers that, according to the investors' assessment, are Government supported, if the issuer falls into financial difficulties or faces bankruptcy.

[76] In May, ECB reduced the interest rate on main refinancing operations from 0.75% to 0.5%, while in November it reduced the interest rate by additional 25 b.p. to the level of 0.25%. The interest rate on the marginal lending facility was reduced at the beginning of May by 50 b.p. from 1.50% to 1%, as well as in November, when it was reduced to the level of 0.75%. The overnight deposits rate remained unchanged in 2013 and it equaled 0%.

[77] The increase in the FED's balance by US Dollar 85 billion on a monthly basis through purchase of mortgage-backed securities in the amount of (US Dollar 40 billion) and longer-term Treasury securities (US Dollar 45 billion).

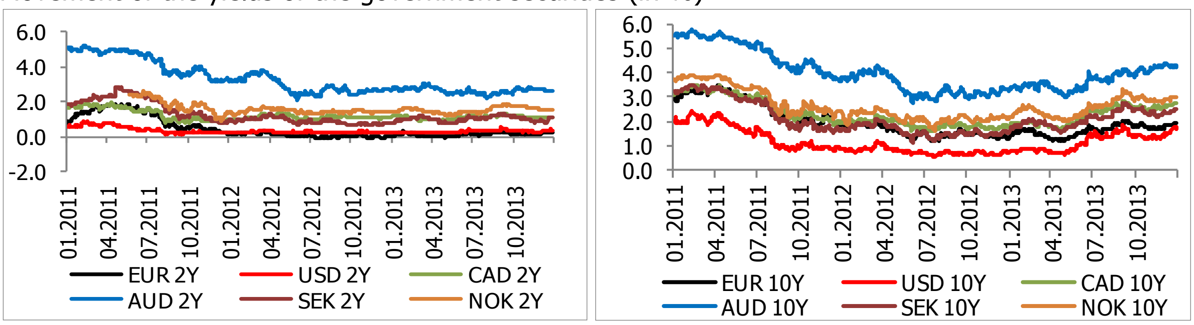
[78] The unemployment rate in the USA decreased from 7.9% in January to 7.5% in May.

securities purchase program should be completed in the fall 2014. The initial reaction of the market participants regarding this announcement of changes in the monetary policy by the FED caused increase in the yields of government securities, a decrease in the prices of shares and capital outflow from the developing countries[79].

The tightening of the global financial conditions, in terms of still fragile economic recovery, imposed a need of verbal interventions by representatives of the central banks of advanced economies. Thus within the semi-annual report to congressional committees, the Chair of FED pointed out that the completion of the quantitative easing program and the first increase in interest rates are two different events, which will happen at different points of time. The ECB and the Bank of England from July, i.e. August 2013 began with forward guidance and explicitly stated that increasing bond yields are incompatible with the objectives of the monetary policy and economic fundamentals.

Such a manner of communication by the central banks affected the market developments, i.e. on the yields of government securities. Thus the yields of the government securities with maturity of up to 2 years increased moderately (but they are still low), while the yields of the long-term securities registered more significant increase, which is in line with the expectations for increase in the interest rates in the medium run. The most evident change in the yields was registered with the U.S. securities, in conditions when, at the end of the year, the FED adopted a decision on reducing the bond purchase[80], having in mind the improved performance of the economy and further decrease in the unemployment.

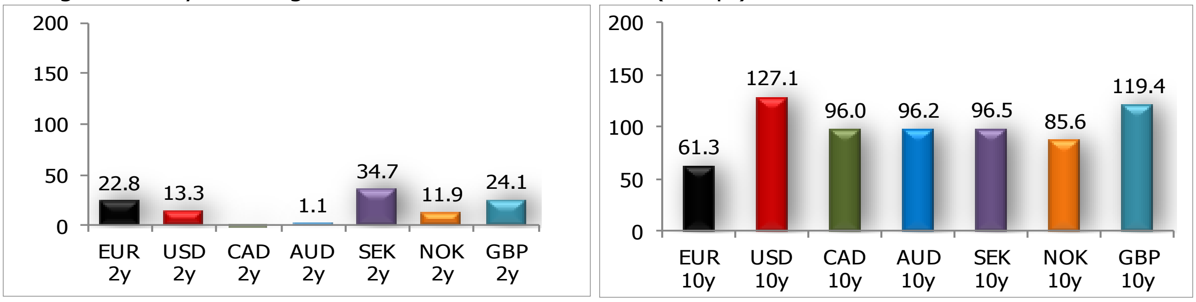
Chart 73
Movement of the yields of the government securities (in %)




[79] The capital outflow from developing countries has been accompanied by depreciation pressures of domestic currencies, market correction on the stock exchanges and pressure on yields of securities in domestic currency. These tendencies were present in countries with high current account deficits in the balance of payments, which are particularly sensitive to sudden capital outflows, such as Brazil, India, Indonesia, South Africa and Turkey. The policy makers in these countries have responded by increasing the referent interest rates and significant interventions on the foreign exchange market, leading to a reduction of their foreign reserves.

[80] In December, FED adopted a decision on reducing the volume of bond purchase (tapering) within the quantitative easing program (QE3) by a total of US Dollar 10 billion per month. Thus from January 2014, the purchase will equal US Dollar 40 billion (compared to the previous US Dollar 45 billion) Treasury securities and US Dollar 35 billion (compared to the previous 40 billion) mortgage-backed securities during every month. According to FED, the quantitative easing program should terminate at the end of 2014.

Chart 74
Changes in the yields of government securities in 2013 (in b.p.)

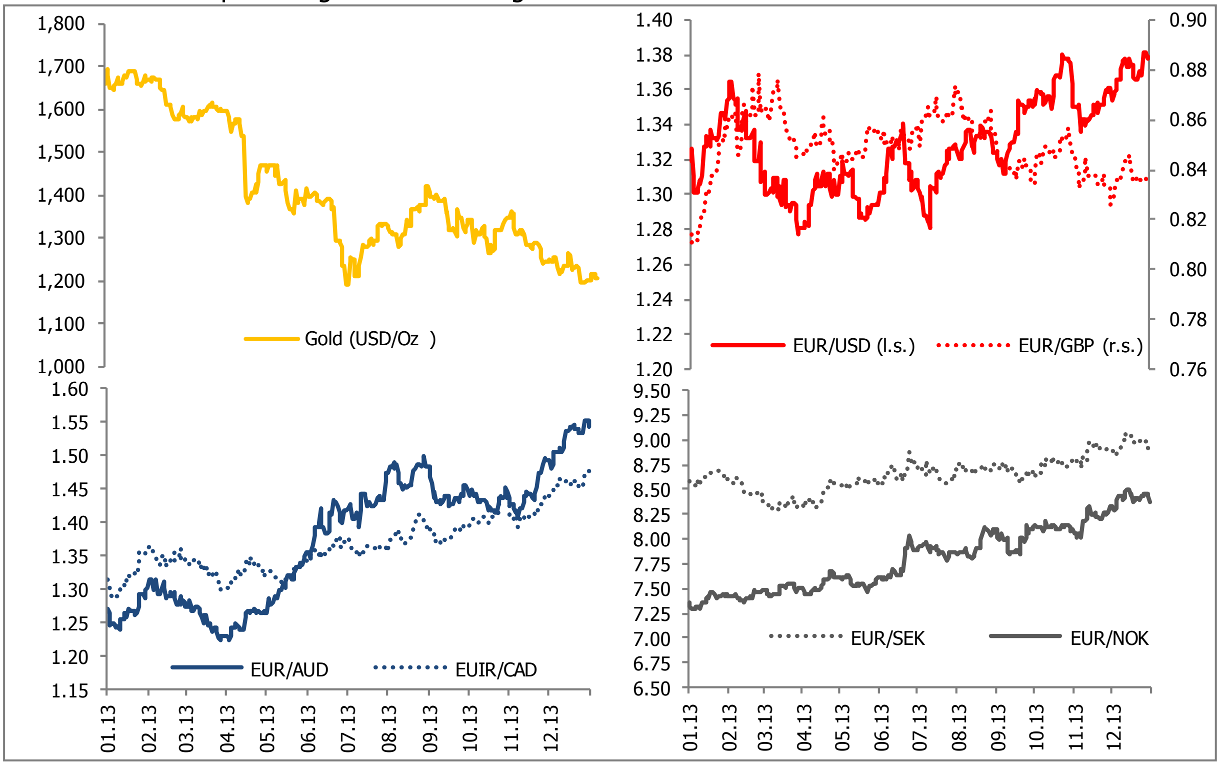



Source: Bloomberg.

The central banks' behavior influenced the movements on the currency markets, as well. In this context, the slower economic recovery in the euro area compared to the U.S. economy, and the decrease in the policy rate by the ECB in the first half of the year, caused a decrease in the value of the Euro relative to the US Dollar, as well as relative to other currencies. The news for the beginning of the normalization of monetary policy by the FED in late May was interpreted by the market participants in the global currency markets as a signal for tightening of the monetary conditions in the United States. That caused a redirection of global investors towards the U.S. financial markets and resulted in a strengthening of the US Dollar. In contrast, by the end of the year there was a downward trend in the value of the so-called commodities currencies, i.e. Australian[81] and Canadian Dollar, as well as the currencies of the Nordic countries[82]. Unlike these currencies, the value of the Euro against the US Dollar increased in the second half of the year[83], due to lower tensions on the European financial markets, the uncertainty with respect to the resolution of the fiscal issues in the USA in October[84] and one-time effect of increasing the demand for Euros by the European banks in order to improve the balance sheets in anticipation of the asset quality review by the ECB, which takes December 31 as a reference date.

[81] The fall in the Australian Dollar was additionally caused by the decision of the Reserve Bank of Australia on reducing the key interest rate by a total of 50 b.p. in two occasions, at the beginning of May (from 3% to 2.75%) and early August (of 2.50%).
[82] At the end of 2013, the value of Australian Dollar, Norwegian Krone, Canadian Dollar, Swedish Krona and British Pound fell by 21.3%, 13.8%, 11.7%, 3.2% and 2.2%, respectively, relative to the Euro, compared to the end of 2012.
[83] The stronger appreciation of the Euro in the second half of the year, than the depreciation in the first half, caused annual increase in the value of the Euro against the US Dollar by 4.5%.
[84] In October, after the two-week shutdown of the federal government because of disagreements between Republicans and Democrats in terms of the budget for the next fiscal year, on October 17, a continuing resolution was adopted, which allowed proper functioning of the government to mid-January 2014. Also, the Congress decided to suspend the validity of the debt ceiling by early February 2014.

Chart 75
Movements of the price of gold and exchange rates




Source: Bloomberg.

In 2013, gold prices registered an annual decrease of 27%, which terminated the trend of annual price growth that lasted in the past thirteen years[85]. This correction in the price of gold was mainly influenced by reduced investment demand amid the announcement of the FED's decision to normalize monetary policy, but also under the influence of certain speculative pressures. Thus, the greatest downward correction in the price of this precious metal was registered in April, due to the speculation that Cyprus provides additional funds in order to exit the debt crisis by selling part of its gold reserves. Also, the gold prices declined after the FED meeting in mid-June, which caused reduced demand for gold as a mean of protection against inflation. By the end of the year, gold prices had a downward trend, conditioned by the increased perceptions of the market participants that the FED could start reducing the volume of securities purchase anytime soon.

Also in the following period, the market developments on the global financial markets will mainly depend on the behavior of central banks, which will determine the degree of the set monetary measures depending on the economic growth and inflation dynamics. The initiated gradual exit from the FED's liquidity creation measures is expected to contribute to higher yields of high-quality government bonds.

## 5.4. Investment of foreign reserves in 2013

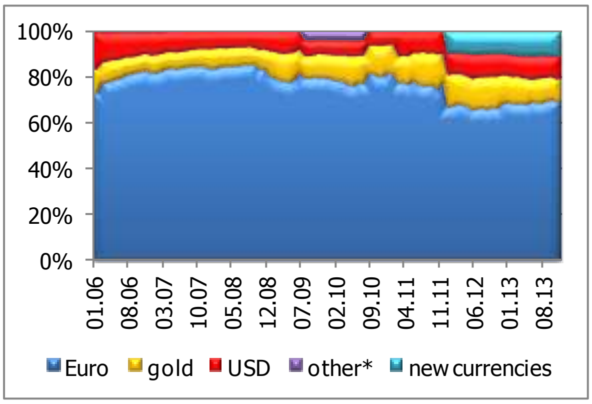
The decisions on investing foreign reserves are based on the basic strategic framework, and include activities that maintain flexibility in the management of foreign reserves amid volatile developments on the international financial markets.

[85] At the end of 2013, the price of gold equaled US Dollar 1,201 per ounce, while at the end of 2012, it equaled US Dollar 1,664 per ounce.

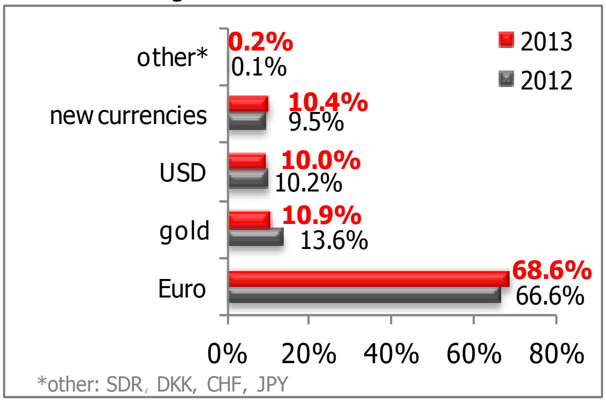
### 5.3.1. Currency structure

The currency diversification within the investment of foreign reserves, which was performed in the last two years, in 2013 was carried out by adhering to the basic strategic orientation in terms of currency structure of foreign reserves. In this context, regarding the foreign reserves' structure, most of the funds are invested in financial instruments denominated in Euros, with an average share of about 69%, while the level of the US Dollar remains stable, with an average share of about 10% of the reserves. The average annual share of currencies, in which a part of the assets in Euro were diversified, equaled 10.4%, which is a moderate increase in comparison with the previous year, as a result of the further diversification of financial instruments denominated in British Pounds. The investments in US Dollars and other currencies in 2013 are in accordance with the envisaged investment restrictions.

Chart 76
Currency structure of the foreign reserves
at the end of the month




annual average




Source: NBRM.

However, despite the strategic course of non-changeability of the gold quantity in the foreign reserves, in 2013 the share of gold in the foreign reserves recorded a significant reduction. This decrease is mainly due to the fall in the price of gold on international markets, and this movement was affected by the reduction in value of the US Dollar against the Euro (having in mind that the price of gold is presented in US Dollars).

### 5.3.2. Credit exposure and liquidity of investments

The safety of the foreign reserves' investment is very important in profiling the investment strategy that the National Bank applies in managing foreign reserves. For that purpose, when defining the scope and the quantitative restrictions of the investments by country, the internal credit rating is taken into consideration, besides the high long-term credit rating given by the international rating agencies.[86]

In accordance with the envisaged investment framework, the largest share of the foreign reserves (about 61 % on average, during the year) was invested in financial instruments of the euro area core countries - Germany, France and the Netherlands, as well as international financial institutions and international development banks (12.3%). Due to the profile of the founders of these institutions, the level of capital they manage, as well as due to the precautionary operating and financial policies applied, the market participants perceive these international financial institutions as issuers of financial instruments with a high degree of security and safety.

[86] The framework for determining internal credit rating covers more macroeconomic indicators (public debt, budget balance, annual GDP growth, current account balance, inflation), market indicators (a rating determined by the market) and financial indicators (a rating for the risk of the banking sector given by the rating agency "Standard & Poor's".

Chart 77
Geographical structure of foreign reserves, annual average

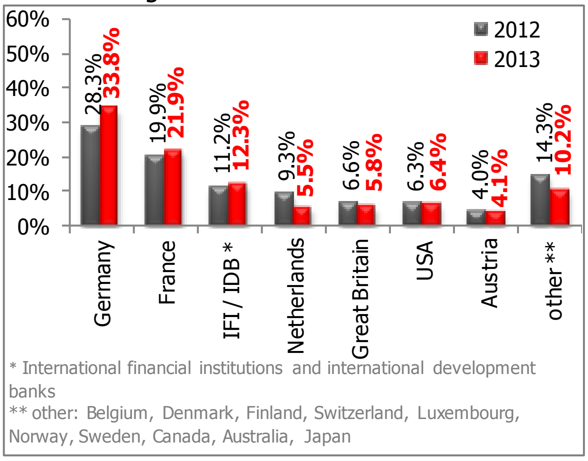
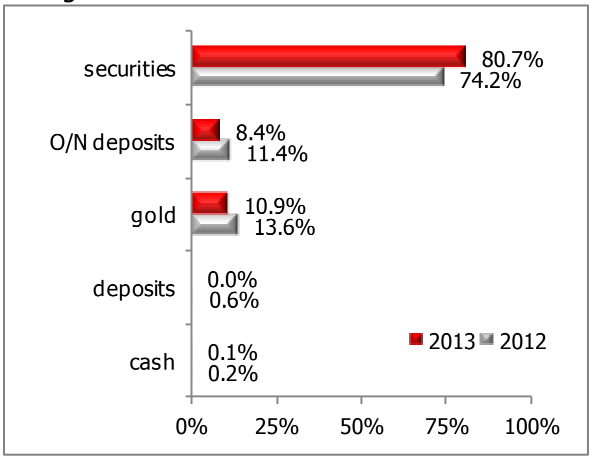



Chart 78
Structure of investments by instruments, annual average




Source: NBRM.

The liquidity of the foreign reserves has been provided primarily by maintaining the liquidity portfolio in Euros and US Dollars, in short-term liquid assets - mainly sight deposits. The liquidity of the foreign reserves is also provided through investments in securities, which with an average share of 80.7% dominate in the foreign reserves' structure by instruments. Most of the investments in securities, or approximately 72.7% during 2013, have been directed towards government securities and securities with an explicit government guarantee, which allows optimal compliance with safety and liquidity principles. A significant share (14.3%) accounted also to the investments in instruments issued by international financial institutions[87], which have higher yield compared to government securities. Some of the investments were also directed in securities issued by the German federal states for a particular comparative advantage in terms of yields compared to the government securities. At the end of the year, besides the financial instruments of supranational and regional issuers, investments in securities of the agency category with implicit guarantee, within the process of diversification of the investments by financial instruments, commenced.

Chart 79
Structure of securities by issuer, annual average

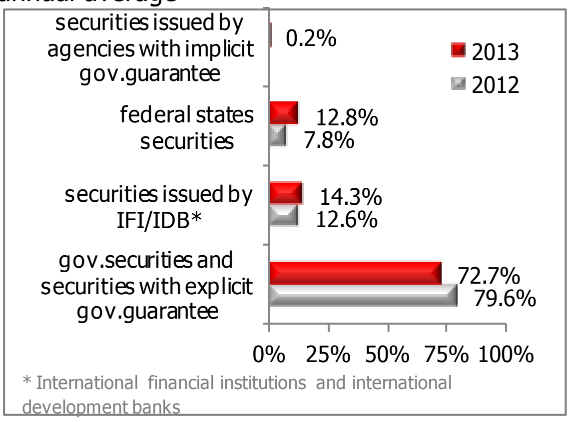
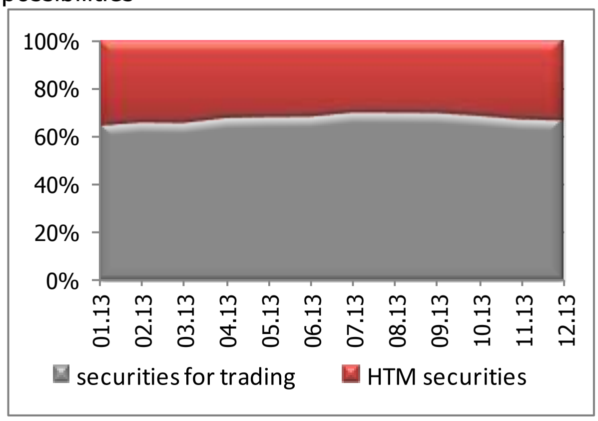



Chart 80
Structure of securities according to trading possibilities




Source: NBRM.

[87] European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB), International Bank for Reconstruction and Development (IBRD), International Finance Corporation (IFC), the Nordic Investment Bank (NIB).

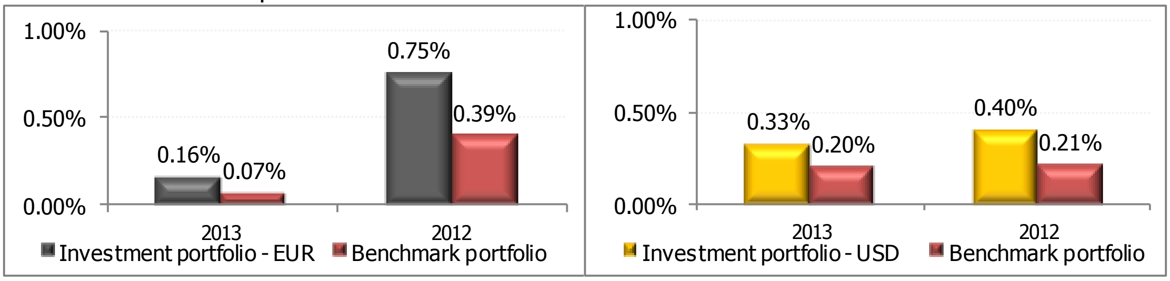
In line with the strategic commitment to limit price changes caused by movements on international financial markets, in 2013, one third of the investments in securities were within the portfolio of securities held to maturity[88]. At the same time, due to limitation of the effects of price fluctuations, the foreign reserves have been invested in securities with a relatively short target modified duration (about 1 year), which was revised during the year. In conditions of expectations for significant growth in yields as a result of more certain FED's announcement on introducing reduced monthly purchase of securities, at the end of the year, the target modified duration of the investment portfolio in Euro and US Dollar, reduced.

In 2013, the National Bank uses again the lending securities transactions that are carried out by simultaneous concluding of repo and reverse repo transactions[89]. Gold, which is usually a financial instrument with lower market yield, during the year was placed in the short-term deposits with foreign commercial banks[90]. When selecting banks that perform such transactions, despite the long-term ratings, also the additional indications for perceiving short-term credit position of foreign banks are analyzed.

### 5.3.3. Results from investments of foreign reserves in 2013

In 2013, yields of the financial instruments in which the foreign reserves were invested are low, but the investment performance, however, has justified the applied investment strategy. The performance in investment portfolios in Euros and US Dollars exceeded the return of the referent market indices[91], confirming the decisions of the National Bank in terms of diversification of the financial instruments' structure the foreign reserves were invested in. Also, investments in other currencies experienced relatively higher rates of return, and the return in the original currency moved in a range of 0.17 % to 3.11 %.

Chart 81
Return on investment portfolios




Source: NBRM.

The total income[92] from the investment of foreign reserves in 2013 amounted to Euro 30.7 million (at the level of the income in 2012), and the total rate of return on foreign

[88] Securities held to maturity, in accordance with international accounting practices, are stated at amortized cost and are not subject to unpredictable fluctuations in price.
[89] As collateral of borrowed securities from the National Bank's portfolio, securities that meet the criteria for investment of foreign reserves are obtained.
[90] In 2013, gold deposits were deposited as term deposits in several commercial banks, with an average maturity of about 2 months. In order to realize higher interest rate, two deposits were deposited on 12 months, and their residual maturity at the end of 2013 equaled 3 months.
[91] Referent index of securities' prices and money market index, comprised of real financial instruments, with modified duration, which corresponds to the target modified duration of the investment portfolio.
[92] Besides interest income, the total investment income includes also income from exchange rate differentials from arbitration, as well as income from securities lending transactions.

exchange reserves, which besides the realized income, covers also the calculated price differentials, equaled 0.4%[93], on annual basis.

**Box 2: Further actions for maintaining efficiency in the foreign reserves management**

According to the analysis of the benefits of expanding the scope of securities transactions, the National Bank plans to join the Euroclear Bank SA program for automatic lending and borrowing of securities next year, as a favorable opportunity for increasing the income from automatic borrowing of securities that are on the custody account with this institution.

In order to improve the institutional capacity of the National Bank in the foreign reserves management, by improving both the portfolios management and the risk management process, the possibility for cooperation with the World Bank was taken into consideration, as well, which should be realized in the forthcoming period.

At the end of the year, the scope of financial instruments within the liquidity portfolio was reviewed, estimating that the criteria for investing in high liquid securities, creates a room for inclusion of liquid short-term and long-term securities (with residual maturity less than a year) within the liquidity portfolio. According to the criteria of liquid assets availability and short residual maturity of the placements for liquidity management, it is normal that they are closer to the category of financial transactions, than to long-term investments. Accordingly, the Foreign Reserves Management Policy of the Republic of Macedonia envisages a possibility, in the part pertaining to the placements for liquidity management, to include financial institutions and countries with investment rating. Also, for the purpose of assessing the ability of the financial instruments issuers, or the ability of banks to manage with the short-term liabilities that mature within maximum one year, the internal Rules for foreign reserves management of the Republic of Macedonia envisages use of the highest short-term credit ratings of the rating agencies.

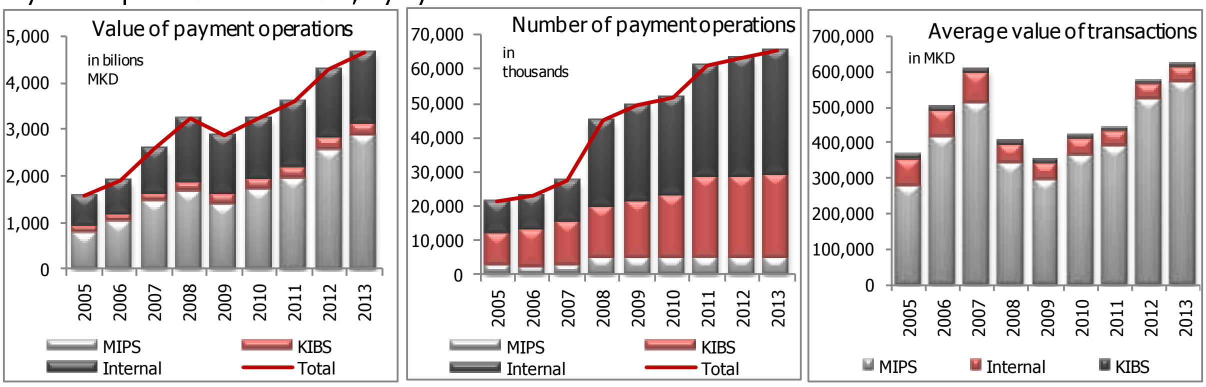
[93] The rate of return is lower by 50 b.p. than the rate of return in 2012, due to higher unrealized price differentials of securities in the second and in the last quarter of 2013, as a result of the fall in the prices given the increase in the yield of securities due to the FED's announcements that the monetary policy began to normalize.

# VI. The Role of the National Bank in the Payment System of the Republic of Macedonia

One of the primary functions of the National Bank is to create conditions for stable, reliable and efficient operations of the payment systems. To exercise this function, the National Bank, pursuing the best practices of central banks of the EU member states, performs four primary roles in payment systems: operational, oversight, development and catalyst role.

The National Bank performs the operational role in payment systems by managing and operating the Macedonian Interbank Payment System (MIPS), which is a real-time gross settlement system of the National Bank. In 2013, the total number of direct MIPS' participants[94] was 24 and the system worked with 100.0% real-time availability. The system averagely processed 20,267 transactions per day and the maximum number of processed transactions per day reached 56,820. In 2013, the annual growth of total number of settled transactions in MIPS equaled 1.9%, while the average value per transaction went up by 9.7% annually, to Denar 570,243.

Chart 82
Payment operations indicators, by system

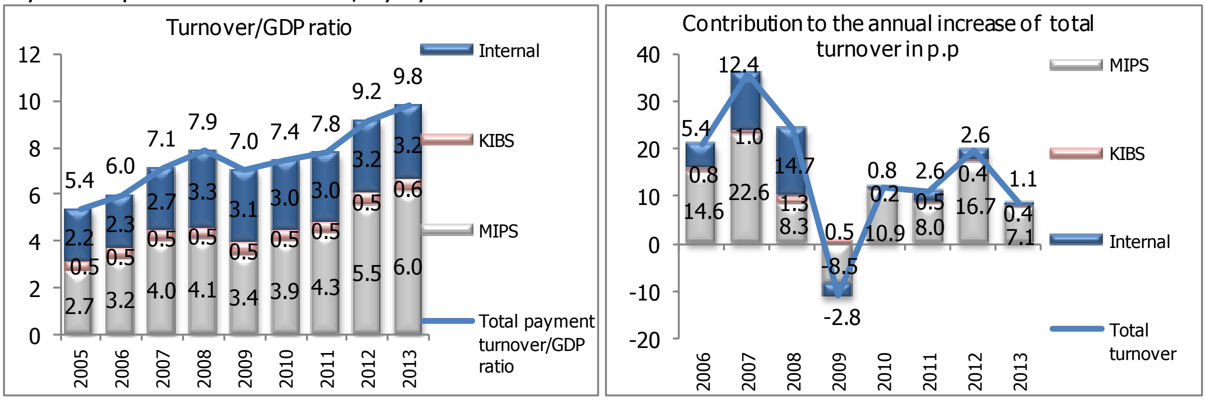



Source: NBRM.

In 2013, the total value of payment operations in the Republic of Macedonia went up by 8.6% annually, mainly due to the increased turnover carried out through MIPS, which registered an annual growth of 11.8%. Given the nominal GDP growth of 3.4% in 2013[95], the relative ratio of total payment operations in the Republic of Macedonia to GDP increased from 9.2 in 2012 to 9.8 in 2013. Higher value of this indicator suggests that the revival of economic activity in the country is followed by a faster growth in the value of total payment turnover caused, mainly, by the increase of turnover carried out through MIPS.

[94] MIPS' participants include the National Bank, fifteen commercial banks, the Macedonian Bank for Development Promotion - AD Skopje, the Ministry of Finance of the Republic of Macedonia, the Health Insurance Fund of Macedonia, the Interbank Clearing Systems - AD Skopje, the Central Securities Depository - AD Skopje, International Card Systems - CASYS, MasterCard International and Fershped Broker AD Skopje.
[95] Estimated data.

Chart 83
Payment operations indicators, by system

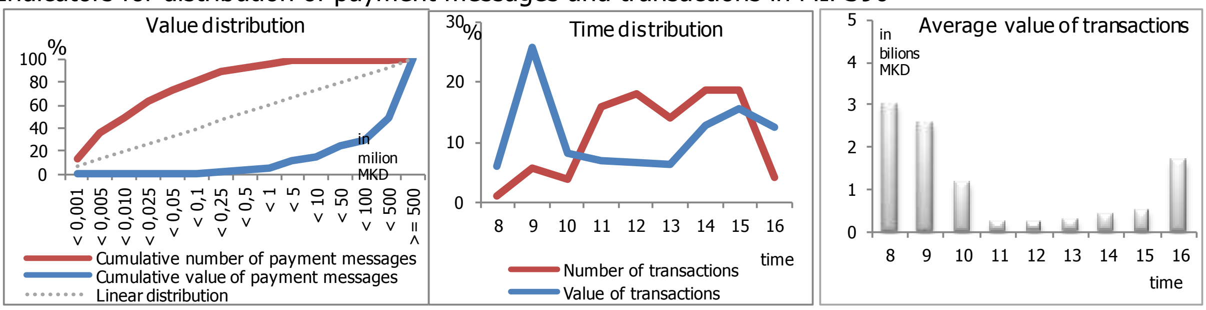



Source: NBRM.

In 2013, the distribution of the number of payment messages carried out by the MIPS according to defined thresholds of the value of an individual payment message shows the largest share (22.5%) of payment messages worth Denar 1,000 to Denar 5,000, with about 95% of the total number of payment messages being worth below 1 million. The distribution of value of payment messages carried out by MIPS shows the largest share (50%) of payment messages worth over Denar 500 million, with payment messages worth over Denar 1 million accounting for 95% of total turnover carried out through MIPS.

Daily time distribution of transactions through MIPS shows that most of the transactions (18.7%) were settled between 14:00 and 15:00, with 85% of transactions being settled between 11:00 and 16:00. Analyzing the value of transactions, the highest value of transactions (with an average value per transaction of Denar 2.6 million) was settled between 9:00 and 10:00 (25.7% of the total value of transactions during the day), while, the smallest value of transactions (5.8%) was settled between 8:00 and 9:00 (with an average value per transaction of Denar 3.0 million).

Chart 84
Indicators for distribution of payment messages and transactions in MIPS[96]

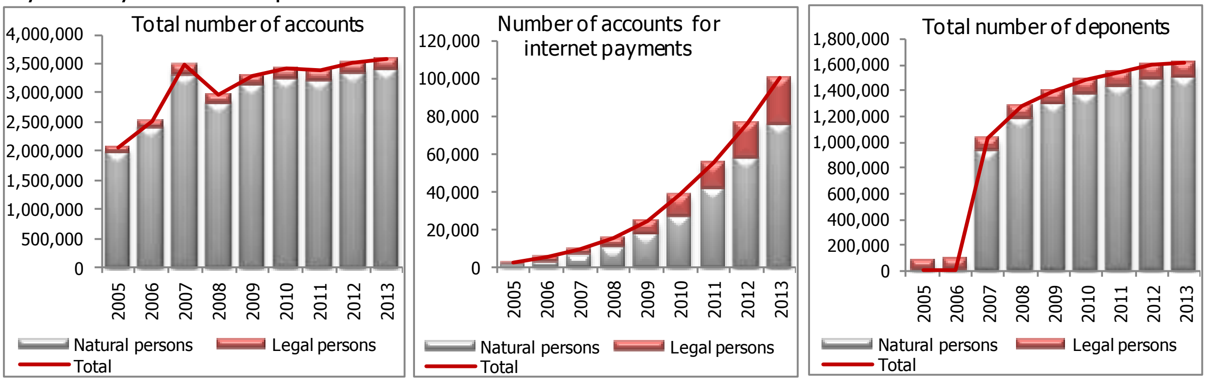



Source: NBRM.

During 2013, again a significantly higher number of online payment accounts were opened, registering an annual growth rate of 31.9%, given the moderate increase in the total number of opened accounts of 2.2%. Of the total number of online payment accounts, 75.4% are accounts of natural persons, and 24.6% are accounts of legal entities. However, the share of online payment accounts in total number of opened accounts is low (2.8% at the end of 2013).

[96] Payment message is an electronic form of payment instrument that can contain multiple individual transactions (e.g., summary transmission order PP32 that allows transfer of funds from one payer to more beneficiaries).

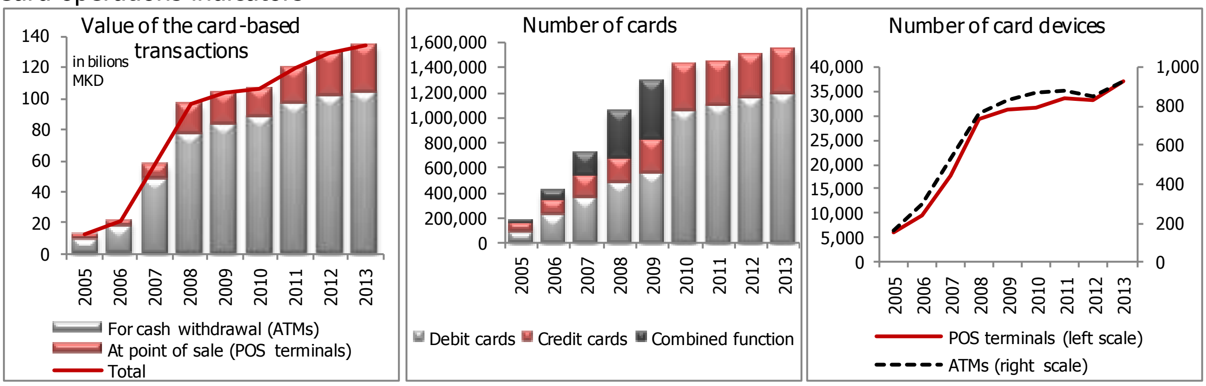
Chart 85
Payment system development indicators




Source: NBRM.

At the end of 2013, the total number of cards in circulation issued by commercial banks in the Republic of Macedonia was 1,557,082, of which 76.4% are debit cards and 23.6% are credit cards. The debit cards accounted for 85.5% of the total value of card-based transactions. In 2013, the value of card-based transactions totaled Denar 134 billion, which is an increase of 3.8% compared to last year. Analyzing the structure, the share of non-cash payment in trade through POS terminals in the value of card-based transactions increased, witnessing a trend of constant relative reduction of raising cash through ATMs. The constant expansion of the network of POS terminals confirms the existing uptrend of the use of payment cards in trade by households. In 2013, the value of payment transactions through POS terminals increased by 10.5%, on an annual basis.

Chart 86
Card operations indicators

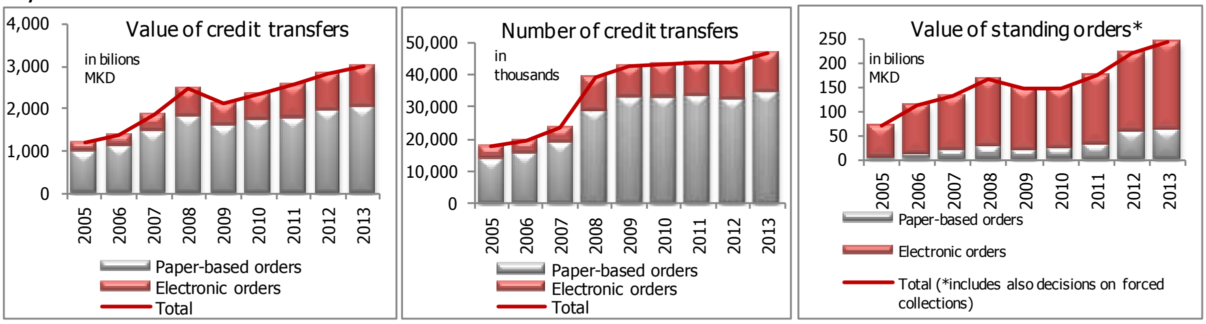



Source: NBRM.

Most of the non-cash payments in the Republic of Macedonia have been carried out in the form of credit transfers. Thus, in 2013, the total value of credit transfers in paper and electronic orders amounted to Denar 2,981 billion, representing a more moderate annual growth of 5.2% compared to last year (11.6% in 2012). The number of credit transfers in 2013 amounted to Denar 46.7 million, which is an annual increase of 6.9%. Despite the higher share of paper orders in the execution of credit transfers (74% in number and 68% in value of credit transfers), the number and value of electronic credit transfers recorded a faster annual growth of 8.3% and 9.4%, respectively. In the last two quarters of 2013, a new way of credit transfers was introduced via mobile phone, which is expected to be more frequently used in the future.

In 2013, the total value of non-cash payments made by using durable orders (including executive decisions) amounted to Denar 245 billion, which is an annual increase of 11.2% compared to last year.

Chart 87
Payment instrument indicators




Source: NBRM.

To improve the oversight role of the National Bank in payment systems, Principles for Financial Market Infrastructure[97] were analyzed during 2013, addressing the experiences and the status of the implementation of these principles in developing and transitional economies, with a focus on activities to be undertaken by the National Bank for adoption and implementation of these standards.

To perform the development and catalyst role in the payment systems, in 2013, the National Bank adopted the Strategy for Development of the Payment System of the Republic of Macedonia for the Period 2013-2017 and an action plan for its implementation, which provided for specific activities for achieving the set strategic guidelines for the future development of the national payment system. The implementation of the action plan is coordinated by the National Payment Systems Council of the Republic of Macedonia through which the National Bank exercises its catalyst role in payment systems.

In 2013, the National Bank, in cooperation with the central banks of the Netherlands and Portugal, organized the Sixth Conference on the Payment Systems and Securities Settlement Systems. The conference was international and involved representatives from the banking sector, payment system operators and regulators of financial market infrastructure in the Republic of Macedonia, as well as representatives from the central banks of Central and Southeastern Europe. The conference topics covered the new operating standards for payment systems and securities settlement systems, the latest trends in large payments, liquidity management, innovative, socially useful and reliable payment products and services, innovative solutions and security aspects of payments. This conference is beneficial for the implementation of the Strategy for Development of the Payment System of the Republic of Macedonia for the Period 2013-2017.

Particularly important event in the field of payment systems in the Republic of Macedonia in 2013 was the release of the so-called Red Book for Payment, Clearing and Settlement Systems in Macedonia[98] by the Bank for International Settlements, which internationally promote the national payment system of the Republic of Macedonia.

[97] Principles for Financial Market Infrastructure are defined by the Committee on Payment and Settlement Systems at the Bank for International Settlements in Basel and the International Organization of Securities Commissions in April 2012.
[98] Payment, Clearing and Settlement Systems in Macedonia, CPSS-BIS, 2013.

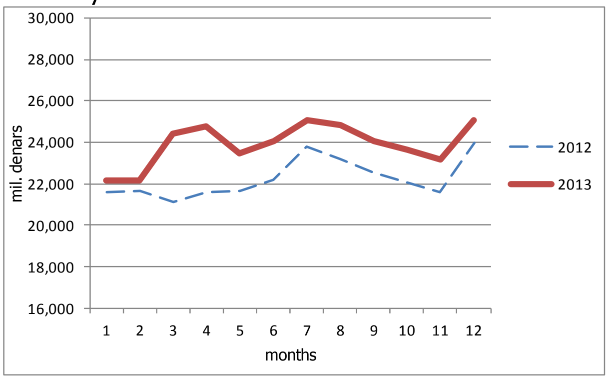
# VII. Cash Issuance and Management in the Republic of Macedonia

## 7.1. Currency in Circulation

As of 31 December 2013, the currency in circulation amounted to Denar 25,045 million, which is by Denar 1.1 million or 4.5% more compared to the end of 2012. The structure of the currency in circulation suggests that at the end of the year, banknotes and coins make up 97.5% and 2.5%, respectively of the total value.

In terms of the number of currency in circulation, the share of banknotes equals 27.7% (70.6 million pieces), and the share of coins equal 72.3% (184.7 million pieces).

Chart 88
Currency in circulation




Source: NBRM.

Banknotes in denomination of Denar 1000 (76%) and Denar 500 (15.4%) account for the most of the total value of banknotes in circulation. Other banknotes account for 8.6% of the total value of banknotes in circulation. In 2013, coins in denominations of Denar 10 (30.9%) and Denar 5 (23.7%) had the largest share in the value of coins.

Chart 89
Value share of banknotes in the turnover, by denomination

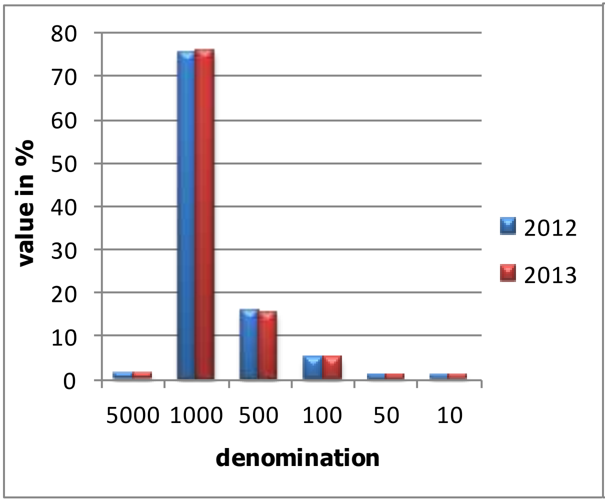
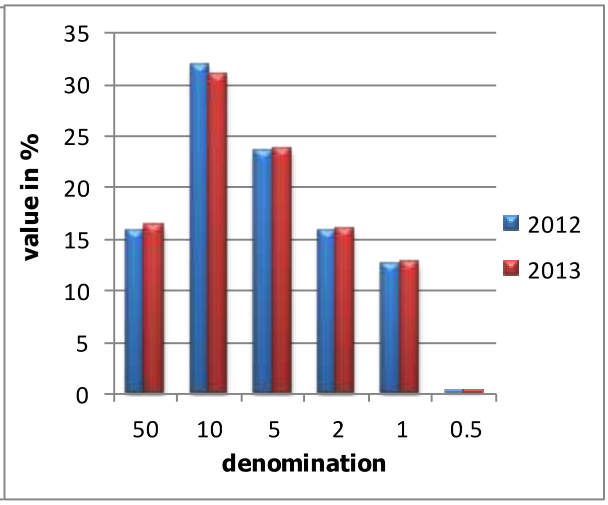



Chart 90
Value share of the coins in the turnover, by denomination




Source: NBRM

Chart 91
Quantity share of banknotes in the turnover, by denomination

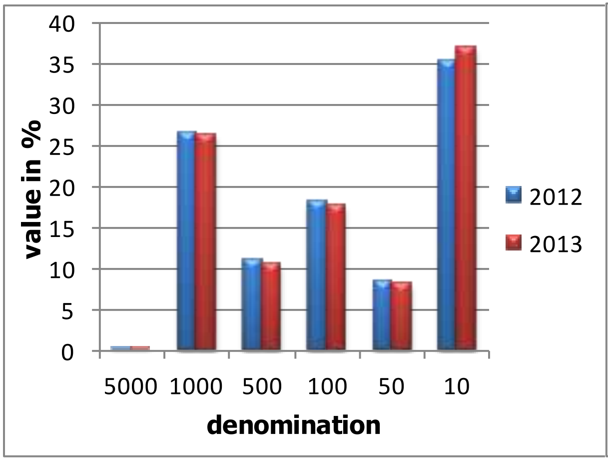
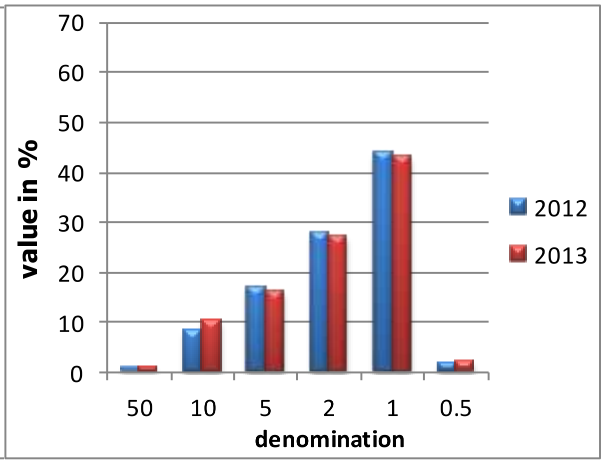



Chart 92
Quantity share of coins in the turnover, by denomination




Source: NBRM

According to the number of issued pieces, the share of banknotes in denomination of Denar 10 (37.1%), Denar 1000 (26.3%) and Denar 100 (17.8%) was the largest. Other banknotes constitute 18.8% of the total quantity of banknotes in circulation. The coin in denomination of Denar 1 (43.1%) constitutes the most of the total coins in circulation.

## 7.2. Supply of Banks with Banknotes and Coins

During 2013, the National Bank, through the Subunit for Operations with Value Papers in Skopje and five subunits for cash operations throughout the country, paid cash to the banks in the amount of Denar 32.7 billion (by 4.1% less compared to 2012), received cash in the amount of Denar 31.6 billion. The analysis of denomination structure indicates that the issuance and receipt of banknotes and coins in 2013 is dominated by banknotes of Denar 1000, accounting for 34.7%, and coins in denomination of Denar 10, accounting for 29.07% of the total issued and received banknotes in 2013 (35.6% in 2012).

Chart 93
Quantity of cash issued to banks
Banknotes

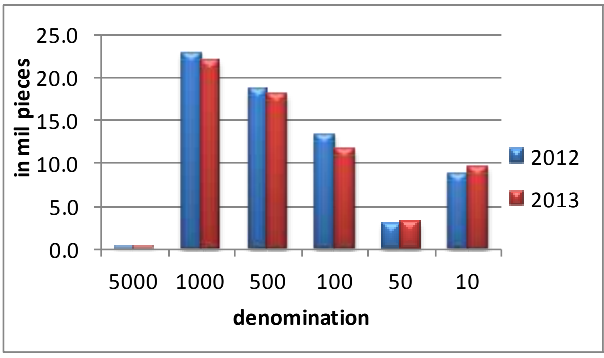
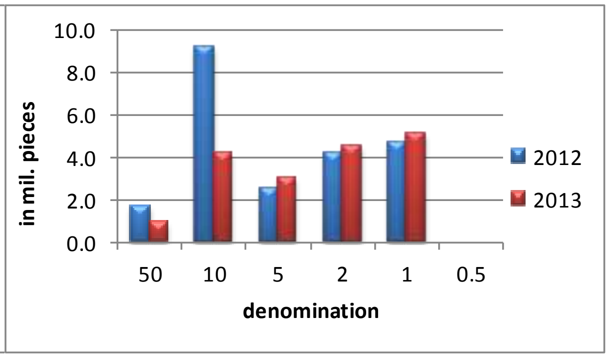



Chart 94

Coins




Source: NBRM.

## 7.3. Processing and Destroying of Banknotes and Coins

During 2013, the quality control process of banknotes in circulation in the central vault and in the subunits for cash operations in the country covered all received banknotes. Of the total processed banknotes, 13.9 million banknotes (17.8 million in 2012) were destroyed due to wear-out or damage. Most destroyed banknotes were denominated in Denar 10 and Denar 100 (58.7%). In 2013, all coins in denominations of 1, 2, 5, 10 and 50 denars that were received were processed, 167 thousand pieces of which being labeled as worn-out.

## 7.4. Expert Analysis of Suspicious Money/Money Counterfeits

In 2013, the National Bank, as a single institution authorized to identify the authenticity of banknotes and coins denominated in denars or foreign currency, continued to perform expert analysis of counterfeit money successfully. In order to strengthen the capacity for accurate detection of suspicious and counterfeit money, in 2013, the National Bank began implementing a project to train employees in commercial banks, financial institutions and other entities. Through presentations and direct handling of authentic and counterfeit money, endeavors were made to convey expertise to officers engaged in daily cash handling that would be applied in their future activities.

As for the number of expert analyses committed during 2013, of the total 221 suspicious Denar banknotes received, which were either identified by banks or confiscated by the Ministry of Interior, the expert analysis carried out in the National Bank found that 6 banknotes were genuine, while the remaining 215 were forged banknotes. In 2013, the number of identified counterfeit banknotes decreased by 43.0% compared to 2012. Most of the total number of identified counterfeit Denar banknotes were in denomination of Denar 1000, Denar 500 and Denar 100, while the total value of counterfeit denars in 2013 amounted to Denar 128,550.00, whose share is negligible in comparison with the value of currency in circulation.

Chart 95
Counterfeit Denar banknotes

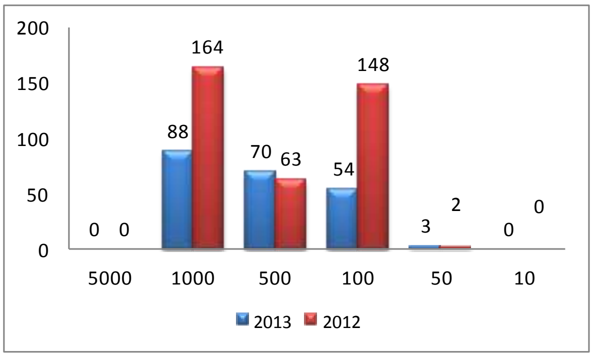
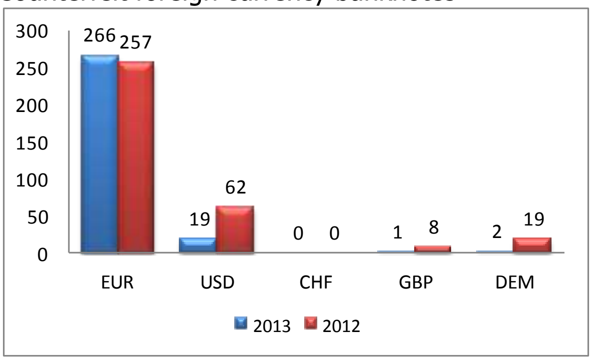



Chart 96
Counterfeit foreign currency banknotes




Source: NBRM.

Concerning counterfeit foreign currency, 303 expert analyses of suspicious banknotes were made in 2013, identifying 288 counterfeit and 15 original foreign currency banknotes. Of the total number of counterfeit banknotes, the Euro banknotes prevailed (266 pieces).

The general conclusion is that counterfeit denars are of relatively poor quality, allowing simple and easy identification and determination of their properties. The expert analysis of the art of making counterfeit banknotes found that they are mostly made on a plain paper without protection marks, by using computer (scan and print) or copying color machine.

As in previous years, no counterfeit Denar coins were identified in 2013. Only one counterfeit foreign currency coin was detected.

During 2013, despite the high price of gold on global markets, the National Bank sold 188 pieces of commemorative coins.

# VIII. Statistics

The National Bank is one of the authorized bodies for carrying out statistical surveys within the national statistical system. The statistical function of the National Bank is defined by the Law on the National Bank of the Republic of Macedonia and the Law on State Statistics. Statistical research carried out by the National Bank is presented in the Statistical Survey Program. Currently, the National Bank produces comprehensive data on Monetary Statistics and Statistics on Interest Rates, Balance of Payments, International Investment Position, Direct Investments, External Debt and Claims, Foreign Reserves and Foreign Currency Liquidity. The statistics are the basis for informing the public about the financial and macroeconomic environment and trends in the Republic of Macedonia, but also represent a key support to the decisions related to the core functions of the central bank.

The National Bank, within the statistical research in its jurisdiction, permanently undertakes activities for monitoring and compliance with international and European statistical standards. For this purpose, the National Bank constantly cooperates with the International Monetary Fund, the World Bank, the Bank for International Settlements, the European Central Bank and Eurostat, for improving the quality of available data, on the one hand, and for regular dissemination of statistical data, on the other. Activities to improve the quality of existing and introducing new statistical surveys continued in 2013, in line with the global efforts to enrich available data beneficial for policy makers. Significant progress in the area of statistical research continued this year, confirmed by the evaluation in the EC's 2013 Progress Report for the Republic of Macedonia, particularly emphasizing the progress of the project on establishing Financial Accounts statistics, compliance of External Statistics with international standards (in terms of Direct Investment) and Monetary Statistics (expanding the coverage of the financial sector).

In particular, progress was made in the statistics of following areas:

- In April 2013, the National Bank took over the role of the institution primarily responsible for the Financial Accounts Statistics. Later on, an interdisciplinary working group on Financial Accounts Statistics was formed to increase the institutional capacity for establishing this statistics. A number of activities were undertaken during the year aimed to introduce new and appropriately exploit existing data sources for the purposes of Financial Accounts, and for trial compilation of the Financial Account for 2010;
- In 2013, External Statistics data were submitted to Eurostat for the first time, including data on Balance of Payments, International Trade in Services, stock and flow of Foreign Direct Investments, by country and by activity. These data will be regularly submitted to Eurostat in the future;
- Regarding Interest Rate Statistics, further compliance with the requirements of EU regulations has been achieved, by preparing and adopting new regulations for reporting weighted interest rates on received deposits and approved loans. The new way of reporting, that will ensure full alignment with the requirements of the European Central Bank, will start from March 2014;
- As a part of the activities to increase the coverage and quality of Monetary Statistics, regular dissemination of quarterly data on the stock of financial assets and liabilities of the Other Financial Institutions sector (investment funds, pension funds, insurance companies, investment fund management companies and pension fund management companies), started in August 2013. Moreover, in order to ensure full coverage of this sector, in September 2013, amendments to the reporting regulations have been adopted, thus including financial companies and providers of financial leasing as reporting entities, whose reporting obligation will apply from April 2014;

- To improve data availability to end users, data on gross external debt and claims and stock of direct investment in denars were disseminated, besides the already available data series in euros and U.S. dollars;
- In September 2013, data on foreign direct investment for 2012 were disseminated, based on the new annual surveys on capital investment in and from the country, thus making some significant methodological improvements to the quality of External Statistics data;
- Within the framework of the medium-term project for establishing securities statistics, a new surveys on collecting data on resident's securities trading on foreign markets was defined. This project has been implemented in cooperation with the regulatory authorities competent for Other Financial Institutions;
- Within the framework of the medium-term project for implementation of the new international standards on External Statistics, a wide range of preparatory activities to adjust data sources and current software solutions were undertaken, in order to ease the start of production of external statistics in accordance with the new standard reporting forms in 2014.

As a part of the activities taken by the National Bank to bring statistics closer to users and reporting entities, as well as to improve the quality of communication, two surveys were conducted: User Satisfaction Survey and Reporting Agents Satisfaction Survey. Based on the result analysis, an action plan for improving communication with users and reporting agents has been set out.

To perform its statistical function, the National Bank cooperates with other authorized bodies for statistical surveys. The cooperation between the Ministry of Finance, the State Statistical Office and the National Bank in the area of macroeconomic statistics is set out in a Memorandum of Understanding and Cooperation, signed in 2009. Two annexes to the Memorandum were signed in 2013. In fact, in April 2013, an Annex was signed designating the National Bank to be the institution primarily responsible for the financial Accounts Statistics. An Agreement on exchange of data for the purposes of Financial Accounts Statistics was signed along with the Annex, which created prerequisites for regular exchange of data among institutions and starting production of Financial Accounts data. An additional annex was signed in December 2013, agreeing upon exchange of data for the purposes of the Application of Economic and Statistical Analysis - AESTA of the Ministry of Finance.

The recent amendments to the Law on State Statistics created an opportunity to improve the exchange of data between the State Statistical Office and the National Bank, which led to a new cooperation agreement, and exchange of data and publication materials. Furthermore, in order to improve the consistency of the national statistical system, an inter-institutional working group for sectorization was established, including a representative of the National Bank.

In October 2013, a Regional Seminar on Statistics was organized in collaboration with the European Central Bank. Target groups included statistics managers in the countries of the region (EU members and candidates for membership). The seminar presented the recent requirements of the European Central Bank in the field of statistics, as well as new challenges for the statistics in Europe and worldwide in the context of the global financial crisis. The participants also presented their experiences and challenges of statisticians from their central banks.

The practice of constant improving of the capacity of the National Bank in the area of statistics, continued this year. Therefore, the practice of training and collaboration with several central banks of the EU Member States through the Instrument for Pre-Accession

Assistance of candidate countries for EU membership - TAIEX continued. In addition, with the aim of optimization of the business processes, increasing and improving performance efficiency and convergence of organizational setup to practices in modern central banks, changes were made in the organizational structure and work processes in performing the statistical function of the National Bank in November 2013. These changes helped the reorganization of the part of External Statistics related to the centralization of data collection for all External Statistics in one unit and centralization of the preparation and dissemination of all External Statistics in another unit.

# IX. Internal Audit

In 2013, through a systematic evaluation and recommendations for improving the risk management process, adequacy and effectiveness of internal controls and management processes, the internal audit exercised its primary objectives by giving assurance on:

- Efficient and economical use of resources;
- Safeguarding of assets;
- Reliability and integrity of financial and other information, and
- Compliance of operations with laws and regulations, internal policies and work procedures.

In 2013, 18 regular audits were carried out for 38 business processes, giving 63 recommendations to improve the internal control system. The recommendations were monitored on a regular quarterly basis and the findings of the monitoring suggest that the recommendations are mainly observed and implemented within the given deadlines. In 2013, 91.6% of the recommendations were implemented.

In addition to regular internal audits, additional activities were carried out to improve the quality and efficiency of its own operations. Thus, during 2013, efforts were made to improve audit planning, primarily in the area of audit procedures to test controls in work processes, defining and formalizing the criteria for measuring the performance of internal audit, revision of the Regulation of the operations of the Internal Audit Department. In addition, technical cooperation was effectuated with De Nederlandsche Bank in the field of promotion of IT audit.

The operation of Internal Audit Department was closely supervised by the Audit Committee, which held four meetings during 2013.

# X. Museum, Library and Historical Archives

In 2013, the National Bank, as a significant supporter of the preservation, study and promotion of the Macedonian cultural heritage, carried out a series of activities in the area of museum, library, and historical and archival work, by organizing several research projects and cultural events. The most important was the promotion of the study "Conservation of Metal Archaeological Artifacts", whose release was intended to mark the International Museum Day. Over the past year, the Museum of the National Bank made efforts to complete the numismatic study on the coin finds from the Samuel's Fortress in Ohrid, simultaneously taking measures and activities to improve the legal status and the internal setup and organization of the Museum.

In 2013, the Library of the National Bank was enriched with the latest literature necessary for the National Bank's operations and continued with the professional training of the librarians for the Cooperative Online Bibliographic System and Services - COBISS.

Moreover, a number of measures and activities were taken to improve the legal status and the internal setup and organization of the Library.

During 2013, the National Bank continued with its ongoing activities to establish own historical archive within the National Bank Library and set the basic framework for its operations, in terms of providing prerequisites for commencement of the historical and archival activities of the National Bank.

## XI. Research

In 2013, the National Bank's research activities were directed towards areas important for achieving the basic goals and strengthening institutional capacity. In this regard, the studies conducted in 2013 supported the decision-making process in the National Bank and contributed to timely consideration of future challenges. Nine research projects were conducted in 2013 (two of which are ongoing), two projects were partly implemented in 2013 and the start of two projects is delayed for the next period. The research program for the period 2014-2016, adopted in May 2013, was supplemented with new projects in the area of monetary transmission and operational implementation of monetary policy, interactions among the main macroeconomic sectors, as well as in the area of financial stability and banking system.

On 26 April 2013, on the occasion of celebrating the anniversary of the monetary independence of the Republic of Macedonia, a second research conference was held, titled Policy Nexus and the Global Environment: A New Consensus Emerging from the Crisis? The conference was organized in three sessions covering topics important for the central banks, academic and research institutions. Researches were presented by representatives of central banks and academic institutions in the region and the EU. At this event, the National Bank awarded an annual prize for best paper in the field of macroeconomics of a young researcher.

In 2013, the Club of Researchers continued operating as a part of the activities to support the development of research and analytical work, in four quarterly sessions where participants presented and discussed several research papers. In order to provide other external sources of funding intended for research, the National Bank delivered several projects funded through IPA and TAIEX instruments and through technical cooperation with other central banks in various areas of central banking. Employees of the National Bank participated in several international conferences and events presenting their papers and presentations, and two employees won the Olga Radzyner Award for 2013 by the Oesterreichische Nationalbank (OeNB), bestowed on young researchers in the field of European integration in Central, Eastern and Southeastern Europe.

## XII. International Cooperation

During 2013, the National Bank continued promoting and strengthening multilateral cooperation, through participation in regular meetings of international institutions and international forums, and bilateral cooperation with other central banks.

Representatives of the International Monetary Fund (IMF) visited the National Bank during regular consultations under Article IV of the IMF's Articles of Incorporation, as well as within the post-program monitoring after the expiration of the IMF's Precautionary Credit Line. On the other hand, the governor and vice-governors of the National Bank participated in the Spring Meetings and the Annual Meeting of the IMF and World Bank Group, as well as the meeting of the Dutch Constituency. The technical cooperation with the IMF for promoting macroeconomic modeling and projecting of the National Bank continued in 2013. Within the cooperation with the World Bank, a range of consultation sessions were held with representatives of this institution related to the development of regular reports and publications of the World Bank. This year, the World Bank also carried out missions regarding the implementation of the Policy-Based Guarantee between the Republic of Macedonia and the World Bank and in respect of Public Expenditure Policy Based Guarantee Program. During 2013, the National Bank took part in the regular meetings of the Bank for International Settlements in Basel and in the meetings of the Central Bank Governors' Club of the Black Sea Region, the Balkan Countries and Central Asia. At the end of 2013, the National Bank became a formal member of the Vienna Initiative 2, which was originally formed to provide coordinated measures to deal with the effects of the global economic and financial crisis and to address drawbacks of the financial deleveraging of certain banking groups in the region. The National Bank's membership in this forum enables active participation and exchange of experiences in order to maintain financial stability in the region.

Within the cooperation with the central banks, the National Bank continued the technical cooperation with De Nederlandsche Bank, Deutsche Bundesbank, as well as other central banks of the EU and the countries in the region. This year, the National Bank continued the fruitful collaboration with De Nederlandsche Bank, as the most important strategic partner. Moreover, in Ohrid, in the period 1 - 3 July, 2013, the National Bank, in cooperation with the De Nederlandsche Bank and Banco de Portugal, organized the sixth international conference on Payment Systems and Securities Settlement Systems, thus continuing the practice of organizing seminars in the field of payment systems. Additionally, within the technical cooperation, representatives of the National Bank participated in the seminar organized by Deutsche Bundesbank, dedicated to establishing an integrated accounting system (SAP-standards) in the National Bank. To promote regional cooperation, in 2013, the National Bank signed a Protocol of Business Cooperation with the Central Bank of Montenegro and the Central Bank of the Republic of Kosovo.

In 2013, the National Bank continued to take active participation in the process of accession of the Republic of Macedonia to the European Union through its participation in the national strategic processes, i.e. within the performance of its obligations arising from the Stabilization and Association Agreement (SAA) in relation to the development and implementation of the Annual National Programme for the Adoption of the Acquis (NPAA), and within the development of the Pre-Accession Economic Programme (PEP).

Regarding the Instrument for Pre-Accession Assistance (IPA), in 2013 the National Bank delivered two projects under the IPA National Programme 2009. Namely, the NBRM Needs Assessment Program that applied from 2012, continued in 2013, and was officially closed on 10 July 2013. It was conducted by the National Bank and the ECB in cooperation with ten central banks of the Eurosystem. The project covered the following areas: monetary policy and exchange rate policy, economic analysis and research, statistics, payment systems, treasury operations, accounting, legal services, internal audit, information technology and human resources. The main objective of the project was to define recommendations for full compliance of the National Bank with the institutional and operational requirements of the European System of Central Banks. In this light, the project resulted in a general NBRM Needs Assessment Report that presents relevant findings for the existing gaps regarding the EU benchmarks and recommendations for their overcoming.

Due to the constant improvement of banking regulation, taking into account the new Basel Core Principles for Effective Banking Supervision, the National Bank launched the second project: Support of the Development and Implementation of the NBRM Methodology for assessment of the banks' internal capital adequacy. The project aims to improve the internal capital adequacy assessment process (ICAAP) by developing a methodology for assessing banks' internal capital adequacy within the supervision, in accordance with the national legislation and the new Basel II Capital Accord.

Within the EU-funded TAIEX instrument, the European Commission has approved 14 solutions. Moreover, during the year, 11 projects were successfully delivered, of which four study visits, three expert missions and three workshops in many areas of central banking.

# XIII. Other Activities

## 13.1. Legal and Personnel Operations

A number of novelties were introduced in the legal and personnel operations during the year. Namely, having participated in the preparation of laws, general and individual legal regulations within the competence of the National Bank and various adopted internal regulations governing the operations of the National Bank, it contributed to achieving the objectives and tasks of the National Bank. An improvement was made in the area regulating the rights and obligations of employees by developing a new Collective Agreement of the National Bank and appropriate amendments to the regulations governing: organization and segregation of duties, methods and procedures for recruiting workers, implementation of internship, manner and conditions for engaging in other work activities. Relevant amendments were made to the acts governing the signing of regulations and documents and the technique of developing general regulations. In addition, research was conducted for the control of the compliance with the regulations in the European central banks and the Bank for International Settlements, after which it was introduced and developed within the National Bank. As of 1 March 2013, the organizational structure was changed by introducing the compliance function, which meant a step towards raising the control quality of regulations (general and individual), and centralized monitoring of compliance of regulations adopted by the National Bank.

## 13.2. Readiness for Crisis Management

The National Bank conducts structured and regular process of planning, updating and testing of measures necessary to ensure business continuity in crisis.

During 2013, the organizational units of the National Bank updated the plans for ensuring business continuity. Furthermore, to confirm the feasibility of business continuity plans, in 2013, testing documentation was developed, staff was trained and several business processes were tested for business continuity in various crisis scenarios.

# XIV. Improving the Institutional Capacity of the National Bank

## 14.1. Strategic Planning

In 2013, the Strategic Plan of the National Bank for the period 2013-2015 came into force, which is fundamental for the strategic planning process, defining the mission, vision, organizational values and strategic objectives of the National Bank for the period ahead.

Strategic planning is actually an expression of interactive relations and activities of all participants in that process, for more effective achievement of objectives by identifying the main priorities taking into account the financial and human resources, technical and time constraints. The Strategic Plan, which is set by the top management of the National Bank, covers a period of three years, enabling timely anticipation of future trends, real understanding of resources and opportunities and establishing specific measures and actions to successfully achieve objectives in the future.

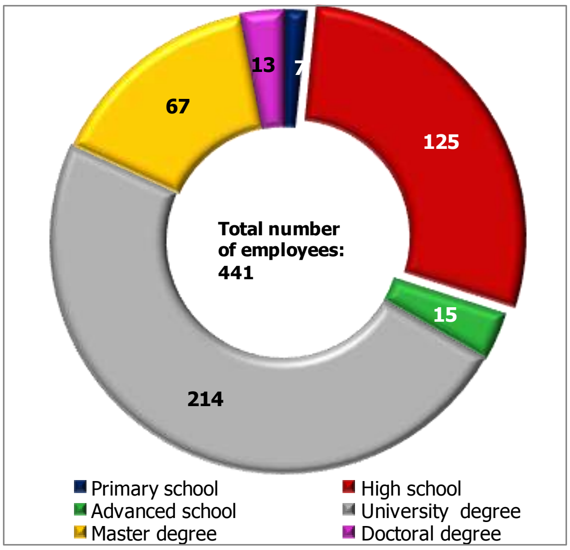
## 14.2. Human Recourse Management

### 14.2.1. Personnel Structure

At the end of 2013, the total number of employees of the National Bank went up to 441, which is moderately higher, compared to the end of 2012, when it equaled 438. During the new recruitments in the National Bank, attention was paid to the qualification structure of employees. Thus, of 19 new jobs, 16 new employees completed a university education, including 2 masters of science. Moreover, there was an equitable representation of citizens belonging to ethnic communities.

Furthermore, within the total number of employees, the trend of improving the qualification structure continued during the year, by increasing the share of employees with university education, primarily masters of science and PhDs, while reducing the number of employees with lower level of education, such as primary, secondary and college education. The improvement of qualification structure is associated with the policy of the National Bank for permanent support to the staff for personal and professional development through co-financing of the further formal education.

Chart 97
Qualification structure of employees in the National Bank

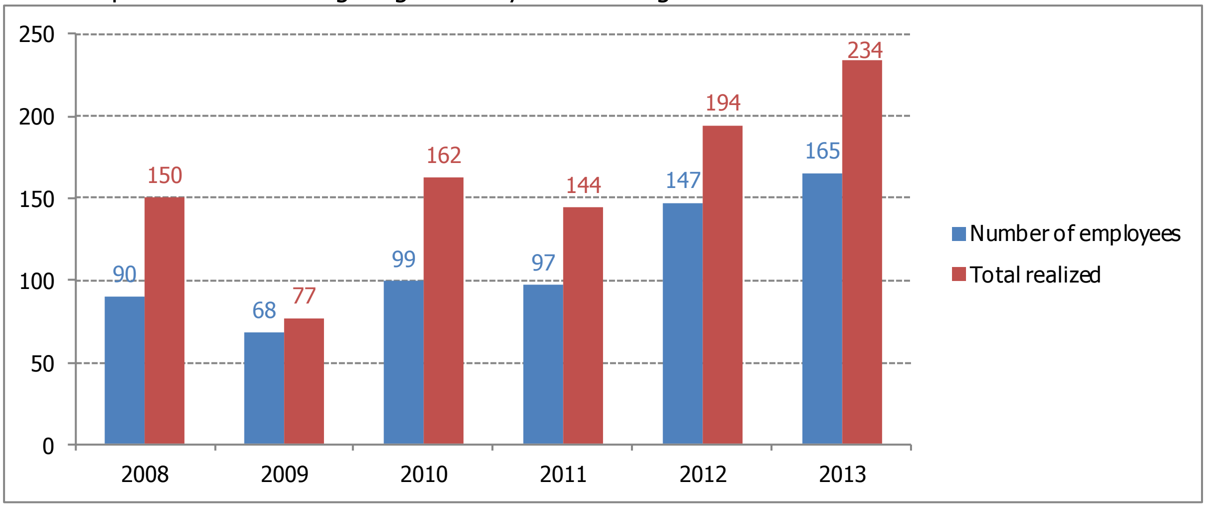



Gender structure of the Bank includes 41% men and 59% women. The average age of employees has remained unchanged in the past few years and equals 44.6 years.

### 14.2.2. Professional Trainings and Continuous Development of Employees

The National Bank pays particular attention to the continued professional development of employees who need to respond to the challenges facing the institution in carrying out its functions. During 2013, the professional trainings mainly related to the basic functions of the central bank, followed by the trainings for logistical functions and organizational units to ensure high quality execution of all work processes.

Chart 98
Attended professional trainings organized by external organizers




During 2013, experts of the National Bank conveyed their knowledge to other staff members by organizing internal trainings for capacity building of staff in areas that are considered necessary for improvement of the work. Namely, in 2013, internal trainings in econometrics was conducted for over 50 employees of various sectors. Internal trainings are not included in the above chart of attended professional trainings since it refers to trainings organized by external organizers.

Main external organizers of professional development and trainings for the National Bank employees in 2013 were the International Monetary Fund, the European Commission, many European central banks that have annual training programs intended to support other central banks, the Economic Chamber of Macedonia as well as other international and national institutions.

### 14.2.3. Strengthening Institutional Capacities in Human Resources Management, Leadership and Teamwork

In order to strengthen the institutional capacity and improve the HRM functions, preparatory activities were conducted during 2013, for integrating administrative and personnel operations and HRM development into an organizational unit. For this purpose, technical assistance and cooperation with the European Central Bank was used through the Needs Assessment of the NBRM, as well as through the long-term cooperation with the De Nederlandsche Bank, when an HRM seminar was held, tailored to the needs of the National Bank's employees.

Furthermore, internal trainings for development of the management skills of management structures were conducted for strengthening the institution's leadership and efficient management of work processes and human resources. To promote teamwork and internal communication within the institution, as a prerequisite for successful cooperation and greater motivation among employees, sector teams building events were organized.

### 14.3. IT Development

Within the activities of the National Bank's IT system development into a modern, efficient and economical system and in accordance with the needs and the requirements of the National Bank's departments, more than 4,000 work cases were completed during 2013, the majority of which (65%) being requests for new services from the catalog of IT services, 25% relates to IT incidents and assistance during the work of employees of the National Bank, while 10% relates to regular maintenance of information infrastructure and its improvement.

Within the IT projects, the National Bank's capacities further enhanced. More than 40 projects were delivered that improve the performance by introducing new or modifying the existing systems, applications and services, including the largest project "Implementing Server Virtualization and Robust Storage". This project also promoted the server infrastructure through full server virtualization and increasing the robust storage. The infrastructure has been raised to a higher level, making the entire system a private cloud in which applications and data are placed in two locations (main and backup). This allows uninterrupted access to information, greater operational flexibility, efficient use of resources and high availability. During the 2013, the server infrastructure in the National Bank was fully moved and upgraded to the latest version of the Microsoft operating system, Windows 2012. In addition, during 2013, the database management system was moved and upgraded to SQL Server 2012 that provides greater operational reliability and efficiency, and application of the latest work technologies.

The Project for IT System Certification in Accordance with the Law on Electronic Management took place alongside the current operations and projects of the National Bank Program for 2013. During 2013, the National Bank's IT system was certified as part of Project for Introducing System Interoperability by the Ministry of Information Society and Administration. A team of assigned representatives of the Ministry examined the security mechanisms, policies and user management of the IT system, and ascertained that it meets the certification requirements pursuant to the Law on Electronic Governance and regulations adopted pursuant to this law.

## XV. Transparency, Public Relations and Financial Education

The ongoing trend of improving public relations policy through open and transparent communication of information continued in 2013. Responsible, regular and promptly information to the public about the operations and activities of the National Bank was made by regular contacts with the media through press releases, interviews, press conferences, briefings and answers to journalists' questions.

Through its website www.nbrm.mk, the National Bank informed the public of changes in the monetary policy setup, changes in interest rates, financial stability, liquidity in the banking system, banking supervision and regulation, exchange rate and currency exchange rates list, payment systems and many other aspects of the NBRM operations. The homepage was updated by regular press releases and increasing number of notices related to the NBRM activities. In addition, there were many interviews, speeches and presentations by the governor and vice-governors of the National Bank.

In 2013, the range of contents published on the website was expanded. New sections were added, such as: changes in the National Bank's policy rate, employment in the National Bank, Club of Researchers, Red Book for Payment, Clearing and Settlement Systems in the Republic of Macedonia, Statistical Research Program 2013-2017, analyses, Privacy Policy, time series of results of the Lending Survey, with regular update of the posted publications in Macedonian and English language.

Moreover, the National Bank informed the public through its paper publications: Annual Report for 2012, Report on the Banking System of the Republic of Macedonia in 2012, Report on Financial Stability in the Republic of Macedonia in 2012, in both Macedonian and English. In addition, publications were also published on the NBRM website.

Since December 2013, the information service and electronic trading platform Bloomberg introduced an information page on the National Bank. The presence of the National Bank with its own page on Bloomberg, which is one of the most exploited sources of financial information and news in real time, ensures an easy access of financial market participants worldwide to relevant financial data for the Republic of Macedonia.

The Financial Education Project launched more activities for closer acquaintance of the population in the Republic of Macedonia with finances and economy by organizing national and international events, developing educational materials that elaborate aspects of the role and functions of the central bank, key financial institutions, savings, financial products and the protection of consumers of financial services.

In May 2013, in competition with above 25 participating countries from Europe and Central Asia, the National Bank won the award for best-organized events and activities during the Global Money Week 2013. Activities included visiting primary schools throughout the country, maintaining interactive classes and granting educational materials to students. Moreover, in cooperation with the top circulation magazines for primary school children, financial and economic texts were published in the form of short comics adjusted for the age of students.

During the year, the National Bank became a member of the Alliance for Financial Inclusion. The membership in this Alliance allows cooperation and exchange of experiences between the central banks in the field of financial education.

At the end of 2013, a Memorandum of Cooperation between the National Bank, the Ministry of Finance, the Insurance Supervision Agency, the Agency for Supervision of Fully Funded Pension Insurance and the Securities and Exchange Commission of the Republic of Macedonia was signed. The financial services regulators signed this Memorandum of Cooperation to raise the level of financial literacy of population in the country, through joint efforts and projects.