National Bank of the Republic of Macedonia

MONETARY POLICY AND RESEARCH DEPARTMENT

Recent Macroeconomic Indicators
Review of the Current Situation

August 2016

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Review of the Current Situation - Implications for the Monetary Policy

The review of the current situation aims to give an overview of the recent macroeconomic data (April - June 2016) and to make a comparison with the latest macroeconomic projections (April 2016). This will determine the extent to which the current situation in the economy corresponds to the expected movements of the variables in the previous round of projections. The review focuses on the changes in external assumptions and performances of domestic variables and the effect of these changes on the environment for monetary policy conduct.

In the period following the April projection, the key event that caused changes in the global economic environment and additionally increased the uncertainty is the decision of the Great Britain to exit EU (BREXIT). This result stirred the materialization of one of the larger downward risks, which deteriorated the global economic environment and resulted in downward revisions of the world economic growth[1]. Namely, despite improved performance at the beginning of the year than expected, the estimations for adverse macroeconomic consequences of Brexit due to the substantial rise of economic, political and institutional uncertainty have corrected downwards the estimations for growth, especially in developed economies. These changes in estimations of the economic recovery pace, primarily relate to the period from 2017, while short-term major effects are not expected. This conclusion applies also to the euro area, where it is estimated that the short-term effects on the activity will not be significant, taking into account positive performance in the first half of the year[2]. In this regard, preliminary data indicate further growth of real GDP in the euro area of 1.6% in the second quarter of 2016 on an annual basis, which represents a minimum deceleration compared to the previous quarter (1.7%). In addition, the surveys about the economic sentiment in the euro area, although available only for one month, do not point to significant changes in terms of economic growth. The recovery of the European economy has certain positive effects on the labor market, where the unemployment rate slightly decreased from 10.2% in April to 10.1% in June. Regarding inflation, July data show minimal acceleration of 0.2% annually, primarily due to higher prices in the category "food, alcohol and tobacco," while core inflation is stable at a level of 0.9%.

Observed from a viewpoint of the individual quantitative indicators for the external environment of the Macedonian economy, the current assessment is that the exit of Britain from the European Union will not affect the foreign effective demand in 2016, while the negative effects are expected in 2017. Thus, the assessment for growth in foreign demand in 2016 has not changed compared to the April cycle, while larger downward revision was made for 2017, given the downward revisions in almost all European economies which are our most common trade partners. However, it should be kept in mind that the uncertainty caused by Brexit is extremely high, and that the effects on foreign demand in the period ahead can not be accurately measured. Regarding the **foreign effective inflation**, over the entire projection period downward revisions were made, i.e. minimal inflation in 2016 is expected, which will further intensify in 2017. Decrease in the prices of primary commodities on the world stock exchange markets in 2016 and their recovery in 2017 is expected, with expectations for a revision of the prices of certain products in different directions. Thus, the expected fall in **world oil prices** in 2016 is slightly smaller compared to the expected decrease with the April forecasts, while for 2017, prices are expected to increase similarly, thus resulting in a slightly higher price level compared to the one previously expected. In **metal prices**, the latest estimates for 2016 point to different movements, expecting smaller decrease in nickel price, while larger in copper price than previously expected, unlike 2017 when favorable developments are anticipated, i.e. higher increase of their prices compared to the April

[1] World Economic Outlook, IMF, update July 2016.

[2] The expected growth in the euro area in 2016 as part of the World Economic Outlook of the IMF, Update, July 2016 has been revised upwards for 2016 by 0.1 percentage points, while in 2017 the correction is downward by 0.2 p.p.

projection, especially regarding nickel. In terms of **world food prices,** in 2016 downward pressure on domestic inflation are expected, given the significantly larger expected drop in wheat and corn prices, due to improved perceptions for production this year compared to previous estimations. The revisions for 2017 are downward, envisaging slightly lower growth in food prices than previously projected. However, it should be kept in mind that the estimations for the prices of these primary commodities are extremely volatile. Common risk for all primary commodities is the growing uncertainty caused by the referendum in the UK, which could cause greater volatility in their movement. The latest assessments indicate that during the current and the next year, the **EURIBOR interest rate will follow similar path as in the April forecasts,** which corresponds to the unchanged ECB's monetary policy setup and the given assurance of the bank's readiness to provide additional stimulus as a response to the enhanced negative risks.

The comparison of the latest macroeconomic indicators with their projected dynamics within the baseline scenario from the April forecasting round presents a divergent picture of the deviations in the individual segments of the economy. Published estimated data on GDP for the first quarter confirm the economic growth, which is still lower than the expected growth in the April projection. In view of the developments in individual sectors in the second quarter, the available high frequency indicators for this period suggest continued growth, but with an indication for its deceleration. Thus, compared to the first quarter, the growth rate in almost all sectors has been decelerating. **Lower performance in the first quarter and indications of growth deceleration in the second quarter point to potentially lower GDP growth in the first half of the year relative to the projection.** Also, the domestic non-economic factors related to the political developments in the country, which culminated in the second quarter, further raise the uncertainty about the performance and assessment of the economic activity. In terms of inflation, in July the consumer prices continued to decrease on an annual basis, but less intensively compared to previous months. Analyzed by individual components, food and energy prices continue to register lower prices, while core inflation remained in the positive zone. The key input assumptions were corrected in different directions, in an environment of still low global prices. The price movements in July 2016 along with the change in input assumptions, so far indicate small downward divergence from the inflation projection for 2016.

Recent foreign reserves data (adjusted for the effects of price and exchange rate differentials and price changes of securities), for July 2016, indicate increase in foreign reserves. Analyzed through the factors of change, the increase in reserves results mainly from transactions on behalf of the government, due to the issued Eurobond, and then, in a smaller part, from the foreign currency deposits of domestic banks with the NBRM and the NBRM interventions on the foreign exchange market, which in July registered a net purchase of foreign currency. In terms of available data on the external sector for the third quarter, the performance on the currency exchange market in July point to further stabilization of the movements and performance, which are within the projection. The latest available indicators of the balance of payments for April and May 2016 indicate higher current account deficit in the second quarter of the year than expected in the April projection, with performances of the financial account at the level expected. To the same conclusion points also the recent data on foreign trade in the second quarter, which showed higher realized trade deficit than projected. The analysis of foreign reserves adequacy indicators shows that they continue to hover in a safe zone.

In terms of developments in the monetary sector, the data as of June show further decrease in deposit base by 0.3% on monthly basis, which represents a significantly smaller monthly decline compared to the realized reduction in the previous two months. The reduction in total deposits is completely due to lower deposits of the corporate sector, while the household savings register small growth, as opposed to the more substantial decrease in April and May. These developments give signals of gradual stabilization of economic agents' perceptions and thus stabilization of the deposit base. On an annual basis, the total deposits in June grew by 2.1% and were below the projection for the second quarter of 2016 (6.6%). In terms of the credit market, in June, there was significant reduction in total loans to the private sector by 1.9%, compared to the minimum drop of 0.1% in

May. The decrease in total loans arises from lower loans in both sectors, which is fully due to the transfer of written-off doubtful and contested bank claims from the on-balance sheet to the off-balance sheet record, pursuant to the NBRM decision[3]. If we exclude this effect, the total loans register an increase of 1.5% on a monthly basis. According to the results of the latest Bank Lending Survey[4], the retention of these favorable developments in the banks' credit activity is related to the net-easing of the overall credit conditions in both sectors, amid moderate net fall in the demand for corporate and housing loans. Regarding the expectations for the following quarter, the banks indicate an increase in the supply of and demand for corporate loans and household loans. On annual basis, the total loans went up by 3.5% (8.5% if we isolate the effect of write-offs), as opposed to the projected growth of 7.6% for the second quarter, according to the April projection.

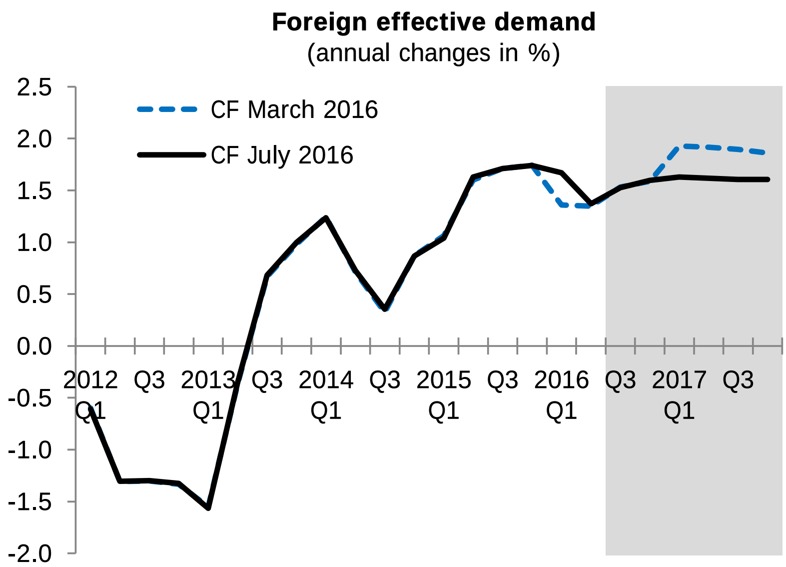
In the first half of 2016, the Budget of the Republic of Macedonia registered a deficit of Denar 6.947 million, most of which was funded by withdrawing funds from the government account with the NBRM. The deficit registered in this period equals 32.8% of the planned budget deficit, according to the Budget Revision for 2016[5].

The latest macroeconomic indicators and assessments indicate changes in some key variables for the monetary policy and more pronounced risks to the baseline scenario provided in the April forecasts. Foreign reserves (adjusted for price and exchange rate differentials and price changes of securities) decreased in the second quarter, primarily under the influence of non-economic factors. However in July, their level increased substantially and is over the projection as a result of the new government borrowing on the international financial market. Also, during this month, the foreign exchange market stabilized significantly, and the NBRM intervened with net purchase of foreign currency. All foreign reserves adequacy indicators show that they continually hover in a safe zone. Available high frequency indicators of economic activity suggest continued growth in the second quarter of 2016, but probably at a slower pace than expected. In terms of inflation, the current performance and assessments of the import prices so far indicate little downward deviations from the inflation projection. Within the monetary sector, the data for June indicate an evident stabilization of expectations, given significant deceleration of the decrease in total deposits and moderate growth in household savings. Also, in June, if we exclude the effects of regulatory changes, a significant revival of credit flows is registered, with simultaneous growth in corporate and household lending. The realization in deposits at the end of June is lower than expected for the second quarter of 2016 and indicate deviations from the level in the April projection. Credit activity is in line with the projections, but given the weak dynamics of deposits as the main source of financing, the risks for future developments on the credit market are present. Given the set of measures undertaken in early May by the National Bank, further stabilization of expectations and normalization of flows is anticipated. In any case, the uncertainty associated with the domestic political upheavals and the global surrounding is still present. The above creates the need for continuous monitoring of the performance and regular reassessment of risks and their relevance in the context of achieving monetary goals.

[3] On 17 December 2015, the National Bank Council adopted the Decision on amending the Decision on credit risk management that requires from banks by 30 June 2016 to write off (and to continue to write off) all claims that have been fully booked for more than two years, and where the bank has identified and fully covered the credit risk of default at least two years before. Despite the write-off of these claims, i.e. their transfer to the off-balance sheet record, banks reserve the right for their collection.
[4] For more information, also see Bank Lending Survey at http://nbrm.mk/?ItemID=F7AC78DEE498764FBAF39049F726CE3C.
[5] On 29 July 2016, the Parliament of the Republic of Macedonia passed the Budget Revision for 2016.

Selected economic indicators /1				2015					2016								
	2012	2013	2014	Q1	Q2	Q3	Q4	2015	Jan.	Feb.	Mar.	Q1	Apr.	May	Jun.	Q2	Jul.
I. Real sector indicators																	
Gross domestic product (real growth rate, y-o-y) /2	**-0.5**	**2.7**	**3.5**	**3.8**	**3.4**	**3.6**	**3.9**					**2.0**					
Industrial production /3																	
y-o-y	-2.8	3.2	4.8	1.5	0.1	5.7	11.7	4.9	8.0	15.2	8.9	10.7	3.6	5.3	-4.4	1.3	
cumulative average	-2.8	3.2	4.8	1.5	0.8	2.5	4.9	4.9	8.0	11.7	10.7	10.7	8.7	8.0	5.6	5.6	
Inflation /4																	
CPI Inflation (y-o-y) /5	4.7	1.4	-0.3	-0.9	0.3	-0.2	-0.4	-0.3	0.1	0.0	-0.4	-0.1	-0.7	-0.7	-0.7	-0.7	-0.3
CPI Inflation (cumulative average)	3.3	2.8	-0.3	-0.9	-0.3	-0.3	-0.3	-0.3	0.1	0.1	-0.1	-0.1	-0.2	-0.3	-0.4	-0.4	-0.4
Core inflation (cumulative average)	2.1	3.0	0.6	-0.4	0.1	0.3	0.5	0.5	1.6	1.6	1.7	1.7	1.6	1.6	1.6	1.6	1.5
Core inflation (y-o-y)	2.1	3.0	0.6	-0.4	0.7	0.7	1.0	0.5	1.6	1.6	1.8	1.7	1.6	1.2	1.5	1.5	1.2
Labor force																	
Unemployment rate	31.0	29.0	28.0	27.3	26.8	25.5	24.6	26.1				24.5					
II. Fiscal Indicators□																	
(Central Budget and Budgets of Funds)																	
Total budget revenues	138,115	140,248	145,929	37,779	40352.0	39,314	43,762	161,207	12,923	12,925	14,742	40,590	14,820	13,344	13,261	41,425	
Total budget expenditures	155,840	159,505	168,063	44,080	43572.0	43,667	49,313	180,632	14,611	15,696	15,918	46,225	14,319	14,528	13,890	42,737	
Overall balance (cash)	-17,725	-19,257	-22,134	-6,301	-3220.0	-4,353	-5,551	-19,425	-1,688	-2,771	-1,176	-5,635	501	-1,184	-629	-1,312	
Overall balance (in % of GDP) /1	-3.8	-3.8	-4.2	-1.1	-0.6	-0.8	-1.0	-3.5	-0.3	-0.5	-0.2	-1.0	0.1	-0.2	-0.1	-0.2	
III. Financial indicators /6																	
Broad money (M4), y-o-y growth rate	**4.4**	**5.3**	**10.5**	**8.8**	**9.2**	**6.2**	**6.8**	**6.8**	**4.5**	**5.4**	**6.2**	**6.2**	**3.8**	**3.7**	**2.5**	**2.5**	
Total credits, y-o-y growth rate	**5.4**	**6.4**	**10.0**	**9.2**	**9.0**	**8.8**	**9.5**	**9.5**	**8.6**	**8.7**	**8.4**	**8.4**	**7.5**	**6.4**	**3.5**	**3.5**	
Total credits - households	6.5	10.2	11.8	12.1	12.4	12.8	12.9	12.9	12.6	12.8	13.0	13.0	12.8	12.2	8.8	8.8	
Total credits - enterprises	4.5	3.8	8.6	7.1	6.7	6.0	7.1	7.1	5.5	5.8	5.1	5.1	3.7	2.0	-0.5	-0.5	
Total deposits (incl. demand deposits), y-o-y growth rate	**4.9**	**6.1**	**10.4**	**8.4**	**8.9**	**5.7**	**6.5**	**6.5**	**4.3**	**5.3**	**6.2**	**6.2**	**3.1**	**3.7**	**2.3**	**2.3**	
Total deposits - households	7.2	6.7	8.9	8.1	6.2	5.0	4.1	4.1	3.6	3.5	3.1	3.1	0.9	-0.4	0.2	0.2	
Total deposits - enterprises	-1.6	3.1	15.7	9.0	17.8	7.1	13.0	13.0	6.4	11.8	16.0	16.0	9.2	14.5	5.6	5.6	
Interest rates /7																	
Interst rates of CBBills	3.73	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	4.00	4.00	4.00	
Lending rates																	
denar rates (aggregated, incl. denar and denar with f/x clause)	8.5	8.0	7.5	7.3	7.1	7.0	6.9	7.1	6.8	6.7	6.7	6.7	6.7	6.6	6.6	6.6	
f/x rates	7.0	6.5	6.3	6.0	5.9	5.8	5.8	5.9	5.7	5.7	5.6	5.6	5.5	5.5	5.5	5.5	
Deposit rates																	
denar rates (aggregated, incl. denar and denar with f/x clause)	5.1	4.4	3.7	3.2	3.0	2.7	2.6	2.9	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	
f/x rates	2.2	1.8	1.4	1.5	1.3	1.2	1.1	1.3	1.1	1.1	1.1	1.1	1.1	1.1	1.0	1.1	
IV. External sector indicators																	
Current account balance (millions of EUR)	**-240.0**	**-134.1**	**-68.7**	**-46.5**	**-82.1**	**130.9**	**-129.6**	**-127.3**	**27.5**	**-5.1**	**-34.0**	**-11.7**	**-84.1**	**-71.5**			
Current account balance (% of GDP)	*-1.6*	*-1.6*	-0.8	-0.5	-0.9	1.4	-1.4	-1.4	0.3	-0.1	-0.4	-0.1	-0.9	-0.8			
Trade balance (millions of EUR) /8	**-1,946.7**	**-1,748.1**	**-1757.9**	**-378.1**	**-446.5**	**-362.3**	**-538.7**	**-1725.7**	**-65.8**	**-131.6**	**-175.8**	**-373.2**	**-160.8**	**-175.8**	**-164.2**	**-500.8**	
Trade balance (% og GDP)	*-25.7*	*-21.6*	-20.7	-4.2	-4.9	-4.0	-5.9	-19.0	-0.7	-1.4	-1.9	-3.9	-1.7	-1.9	-1.7	-5.3	
import (millions of EUR)	-5,070.6	-4,983.3	-5504.5	-1308.1	-1481.7	-1394.0	-1593.2	-5776.9	-354.1	-477.5	-525.0	-1356.5	-529.4	-531.1	-495.0	-1555.5	
export (millions of EUR)	3,124.0	3,235.2	3746.6	929.9	1035.2	1031.7	1054.4	4051.2	288.3	345.9	349.2	983.3	368.5	355.3	330.8	1054.7	
rate of growth of import (y-o-y)	0.3	-1.7	10.5	5.4	8.2	-0.7	6.9	4.9	-3.1	16.8	-1.6	3.7	6.3	13.1	-3.7	5.0	
rate of growth of export (y-o-y)	-2.8	3.6	15.8	13.9	9.9	4.5	5.4	8.1	-1.2	15.6	3.0	5.7	24.8	-1.0	-13.2	1.9	
Foreign Direct Investment (millions of EUR)	**131.1**	**229.4**	**197.4**	**68.0**	**46.5**	**5.5**	**50.7**	**170.7**	**0.0**	**36.6**	**29.8**	**66.3**	**32.7**	**47.8**			
External debt																	
Gross external debt (in milllions of EUR)	5171.7	5219.7	5992.3	6251.5	6359.8	6240.1	6353.7	6353.7				6707.4					
public sector	2162.1	2172.4	2846.8	3024.7	3059.8	3036.6	2935.4	2935.4				3282.3					
public sector/GDP (in %)	28.5	26.7	33.4	33.3	33.7	33.4	32.3	32.3				34.7					
private sector	3009.5	3047.4	3145.5	3226.9	3300.0	3203.5	3418.3	3418.3				3425.2					
Gross external debt/GDP (in %)	68.2	64.0	70.3	68.8	70.0	68.6	69.9	69.9				70.9					
Gross official reserves (millions of EUR) /9	**2,193.3**	**1,993.0**	**2,436.5**						**2,246.9**	**2,253.4**	**2,266.3**		**2,193.8**	**2,164.3**	**2,158.8**		**2,588.0**

/1 While calculating the relative indicators, the annual GDP from the official announcement of SSO is used. For 2015, the projected level from the NBRM projections from October 2015 is used.
/2 Preliminary data for 2014. Estimated data for 2015.
/3 The changes of Index of industrial production are according to base year 2010=100.
/4 CPI calculated according to COICOP.
/5 Inflation on annual basis corresponds to end-year inflation (December current year/December previous year)
/6 The calculations are based on the New Methodology for compiling standard forms of the monetary balance sheets and surveys and the new accounting plan (in force since 01.01.2009).
/7 As of January 2015 data for active and passive interest rates are compiled according to the new methodology of NBRM.
/8 Trade balance according to foreign trade statistics (on c.i.f. base).
/9 The data from 2008 include accrued interest. The latest available data on gross official reserves are preliminary data.



Source: "Consensus Forecast" and NBRM calculations.

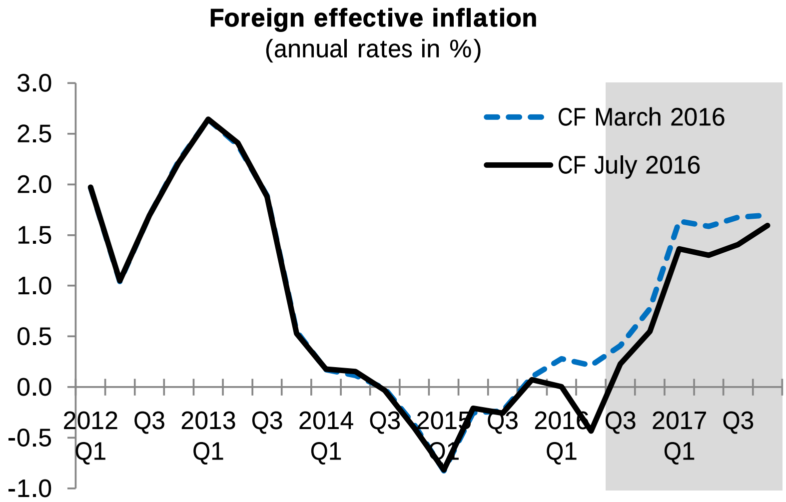
The latest estimations for the increase in the foreign effective demand[6] in 2016 remained unchanged compared to the April projection, despite the outcome of the British referendum...

...i.e., it is still expected that the growth will reach 1.5% on an annual basis.

On the other hand, greater economic effects of Brexit are expected in 2017, when foreign demand is revised substantially downwards...

...the growth of which is now being assessed at 1.6%, as opposed to the April projection of 1.9%...

...which, by country, primarily arises from the reduced economic growth rates of Germany, and less, to Italy.



Source: "Consensus Forecast" and NBRM calculations.

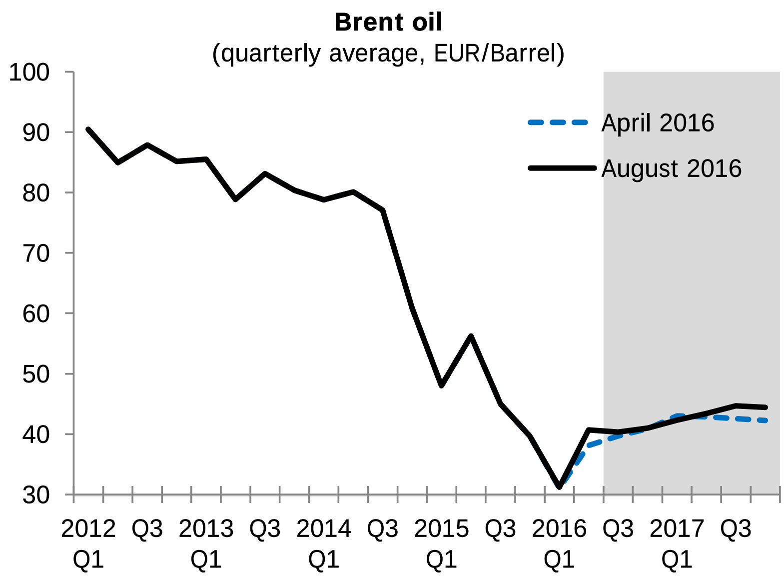
Compared to April, the foreign effective inflation was revised downwards throughout the entire projection period.

Thus the latest estimates indicate minimal foreign inflation of 0.1% in 2016, as opposed to the April projection of 0.4%...

...given the downward revisions in almost all partner countries, with the highest contribution of the neighboring countries (Serbia[7] and Bulgaria), due to the new expectations for decrease instead of increase in the prices.

A similar downward revision was made for 2017, as well, when it is expected that the foreign inflation will equal 1.4% (1.7% in April), primarily as a result of lower expected growth in prices in Serbia and Germany.

[6] The analysis of the foreign effective demand and inflation is based on the projections of the international company for economic surveys Consensus Forecast.
[7] Inflation in Serbia has been adjusted for the changes in the exchange rate.



Source: IMF and NBRM calculations.

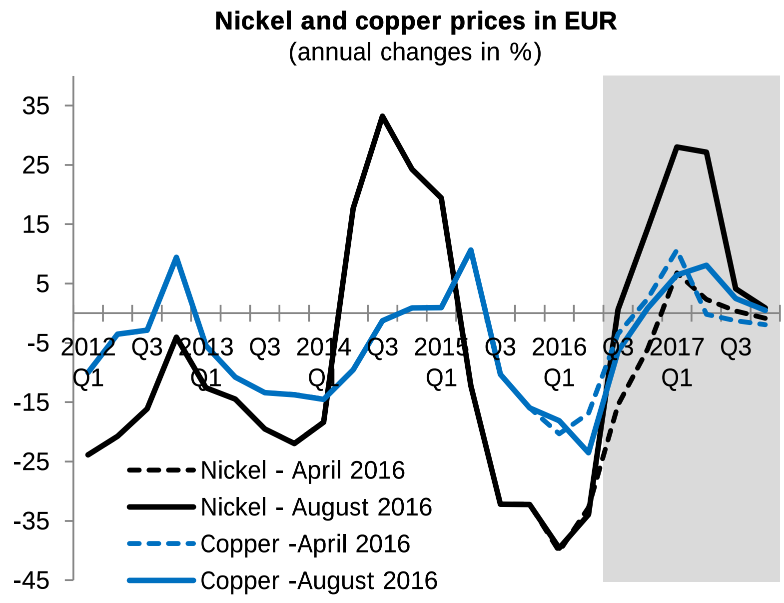
According to the latest estimations[8], the projections for the Brent oil prices are close to the April prices...

... now expecting the fall in prices in 2016 to be minimally lower, mainly due to higher performance in the second quarter.

Namely, during the second quarter, the oil prices registered upward movement due to the disturbances on the supply side in many countries and reduced oil production in the United States.

In this period, following the referendum in the UK, the volatility in oil prices increased, taking into account the increased macroeconomic uncertainty.

In 2017 the oil prices are expected to rise with an intensity similar to the April projection.



Source: IMF and NBRM calculations.

The revisions in the metal prices in 2016 were made in different directions.

Thus, smaller decrease in the price of nickel is now expected...

...given the significant upward revision in the second half of the year, due to the expectations for a reduction of global production (lower offer from Philippines[9])...

... while the price of copper is projected to decrease more...

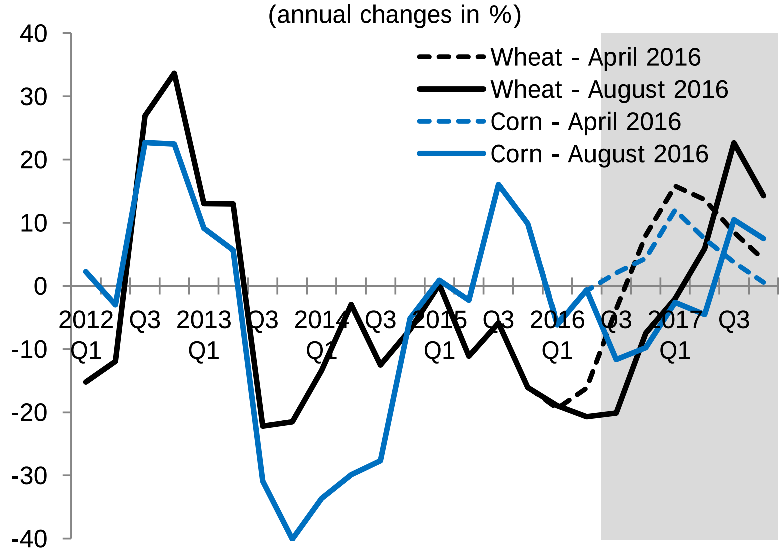
... as a result of the enduring situation of excess supply on the market and more pessimistic assessments of prospects for the manufacturing industry in China.

The prospects of the primary metals in 2017 are more favorable than in April. This especially refers to nickel,

[8] For the analysis of prices of oil, metals and primary food products, various reports of the IMF, World Bank, FAO, OPEC, the ECB and the specialized international economic portals are used.

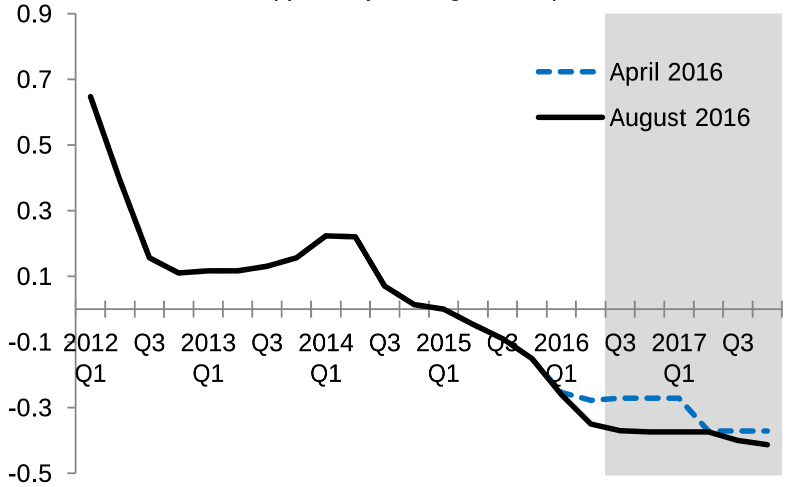
[9] New authorities in the Philippines launched a review of the operation of mines in terms of their impact on the environment, which could lead to the closure of certain mines which cause damage to the environment. At the same time, moratorium on issuing new permits for mining were put.

Wheat and corn prices in EUR
(annual changes in %)



Source: IMF and NBRM calculations.

1-month Euribor
(quarterly average, in %)



Source: "Consensus Forecast" and NBRM calculations.

whose price increase was substantially revised upwards. And the price of coper is expected to register growth, moderately higher than in the April projection.

The prices of the primary food products were revised downwards throughout the entire projection period.

Thus, **in 2016** according to the latest estimations the wheat price will register a twice-higher drop than in the April projection, which is explained by improved production prospects in Europe, the US and the Black Sea region ...

...given simultaneous significant downward revision of the price of corn, due to the solid supply and higher potential of the current year yields.

In addition, downward revision was made also in 2017, expecting that the prices of wheat and corn will register moderately lower growth than projected in April.

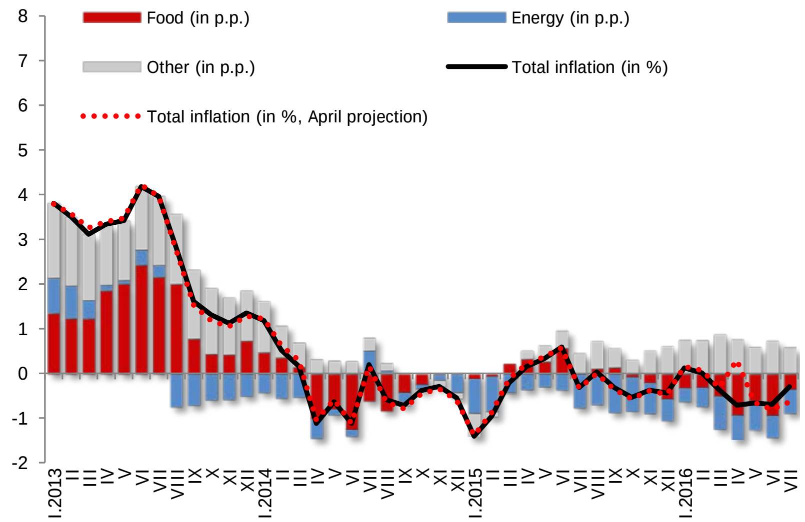
In circumstances of implementation of the Quantitative Easing Program by the ECB according to the plan, the maintenance of the interest rates on low or negative level and emphasizing the bank readiness to be more stimulating in response to the increased risks, there are no major changes in terms of the future trend of the monthly Euribor compared to April estimates.

However, it is still expected that the short-term interest rate on the money market will remain in the negative zone for a longer period...

...whereby this interest rate is expected to average -0.34% and -0.39% in 2016 and 2017, respectively, compared to -0.27% and -0.35% in the April forecast.

Inflation rate

(annual impacts to inflation, in p.p.)



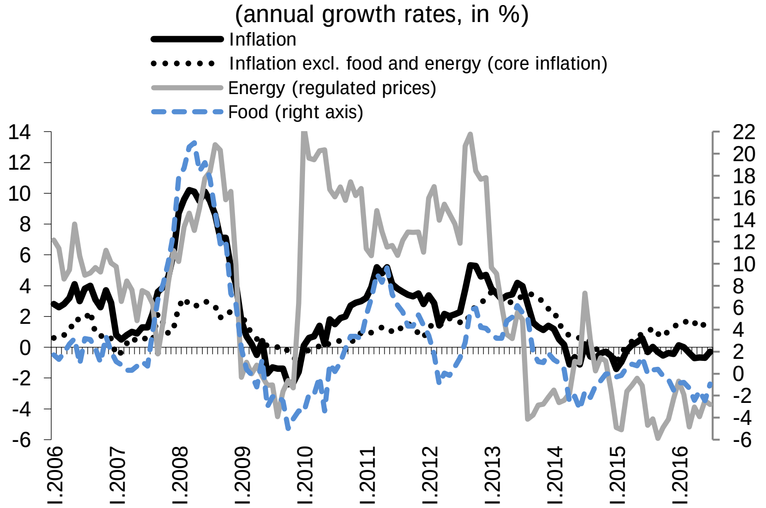
Source: SSO and NBRM.

After the four-month slight monthly increase[10], in July 2016 the domestic consumer prices went down by 0.3% on a monthly basis...

...due to the lower prices of food components[11] and energy, while the core inflation continued to rise.

Inflation and volatility of food and energy

(annual growth rates, in %)



Source: State statistical office and NBRM calculations.

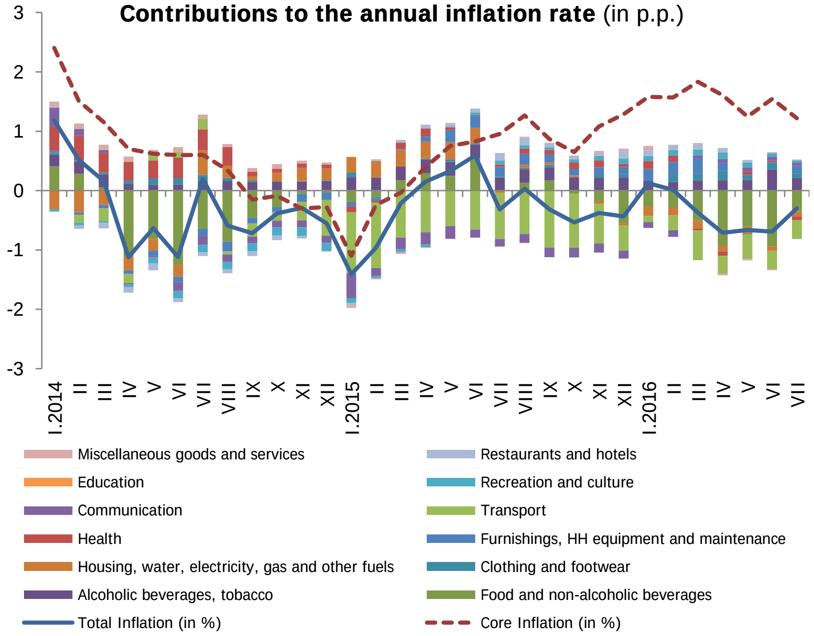
In accordance with the monthly decrease, the annual rate of inflation in July remained in the zone of negative growth and stood at -0.3%, which still represents a substantial slowdown of annual decline of 0.7% registered in the previous three months.

With regard to the projection, the changes in domestic prices in July 2016 indicate a possible slight downward deviation compared with the expected inflation rate for 2016 within the April cycle projections.

[10] ...except for June, when stagnation of inflation on a monthly basis was registered.

[11] A category registering the highest individual negative monthly contribution in July is vegetables (monthly drop of 6.2%).

Contributions to the annual inflation rate (in p.p.)

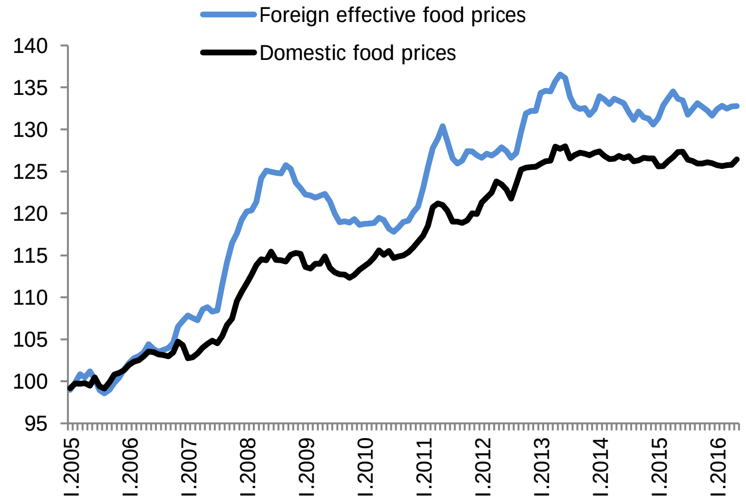


Source: SSO and NBRM.

Core monthly inflation rate in July was 0.1%, while on an annual basis it grew by 1.2%, slightly slower than the growth of 1.5% in the previous month.

Regarding the core inflation structure, the July annual growth is due to the small rise in the prices of most categories within core inflation, with the highest contribution of tobacco prices[12], footwear, the prices in the category "furniture, household equipment and household maintenance" and transport prices.

Foreign effective food prices* and domestic food prices



* Foreign effective food prices are calculated as weighted sum of food prices in countries that are major trade partners with Macedonia.
Source: State statistical office, Eurostat and NBRM calculations.

External input assumptions for 2016, which are included in the inflation projection, have been revised in divergent directions...

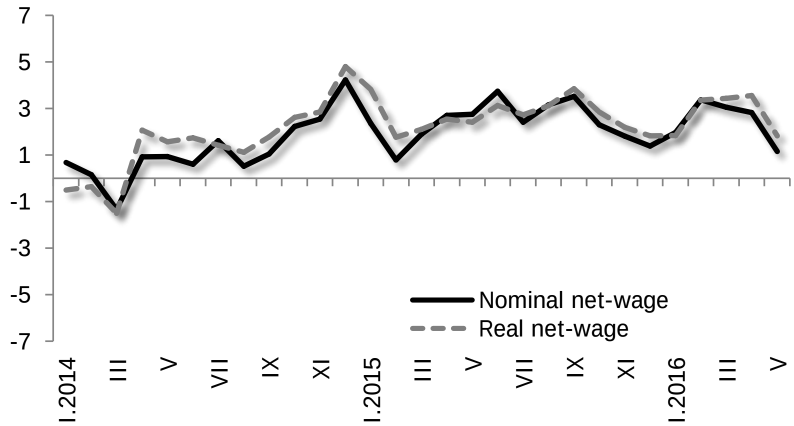
...amid minimal upward correction in oil prices, and downward correction of the expected price of wheat, corn, and foreign effective inflation.

However, the environment of low global prices is still present, thus it is not expected that the minimal upward correction in oil prices to create pressures on domestic price movement.

The domestic price performances in July, as well as the changes in the expected trajectories of exogenous variables, so far indicate little downward deviations from the inflation projection for 2016. **The risks with regard to the forecast for 2016** are mainly associated with the uncertainty about the expected movement in prices of primary commodities.

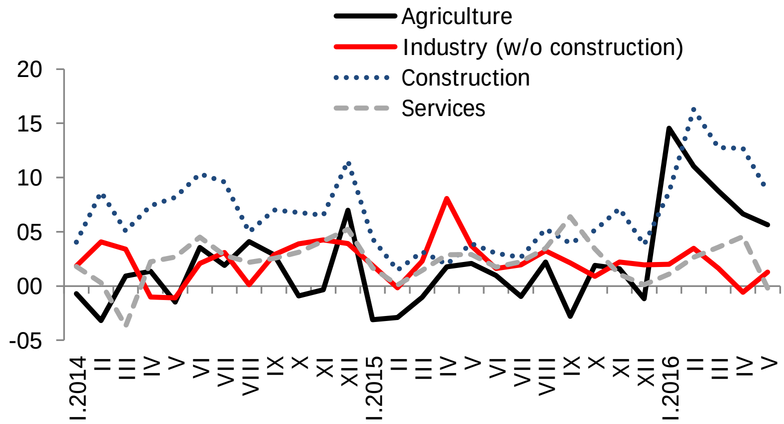
[12] The annual growth of tobacco prices in July is a combination of the flat increase in cigarette prices by five denars per box in March 2016 and increase in the price of a certain type of cigarettes in June 2016. In July 2016, the excise on cigarette additionally increased (from July 1, 2017 to July 1, 2023 the excise duty will increase by 0.20 denars each year), but the monthly change in prices of tobacco in July showed no price adjustments during this month.

Average net-wage
(annual changes, in %)



Source: SSO.

Average monthly net wage paid by sectors
(nominal annual changes, in %)



Source: SSO.

In May 2016, the average net wage registered nominal annual growth of 1.1%, which is a significant slowdown compared to the growth in the previous month (2.8%), but also in comparison to the annual growth in the first quarter, when net wages increased by 2.8%.

Analyzed by individual sectors, upward movement in wages in May was registered in most of the activities. The highest growth rates were recorded in construction, administrative and auxiliary service activities, as well as agriculture.

On the other hand, lower wages in May are paid in several service activities[13], which is the main reason for deceleration of the annual growth dynamics, while minimal fall is registered also in the wages in the energy sector.

Given the decrease in consumer prices, in May, the **real wages** increased by 1.8%.

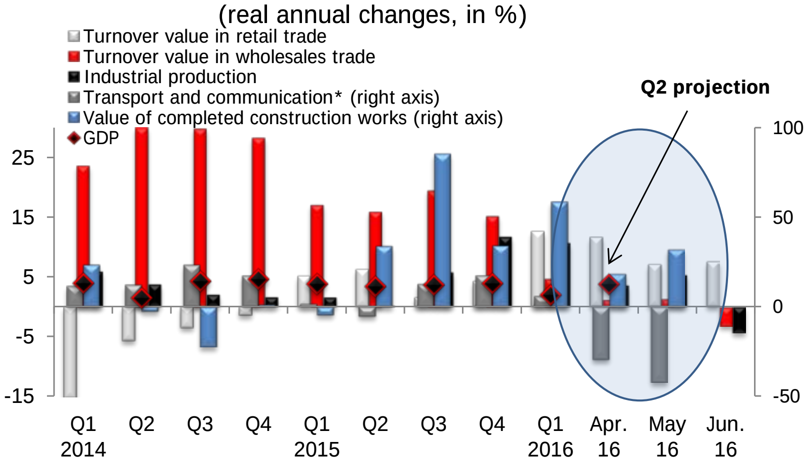
In the first two months of the second quarter, the net salary recorded nominal and real annual growth of 2% and 2.7%, respectively. The real wage growth is in line with the expected movement for the quarter as expected in the April projection, while a certain deviation is registered in the nominal wages (expected nominal annual growth of 2.7%).

High frequency data for the second quarter of 2016 point to growth of the domestic economy, but significantly slower compared to the previous quarter. Given these developments, which show a slower growth pace in the first half of the year than expected, and still present uncertainty about the economic effects of political developments in the country, the risks around the April projection for economic growth are unfavorable.

[13] Within the services sector lower wages in May were paid in "professional, scientific and technical activities", "art, sport and recreation", "activities related to real estate" and "activities of health and social care".

Economic activities

(real annual changes, in %)



*Simple average of annual growth rates of the different types of transport and the telecommunications.
Source: SSO and NBRM calculations.

In the second quarter, industrial output registered an average growth of 1.3%, which represents a significant slowdown compared to the first quarter, when the industrial output grew by 10.7%. The slowdown in the growth rate is a result of the downward deviations in all sectors, but it is most pronounced in manufacturing, where the positive contribution of the activity of some of the new facilities in this quarter is lower.

The small increase in the industrial activity in the second quarter entirely reflects the higher production in manufacturing, on the backdrop of a fall in the production in mining and energy sectors.

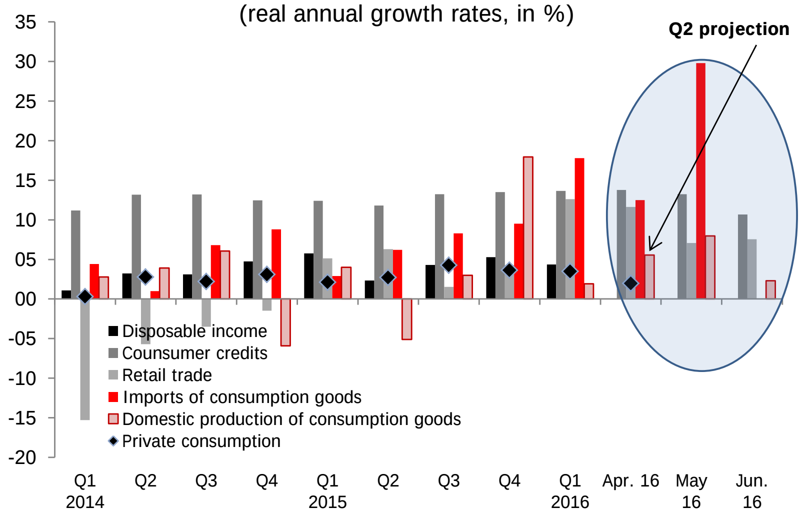
Analyzing the manufacturing industry, the manufacture of rubber, machinery and motor vehicles i.e. sectors of foreign export facilities, as well as some traditional sectors (manufacture of tobacco products, non-metallic minerals, beverages and food products) have made the greatest contribution to the growth.

In the second quarter, annual growth was registered also in the total **trade**, but at a slower pace due to slower growth in retail sale, as well as the annual fall in the trade of motor vehicles and wholesale trade.

Favourable developments in the **construction** sector continued also in April and May, registering a two-digit growth in the value of completed construction works, which was however, twice smaller than the growth in the previous quarter. Within the **catering services**, the available indicators (growth in the number of tourists, the number of overnight stays, the value of turnover) point to a growth in activity in the second quarter, but at a slower pace.

On the other hand, the available data for the **transport sector** (unfavorable trends in indicators related to rail road transportation in April and May) indicate possible deterioration in the developments in this sector during the second quarter.

Indicative variables for private consumption
(real annual growth rates, in %)



Source: SSO and NBRM calculations.

Available aggregate demand indicators mainly confirm the estimates for growth of economic activity in the second quarter of 2016, but at slower pace.

Most of the high frequency data on **private consumption** point to its further increase in the second quarter of 2016...

...supported by the favorable performances in the main disposable income components (higher real wages, pensions, social government transfers) and by the solid growth of household lending (although certain deceleration is evidenced).

Growth in household consumption in this period is also indicated by the solid growth in domestic production and the import of consumer goods, the increase in turnover in retail trade and the growth of net revenues from VAT.

Regarding the indicative private consumption categories, a decline was noticed only in private transfers, as a reflection of the uncertain domestic political environment which prevailed in this period.

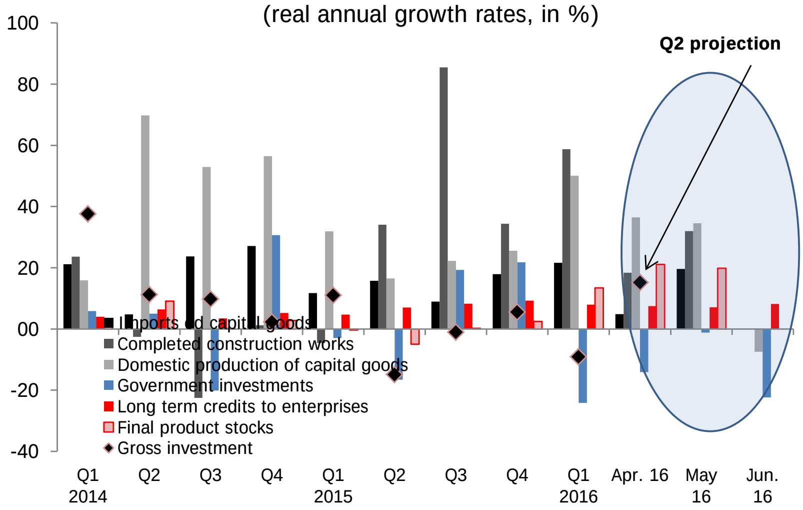
Available short-term indicators of **investment activity** point to an annual growth of investments in the second quarter of 2016.

Such statement is underpinned by the positive signals in both most important indicative categories for investments in fixed assets, i.e. completed construction works and the import of machinery and equipment (two-digit increase in both categories, but more moderate compared to the previous quarter)...

...as well as the rapid growth of long-term lending to the corporate sector.

The data on domestic production of capital goods give signals for higher investment activity, given high annual growth, but at a slower pace compared to the previous quarter. Growth was registered also in

Indicative variables for investments
(real annual growth rates, in %)



Source: SSO and NBRM calculations.

inflows based on foreign direct investment.

Concerning the movement of stocks, the index of stocks of finished products in industry in April and May was higher on an annual basis, indicating possible growth of this gross investments' category during the second quarter of the year.

Among the indicative categories for the investment trends, the only unfavorable performance was registered in the government capital expenditures[14], which are reducing, but at slower pace.

The nominal data on **the balance of trade of goods according to the foreign trade statistics** in the second quarter of 2016 indicate to widened deficit, which does not correspond to the April projection, where slight narrowing is envisaged...

...given the higher increase in imports compared to exports of goods.

The budget performances in the second quarter, indicate small decline in **public consumption**, contrary to the expectations for growth as projected in April...

...given the severe decrease in the expenditures for goods and services.

On the other hand, expenditures for wages for the employees in the public sector and health care transfers increased[15], but at a slower pace compared to the annual growth registered in the previous quarter.

[14] It should be kept in mind that the government capital investments refer to capital expenditures of the central government, not to the public enterprises through which most of the major infrastructure projects are realized.
[15] Most of these assets refer to expenditures for goods and services.

During the second quarter, the intensified growth of imports compared to exports led to an **increase in the foreign trade deficit by 12.2 % on an annual basis**...

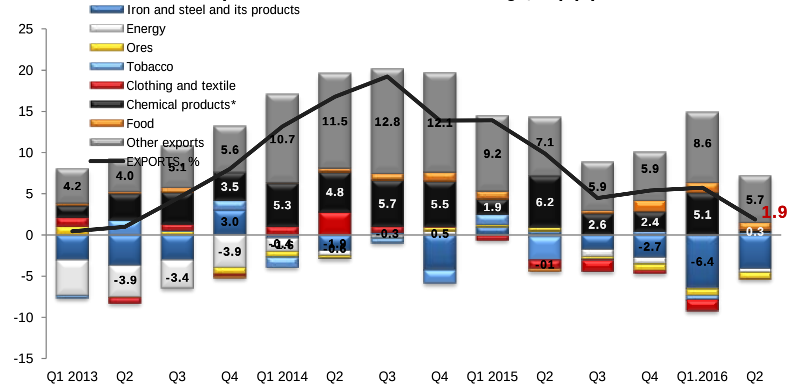
...contrary to April projection, which envisaged narrowing of the trade deficit.

The **export** of goods in the second quarter registered an annual growth of 1.9%, with higher export of new production facilities, and to a lesser extent, to higher exports of food...

...the trends which were largely neutralized by lower export of iron and steel and mining.

Compared to the April projection, the realized export in the second quarter was lower than expected, with more pronounced negative deviations in one industrial capacity in foreign ownership, as well as in the export of tobacco and clothing and textiles.

Exports by components
(contributions to the annual change, in p.p.)



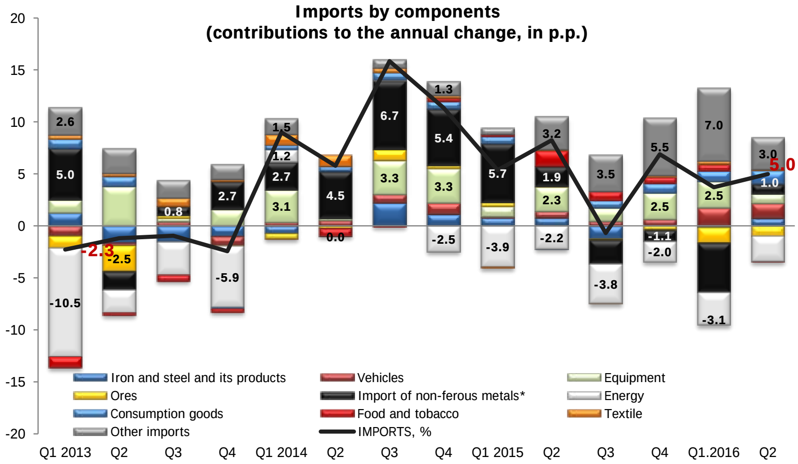
Source: NBRM.
** The following data depict the overall exports of one major export capacity in the free industrial zone.*

In the second quarter, the **imports** rose by 5% on an annual basis, as a result of the increase in raw materials imported for the new facilities, as well as in the import of vehicles and consumer goods...

...while the import of energy continued decreasing.

Imports in the second quarter were slightly higher than expected in April projection. Considering by individual categories, this deviation is due to "other imports", the import of vehicles and the import of iron and steel, amid prominent downward deviation in the import of raw materials for some of the new facilities in the economy compared to the projection.

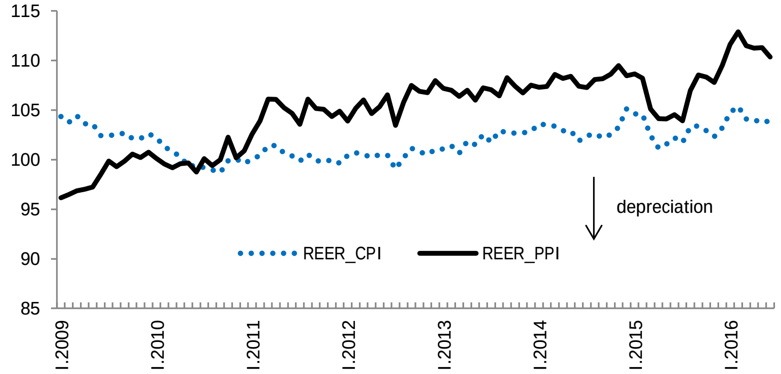
Imports by components
(contributions to the annual change, in p.p.)



Source: NBRM.
** The following data depict the overall imports of one major export capacity in the free industrial zone.*

Performance in the foreign trade components in the second quarter of 2016 show a trade deficit that is higher than expected for the second quarter according to the April projection.

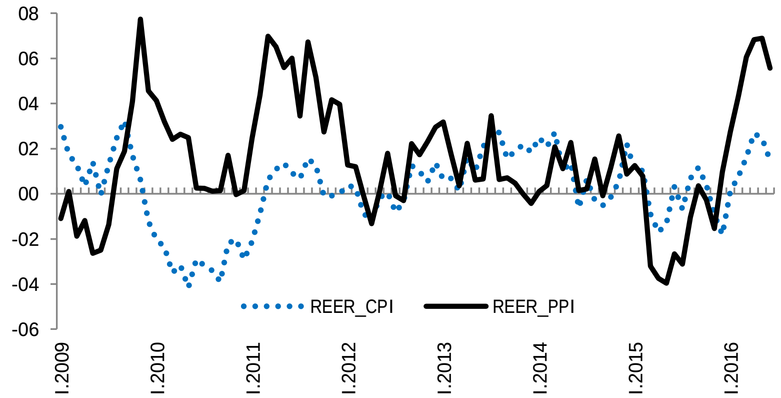
REER
(2010=100)



Source: NBRM.

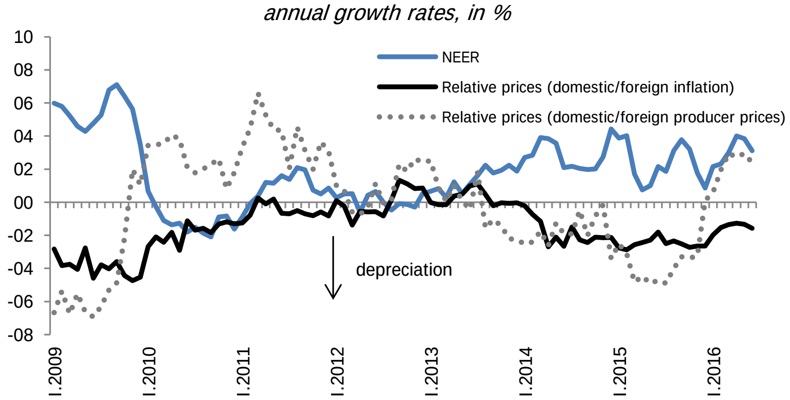
In July 2016, the REER, as an indicator of change in the price competitiveness of the local economy, appreciated on annual basis. The REER index deflated by consumer prices appreciated by 1.5%, while the REER index deflated by producer prices registered a more pronounced appreciation of 5.6%[16].

REER
annual changes, in %



Source: NBRM.

NEER and relative prices
annual growth rates, in %

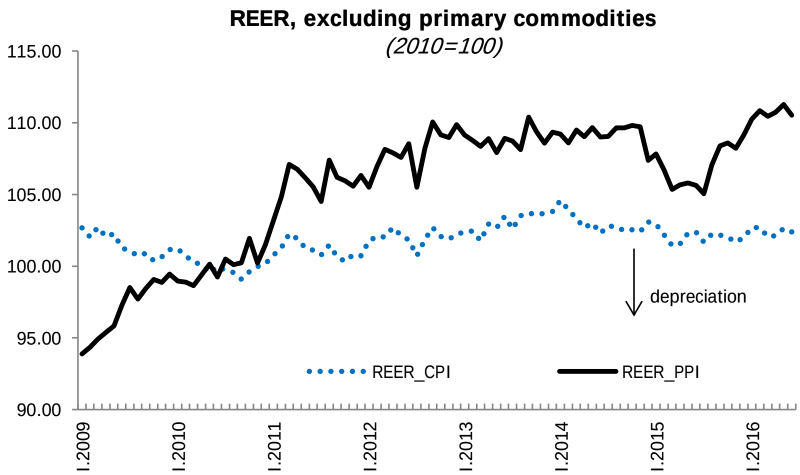


Source: NBRM.

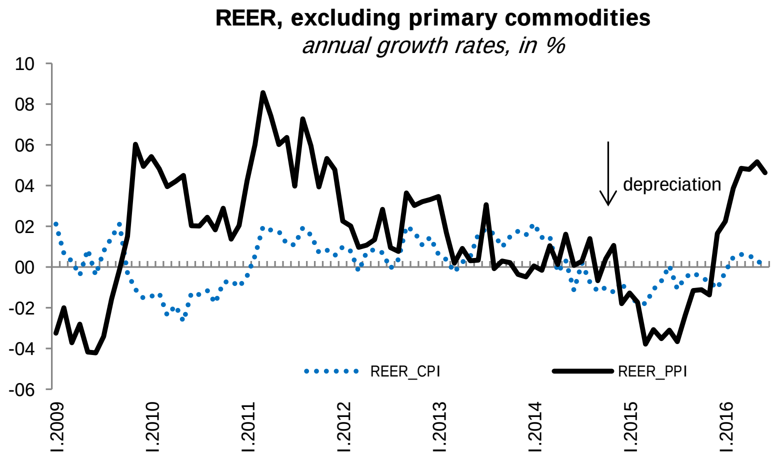
These developments are partially due to the NEER dynamics, which appreciated by 3.1% on an annual basis, as a result of the depreciation of the Russian ruble, the British pound and the Turkish lira against the Denar. Additionally, the relative prices of industrial products increased by 2.4%, while the relative consumer prices decreased by 1.6%.

The analysis of the movement of the REER indices, calculated using weights based on the foreign trade

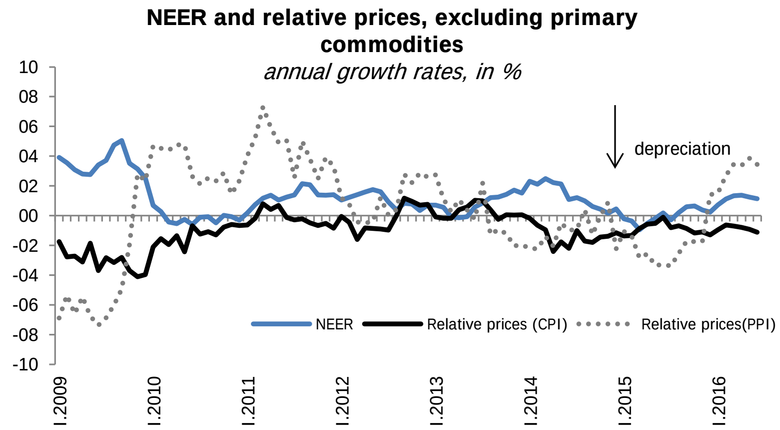
[16] The appreciation through relative prices of the producers of industrial products may be overestimated. Namely, unlike the foreign prices which dropped, the domestic prices during 2016 stagnate. But it should be kept in mind that the weight structure of the domestic index does not include yet the latest changes in the structure of domestic production, as a result of which probably, the picture of price changes through this index is not entirely appropriate to the actual changes.



Source: NBRM.



Source: NBRM.

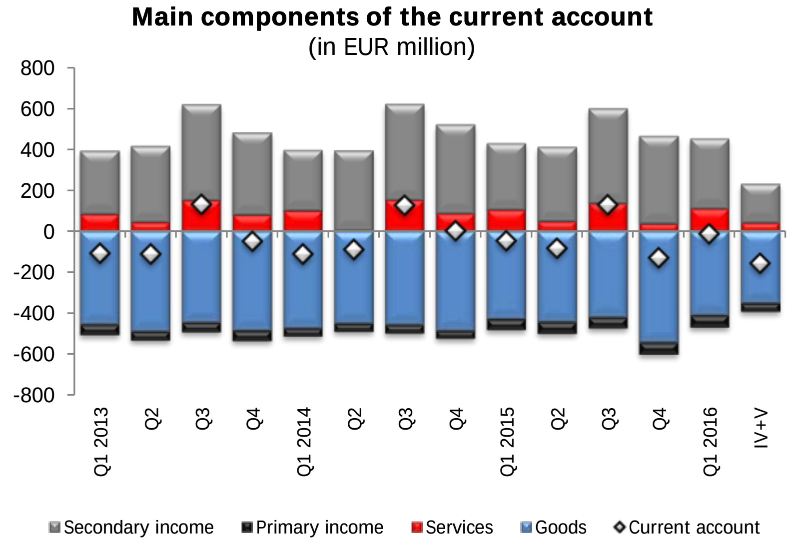


Source: NBRM.

excluding primary commodities[17] **also shows appreciation, especially evident in the index based on price of industrial products.** Namely, in June, the REER deflated by the prices of industrial products appreciated by 4.6% on an annual basis, while the change in REER deflated by consumer prices is negligible and close to 0%.

On an annual basis, relative consumer prices fell by 1.1%, while the relative prices of producer prices increased by 3.5%. The NEER appreciated by 1.1% on an annual basis.

[17] Primary commodities not included in the calculation are: oil and oil derivatives, iron and steel, ores and imported raw materials for the new industrial facilities in the free economic zones.

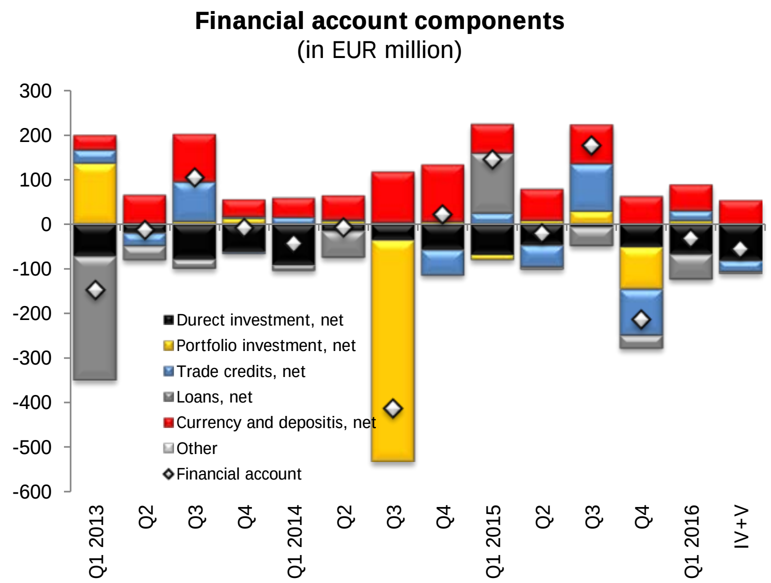


Source: NBRM.

In April and May 2016, the balance of payments' current account registered a deficit of Euro 155.6 million (or 1.6% of GDP), which is higher than forecasted in April for the second quarter.

In terms of individual components, this performance is largely due to significantly lower surplus in secondary income, larger deficit in trade of goods, driven by major import pressures, as well as higher deficit in primary income compared with the April projection. On the other hand, the balance of the trade of services registered favorable movements, amid higher surplus than expected.

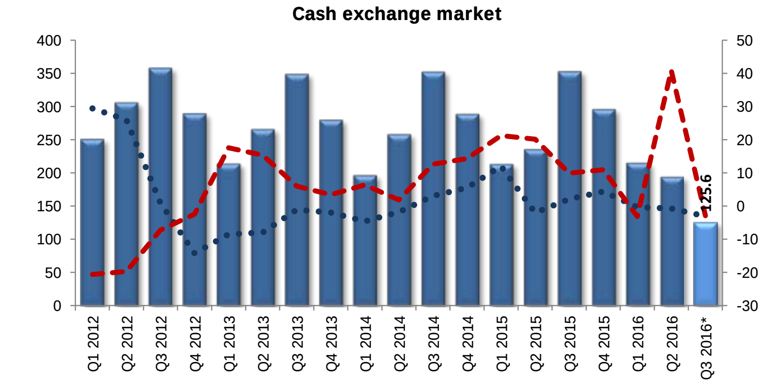
In April and May 2016, the financial account registered net inflows of Euro 54.6 million (or 0.6% of GDP), which do not differ significantly from the expectations for the second quarter according to the April projection[18].



Source: NBRM.

Divergence from the April projection is evident in loans, where contrary to expectations of higher net inflows, in April and May almost neutral flows were realized (mainly due to lower withdrawals in state and public enterprises) and the currency and deposits category (significantly higher outflows in other sectors of the economy, and higher inflows of depository institutions). The realization regarding direct investments are sound and higher than projected, with the positive achievements also being recorded in trade credits, which produced net inflows, contrary to the expected small net outflows according to the April projection.

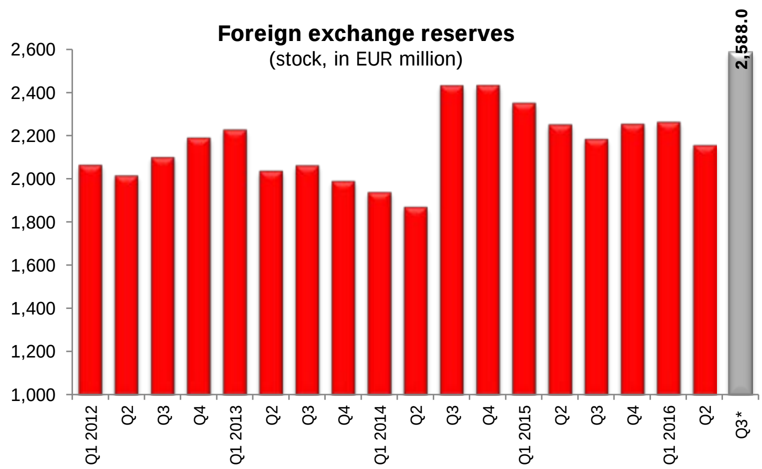
[18] According to the new methodology for compilation of the balance of payments (BPM6), the terms "net inflows" and "net outflows" denote net incurrence of liabilities and net acquisition of financial assets, respectively.



*Last available data 31.07.2016.

Source: NBRM.

Following the annual increase in net purchase of foreign currency on the currency exchange market in June, in July 2016, it dropped. Moreover, during this month the demand for foreign currency continued to fall, signaling reduced pressures on the currency exchange market, pronounced in April and May, and caused by non-economic factors. The net purchase on the currency exchange market in July totaled Euro 125.6 million, which is an annual decrease of 3.2%, given lower supply of foreign currency. In this period, annual decrease in the demand for foreign currency is also registered.

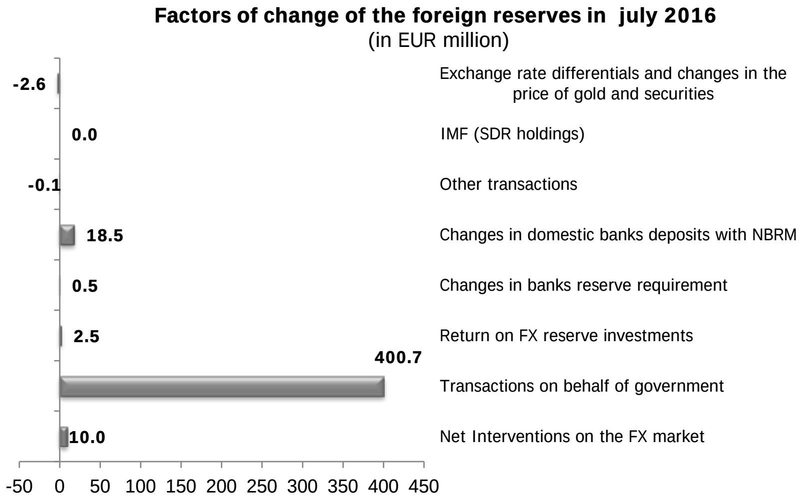


Source: NBRM.

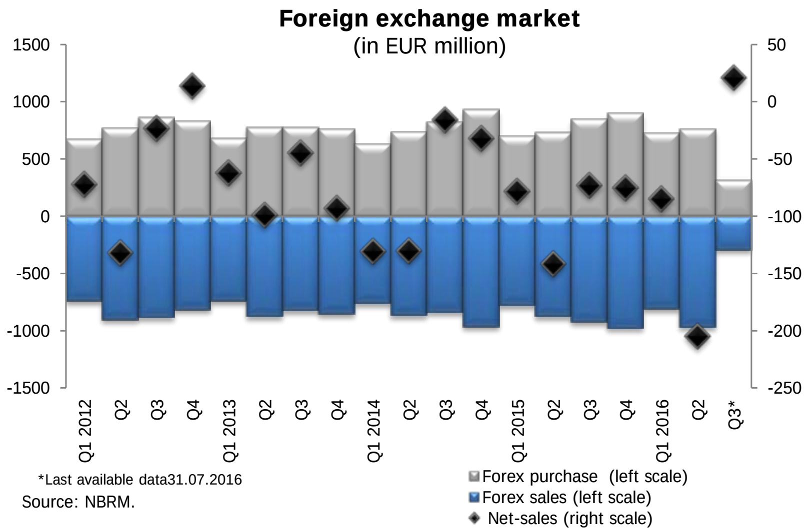
As of 31 July 2016, the gross foreign reserves stood at Euro 2,588.2 million, which is an increase of Euro 429.4 million compared to the second quarter of 2016. The increase in foreign reserves mainly arises from transactions on behalf of the government, i.e. the issued Eurobond[19], as well as from the foreign currency deposits of domestic banks with the NBRM[20] and the NBRM interventions on the foreign exchange market, which acted towards increase in the foreign reserves through the realized net purchase. The other transactions have no significant influence on the foreign reserves amount.

[19] On 26 July 2016 the government issued the fifth Euro bond in the amount of Euro 450 million, with maturity of seven years and interest rate of 5.625%.

[20] The growth of foreign currency deposits of domestic banks with the NBRM stems from the Decision on foreign currency deposit with the National Bank of the Republic of Macedonia, adopted on 6 May 2016, which allows interest rates to be determined at a level higher than the level of interest rates which domestic banks receive in placing funds in euros abroad.



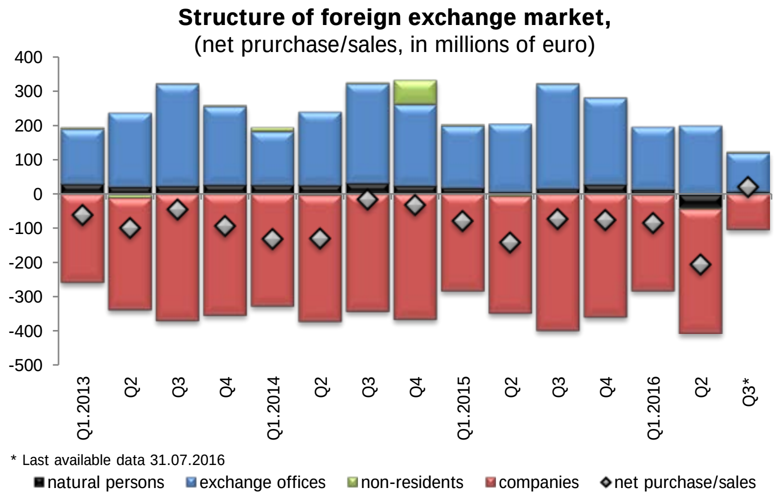
Source: NBRM.



*Last available data31.07.2016

Source: NBRM.

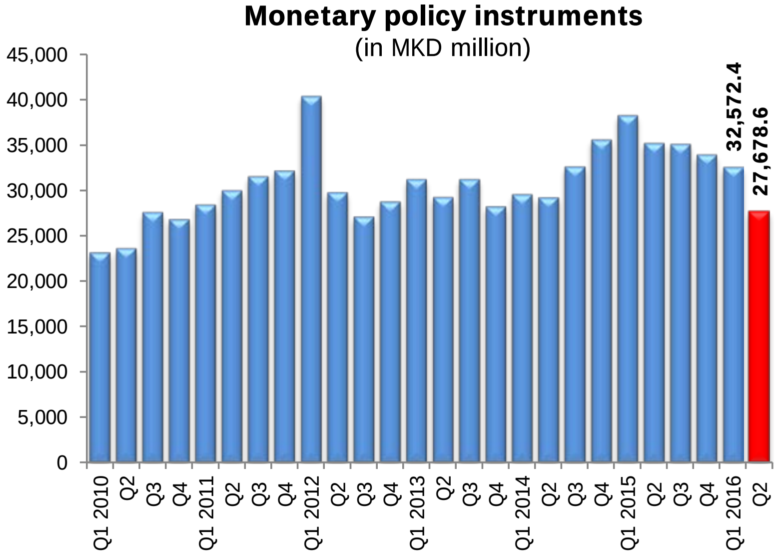
In July 2016, on the banks' foreign currency market net, purchase of Euro 21 million was realized, which is an increase of Euro 33.9 million on an annual basis (in July 2015 a net sale of Euro 12.9 million was realized). This annual change was mostly due to declining demand for foreign currency (by 7.4%) amid a slight increase in the supply of foreign currency (3.4%).



* Last available data 31.07.2016

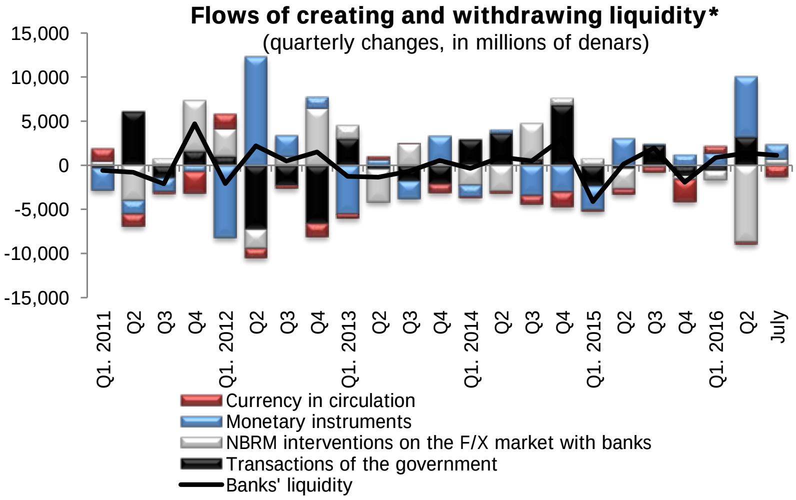
Source: NBRM

Sector-by-sector analysis shows that such annual performance is mostly a result of the reduced net sales of the bank-company segment.



Source: NBRM.

Flows of creating and withdrawing liquidity*
(changes, in millions of denars)



*Positive change- liquidity creation, negative change- liquidity withdrawal
Source: NBRM.

Data as of June indicate liquidity creation through monetary instruments relative to the end of the first quarter, contrary to the expected small withdrawal for the second quarter, as projected in April.

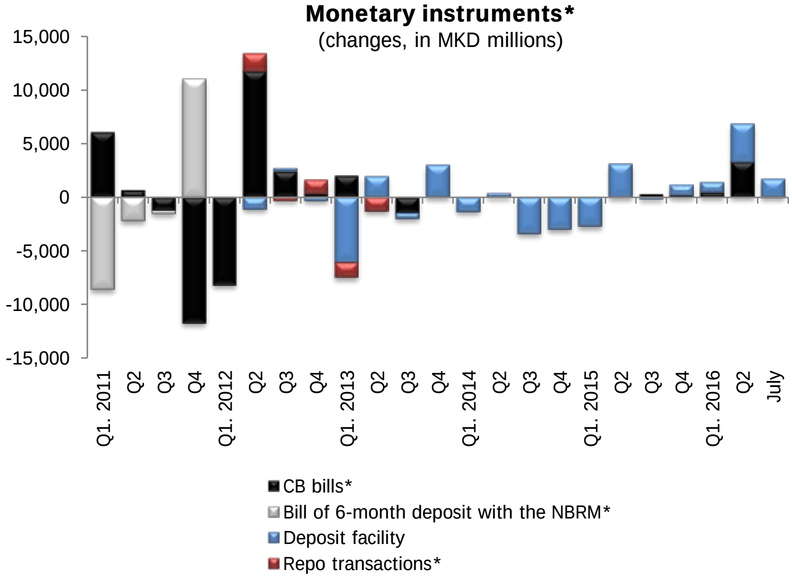
The analysis of the flows of liquidity creation and withdrawal from the balance sheet perspective in the second quarter suggests significant withdrawal of liquid assets through the NBRM net foreign assets, which declined contrary to the expectations for a small increase in the second quarter. These developments mainly reflect the interventions of the NBRM to stabilize the situation on the foreign exchange market at present pressures on the demand for foreign currency, caused by the political crisis. On the other hand, total government deposits with the NBRM in June decreased, more than expected for the second quarter.

In June reserve money are higher compared to the end of the first quarter, which is in line with expectations for the second quarter of the year, but with a slightly higher intensity.

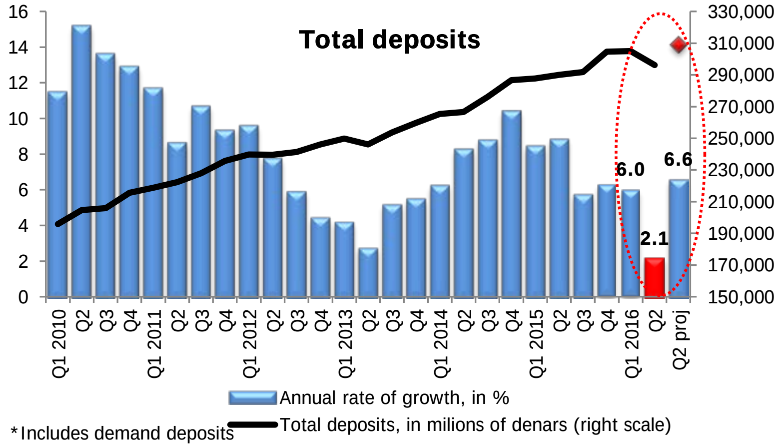
Taking into account the changes in the individual balance sheet components and their deviations from the forecast, the lower than expected level of monetary instruments, from the balance sheet aspect, is explained by the deviation in net foreign currency assets.

According to the operational data, the liquidity of the banking system in July increased. Analyzing by individual factors, the monetary instruments, the foreign currency transactions of the National Bank with the market makers, as well as the government transactions, acted towards liquidity creation, while the currency in circulation acted towards liquidity withdrawal from the banking system.

Monetary instruments*
(changes, in millions of denars)



*Positive change- liquidity creation, negative change- liquidity withdrawal
Source: NBRM.

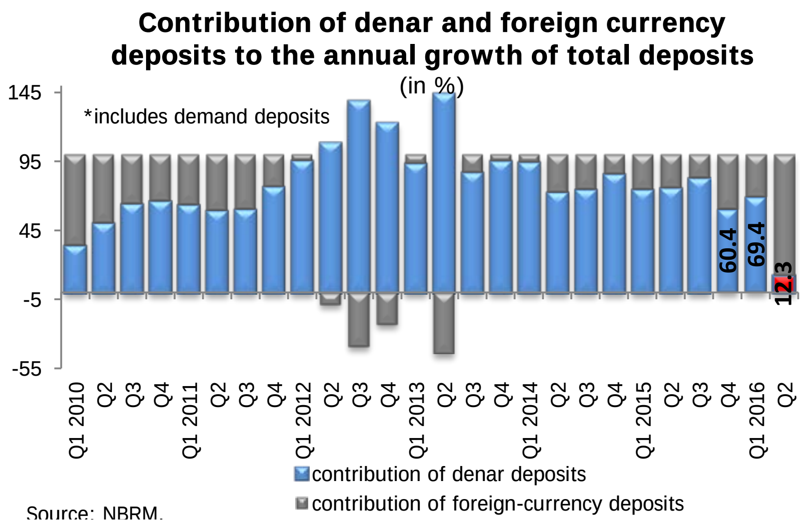


*Includes demand deposits
Source: NBRM.

Total deposits continued to decrease also in June, but twice slower than in the previous month. Namely, after the significant fall in April, as a result of the deteriorated political situation in the country, the deposit base began stabilizing gradually from the end of May and June. Analyzed by sectors, the fall fully arises from the decrease in the corporate deposits, amid moderate growth of household deposits and other financial institutions[21]. The increase in the household deposits, although moderate, is, however, important indicator that shows significant stabilization in the expectations of the economic entities.

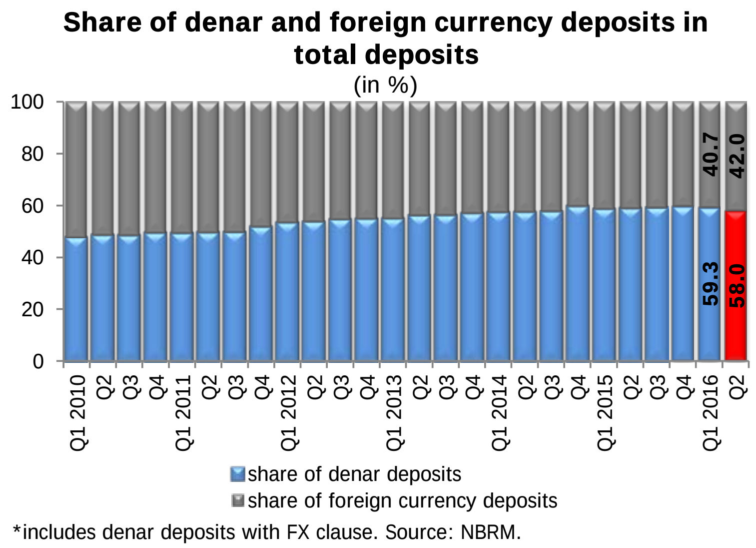
In June, the annual growth rate of total deposits equaled 2.1%, which is below the growth of 6.6% for the second quarter of 2016, as forecasted in April.

[21] Other financial institutions include investment funds, pension funds, insurance companies, investment funds management companies and pension funds management companies, financial companies and leasing companies.

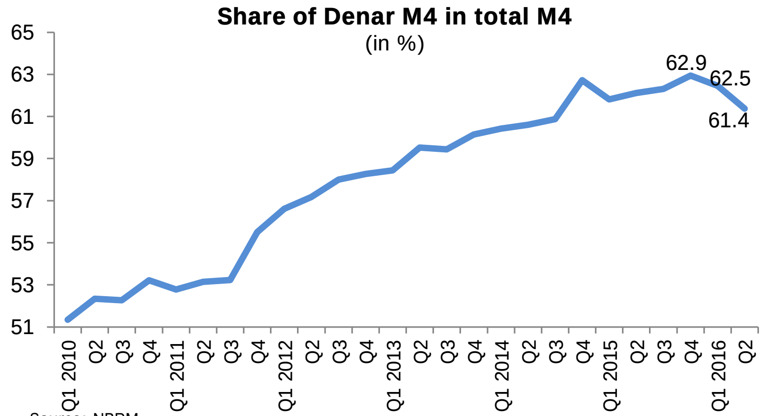


*Includes demand deposits.

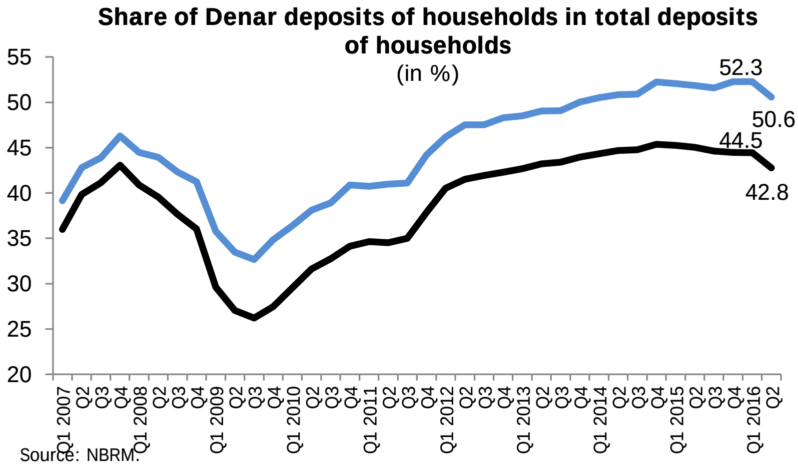
In terms of currency structure of deposits, the denar deposits have positive contribution to the annual growth of total deposits also in June, but with reduced intensity and exclusively due to the growth of demand deposits. The foreign currency savings continued to grow on annual basis also in June, and its contribution to the annual growth of total deposits strengthened.



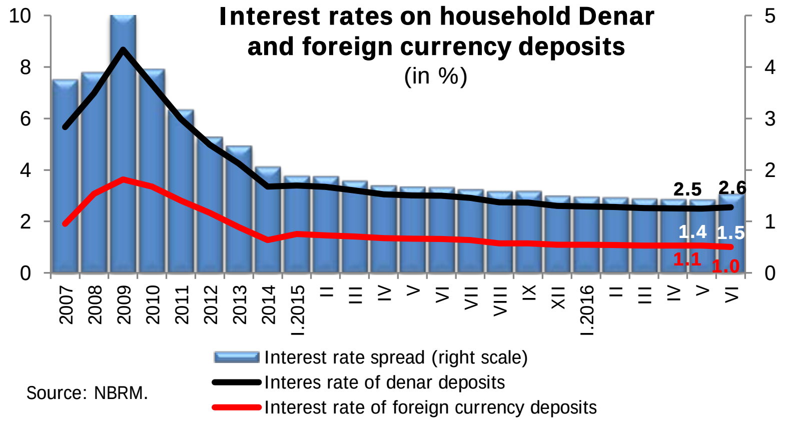
Despite these developments, the share of denar deposits in the total deposits in June remained relatively stable compared to the previous month. Denar deposits dominated in the banks' deposit base.



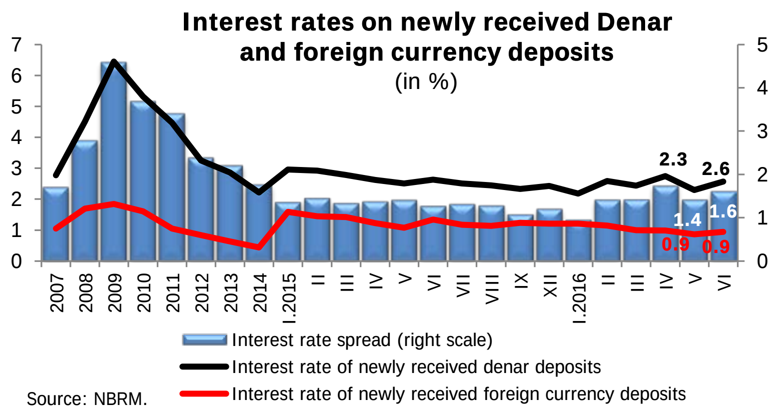
Source: NBRM.



Source: NBRM.



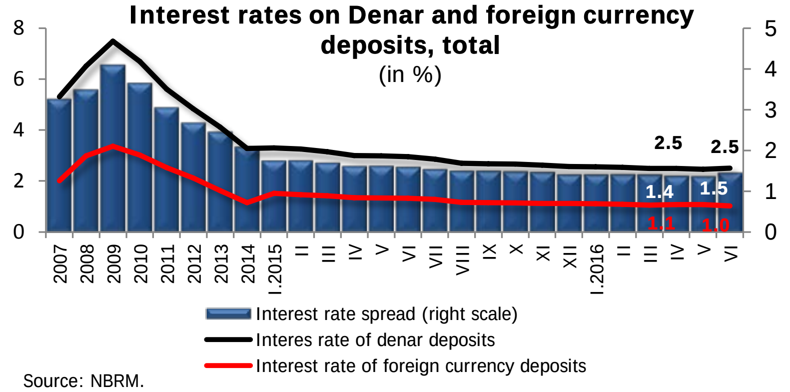
Source: NBRM.



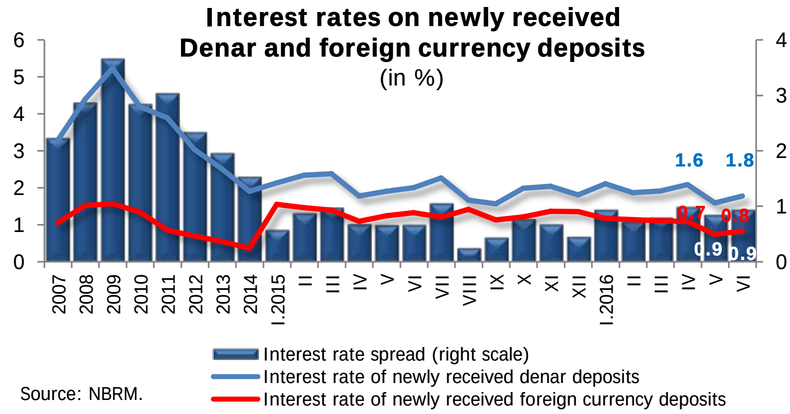
Source: NBRM.

The household deposits in June registered a moderate growth compared to the decrease in the previous two months. By currency, the increase in household deposits is completely due to the growth in foreign currency deposits, amid further decrease in the denar deposits. This led to a further reduction of the share of denar deposits in total household deposits.

In June, the interest rate spread between denar and foreign currency interest rates on household deposits increased compared to the previous month, for the first time since 2011. This results from the increase in the interest rate on denar deposits, given simultaneous decrease in the interest rates on foreign currency deposits. Interest spread of newly received deposits has widened as a result of the more pronounced rise in the interest rate on denar deposits, amid unchanged interest rate on foreign currency deposits. These changes in the interest rate spreads are consistent to the current changes in the monetary instruments aimed at stimulating the savings in domestic currency.

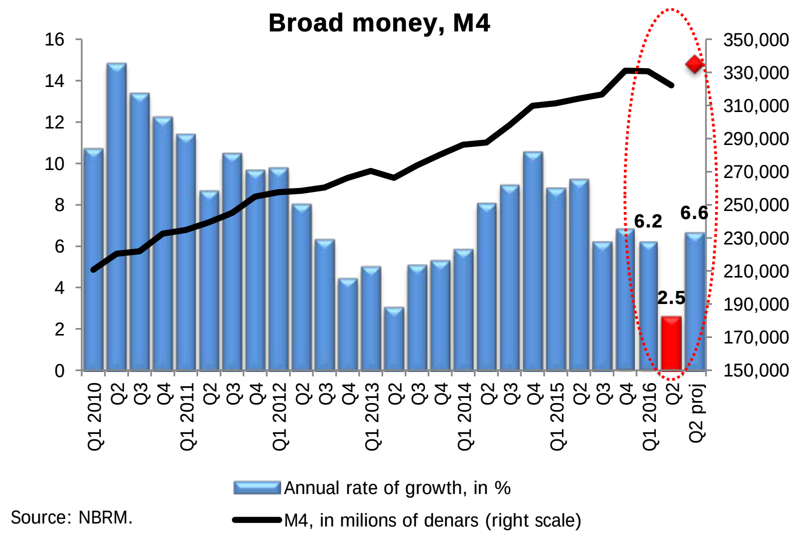


Source: NBRM.



Source: NBRM.

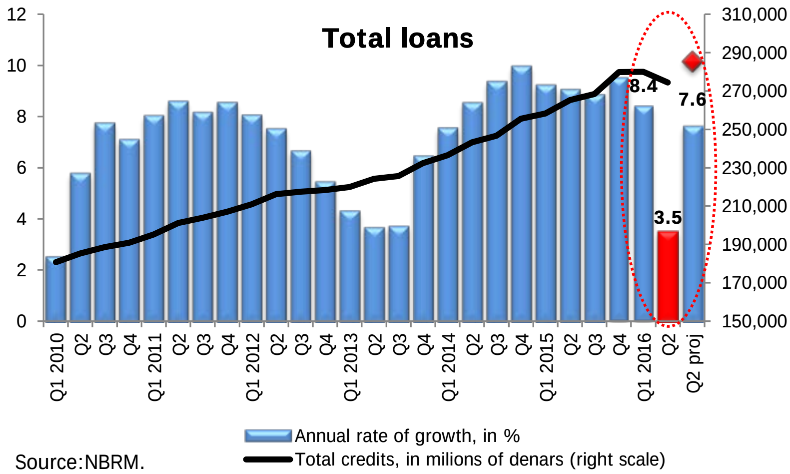
Regarding the total interest rates, in June, there was a slight decrease in the interest rate of foreign currency deposits, given unchanged interest rate on denar deposits relative to the previous month. In June, the interest rates on newly accepted deposits registered simultaneous increase in the interest rates on both denar and foreign currency deposits, but with greater intensity in the denar deposits. However, note that the interest rates on newly accepted deposits are volatile[22], possibly resulting in frequent and temporary adjustments of the interest spread.



Source: NBRM.

During June, broad money M4 decreased on a monthly basis, but less intensively compared to the previous month. The fall in the money supply is fully due to the decrease in the total deposits, given moderate increase in the currency in circulation. **On annual basis, the broad money have increased by 2.5%, which is below the forecasted growth of 6.6% for the second quarter of 2016.**

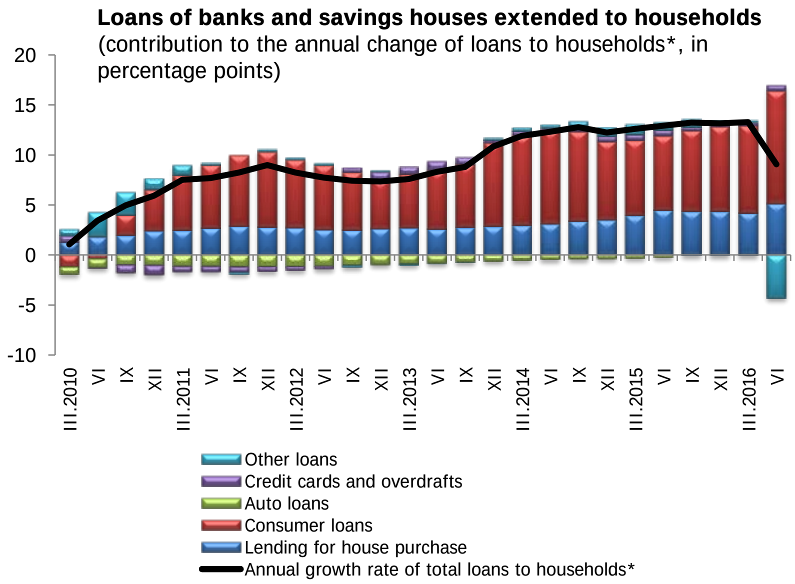
[22] Volatility of interest rate on newly accepted deposits results from the fact that they have been driven by the volume of newly received deposits (which can vary from month to month) and their interest rate.



Source:NBRM.

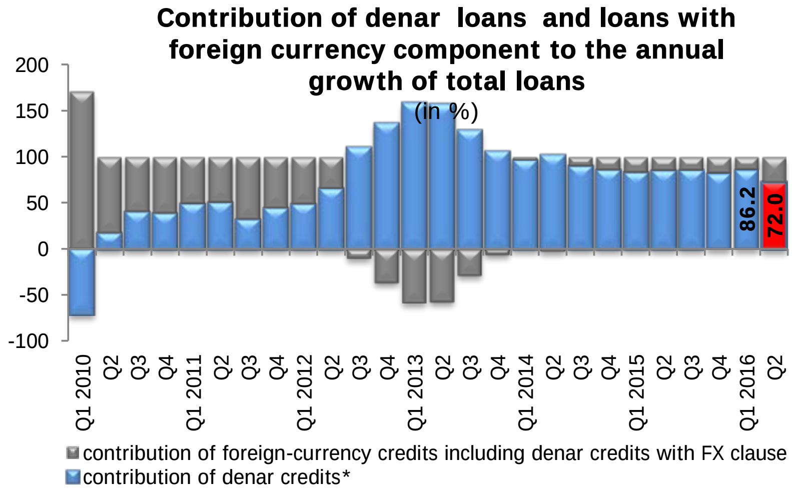
The loans in June registered a decrease of 1.9% compared to the previous month, fully as a result of the regulatory changes, in line with the NBRM decisions adopted in December[23]. If we exclude this effect, the loans of the private sector register solid monthly growth of 1.5%

At the end of June, the annual growth rate of total loans equaled 3.5%, while if we exclude the effect of the regulatory changes, it equals 8.5% and is over the projected annual growth of 7.6% for the second quarter of 2016, as forecasted in April. In the period from April to June, the level of total loans decreased as a result of implementation of the new regulation, but without this effect the new credit flows register a solid quarterly increase of Denar 7,726 million.



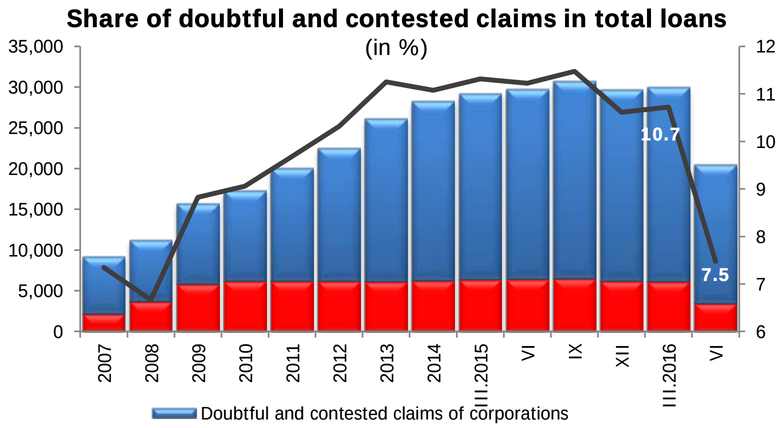
*Total loans to households do not include loans to self-employed individuals. Source: NBRM.

[23] On 17 December 2015, the National Bank Council adopted the Decision amending the Decision on credit risk management, which requires from banks, for the period from 1 January 2016 through 30 June 2016, to write-off any claim that has been fully provisioned for more than two years, and where the bank identified and fully covered the credit risk of default at least two years before.



* does not include Denar credits with FX clause. Source:NBRM.

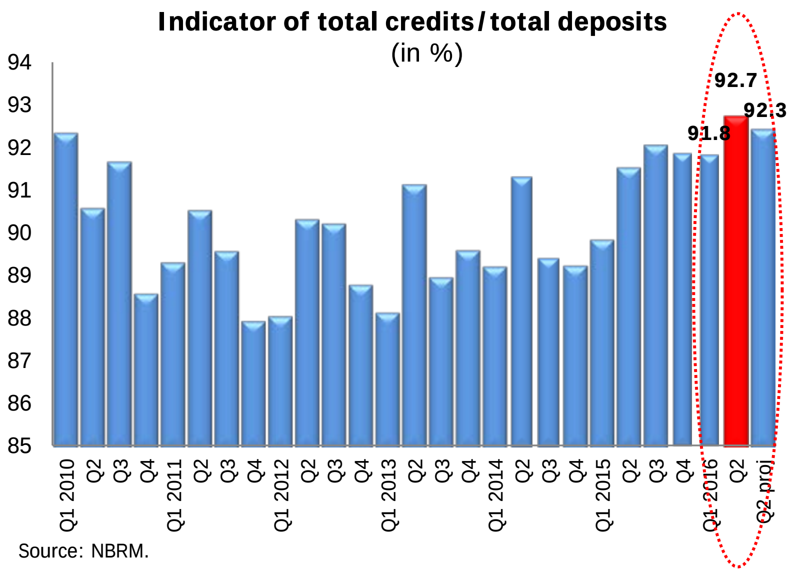
The annual rise in the total loans mostly results from the denar loans[24] and denar loans with FX clause, while the foreign currency loans registered a decrease.



Source: NBRM.

The share of doubtful and contested claims in total loans in June decreased significantly and reduced to 7.5%, or 2.6 percentage points compared to the previous month. The realized decrease is mainly due to the transfer of the doubtful and contested claims, which were fully provisioned for more than two years, to the off-balance sheet record. Analyzed by sector, the reduction in doubtful and contested claims is present in both, households and enterprises.

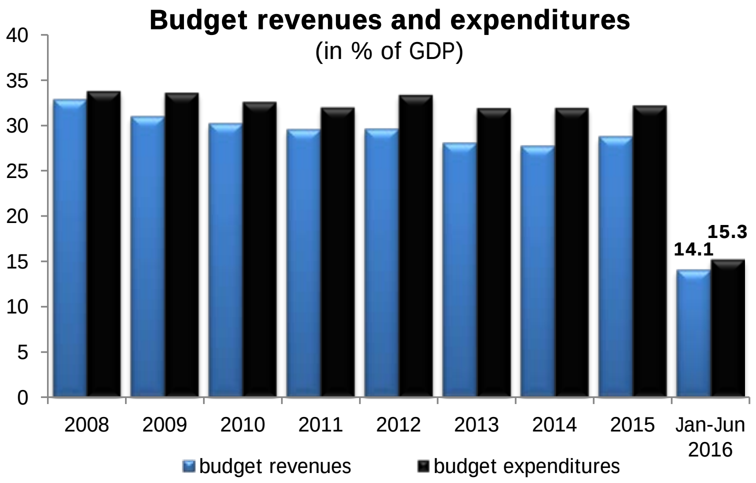
On an annual basis, the total non-performing loans in June registered a significant decrease of 3.8 percentage points compared to the same period of the previous year.



Source: NBRM.

Utilization of the deposit potential for lending to the private sector as measured by the loan-to-deposit ratio amounted to 92.7% in June and is higher than the April projection. Compared to the previous month, the same indicator decreased by 1.5 percentage points. Excluding the effect of the write-off, the loan-to-deposit indicator equaled 97.1%, which is by 4.8 percentage points above projections for the second quarter of the current year.

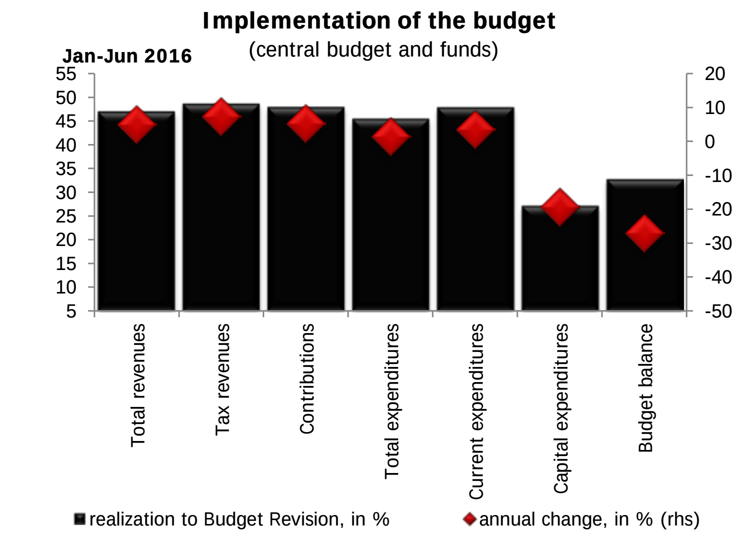
[24] Includes denar loans without FX clause, accrued interest and doubtful and contested claims.



Source: Ministry of Finance and NBRM's calculations.

In the period January - June 2016, the Budget of the Republic of Macedonia (central budget and budgets of funds) generated total revenues of 14.1% of GDP[25] (13.9%in the same period of the previous year. On an annual basis, the total budget revenues increased by 5%, which largely results from the higher realization in taxes, and to a lesser extent from contributions. Analyzed by individual tax category, the increase is predominantly driven by the annual growth of inflows based on VAT and excise, while the profit tax acts in opposite direction.

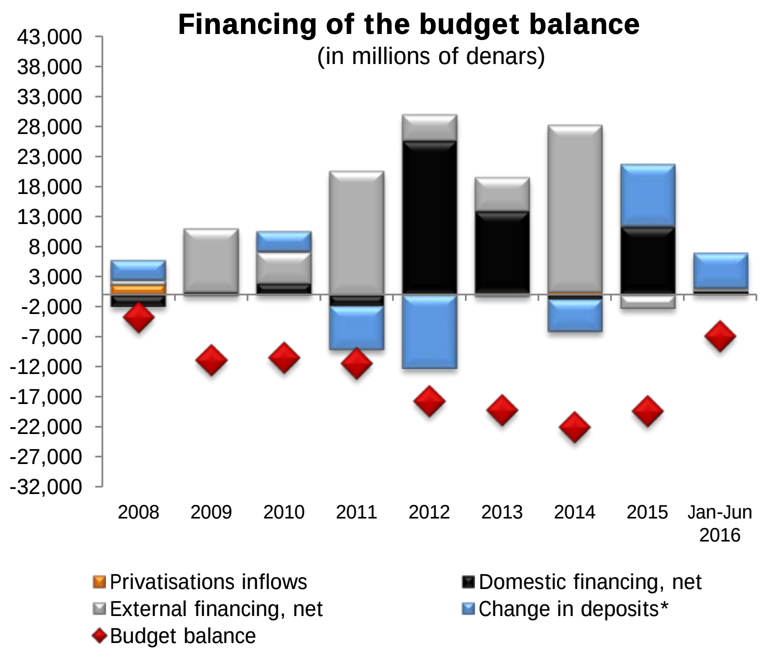
In January - June 2016 period, the total budget expenditures accounted for 15.3% of GDP, down by 0.3 percentage points compared to the same period of the previous year. If analyzed on annual basis, the budget expenditures increased by 1.5%, which fully arises from the higher current expenditures. The capital expenses continue to register annual decrease.



Source: Ministry of Finance and NBRM's calculations.

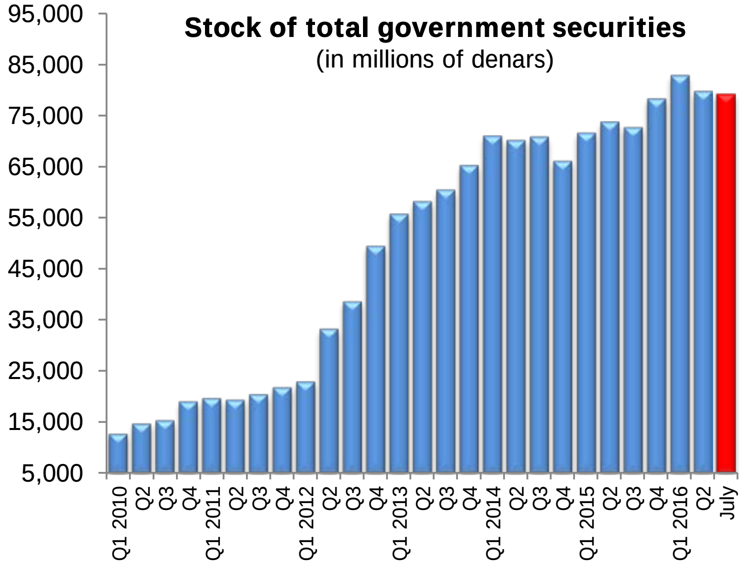
In the period January - June, the realized budget revenues constituted 47.1% of the revenues projected for the entire 2016, according to the Budget Revision for 2016[26]. Within the main categories of the budget revenues, the total taxes[27] and contributions registered realization of 48.7% and 47.9%, respectively. In terms of expenditures, as of June, 45.5% of planned expenditures for 2016 were realized, with the highest realization being registered in current expenditure (47.9%). Realization of capital expenditure is considerably lower, at 27.2% of the annual plan for 2016.

[25] The analysis uses the NBRM April forecasts for the nominal GDP for 2016.
[26] On 29 July, the Parliament of the Republic of Macedonia passed the Budget Revision for 2016.
[27] It includes tax revenues (SSP).



* Positive change- deposits withdrawal; negative change-deposits accumulation.
Source: MoF.

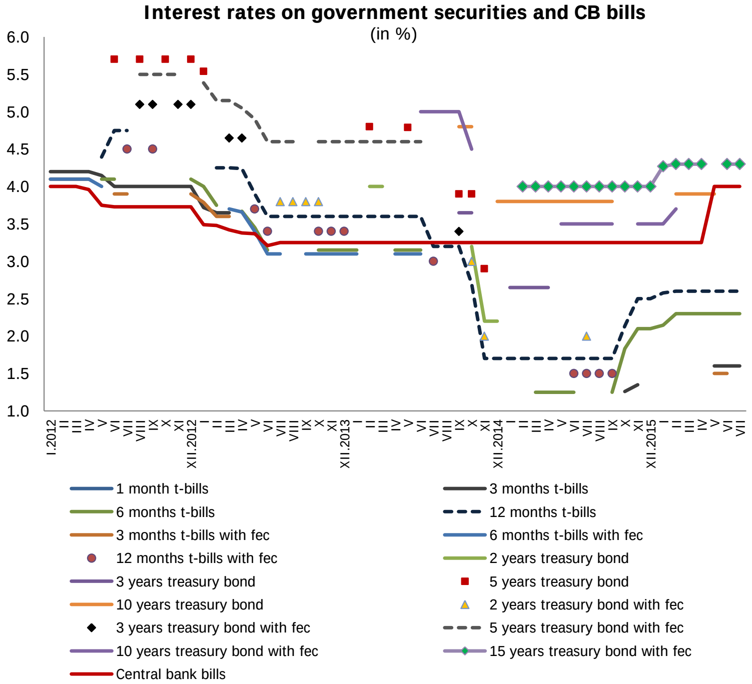
In the period January-June 2016, a deficit in the Budget of the Republic of Macedonia of Denar 6,947 million (or 1.2% of nominal GDP[28]) was registered, which constitutes 32.8% of the projected budget deficit according to the Budget Revision for 2016. The deficit was mainly financed through withdrawals of government deposits with the NBRM, and in small volume, by net-issuance of government securities and borrowing on the international financial markets.



Source: NBRM.

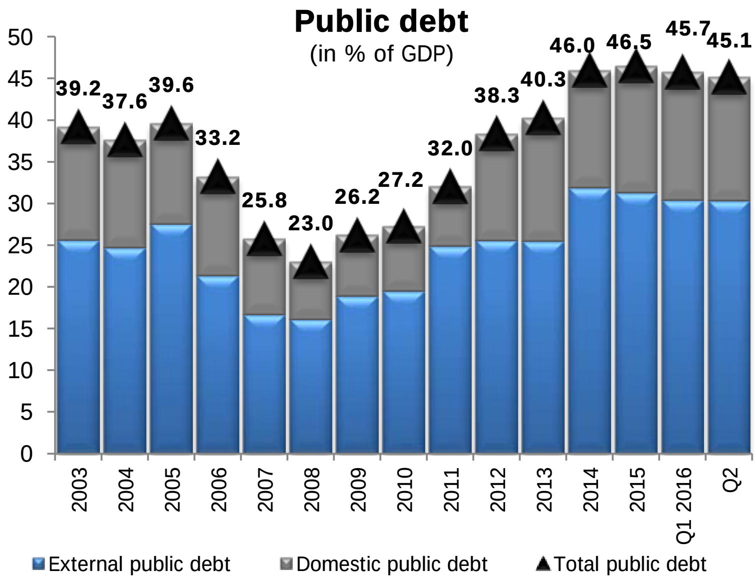
The stock of government securities amounted to Denar 79,237 million at the end of July, which is by Denar 557 million less compared to the end of the second quarter. On a cumulative basis, net amount of Denar 903 million of government securities has been issued since the beginning of 2016.

[28] The analysis uses the NBRM April forecasts for the nominal GDP for 2016.



Source: NBRM.

Interest rates on treasury bills offered at the auctions held in July amounted to 1.6%, 2.3% and 2.6% for 3-month, 6-month and 12-month treasury bills without currency clause, respectively. Interest rates on government bonds equaled 3.9% for 10-year government bonds without foreign currency clause and 4.3% for 15-year government bonds with currency clause. The interest rates on all government securities issued in July remain at the level of previous auctions.



Source: NBRM's calculations based on data from the Ministry of Finance.

According to recent data, as of 30 June 2016, the total public debt[29] equaled 45.1% of GDP, which is a slight fall of 0.6 percentage points of GDP compared with the end of the first quarter. The reduction fully stems from the registered decrease in domestic debt, which as of the end of June equaled 14.8% of GDP, while external debt remained at the level in the previous quarter (from 30.4% of GDP). The total government debt[30] at the end of the second quarter reduced to 36.8% of GDP (37.5% at the end of the first quarter), while the debt of public companies[31] stabilized at the level of 8.3% of GDP.

[29] The public debt is defined under the Law on Public Debt (Official Gazette of the Republic of Macedonia No. 165/14) , according to which it is the sum of the government debt and the debt of public enterprises established by the state or municipalities, municipalities within the city of Skopje and the city of Skopje, and companies that are entirely or predominantly owned by the state or by the municipalities, the municipalities within the city of Skopje and the city of Skopje, for which the Government has issued a state guarantee.
[30] Government debt is defined as a sum of debts of the central and the local government.
[31] Refers to guaranteed debt of public enterprises and joint stock companies owned by the state, according to the public debt definition under the Law on Public Debt (Official Gazette of the Republic of Macedonia No. 165/14) was submitted.

Annex 1 Timeline of the changes in the setup of the NBRM monetary instruments and selected supervisory decisions adopted in the period 2013 - 2016

January 2013

- A Decision amending the Decision on the reserve requirement (adopted in November 2012) came into force, allowing reduction of the reserve requirement base of banks for the amount of new loans to net exporters and domestic producers of electricity, as well as for the investments in debt securities in domestic currency without a currency clause, issued by the aforementioned companies. This decision fully exempts the banks from allocating reserve requirement for liabilities based on debt securities issued in local currency with an original maturity of at least two years. The Decision will apply throughout 2014, after which, depending on the results, the need for further application will be reconsidered.

- A Decision on reducing CB bill interest rate was adopted to cut the policy rate from 3.75% to 3.5%. At the same time, the interest rate on seven-day deposit facility and on overnight deposit facility was cut from 2% to 1.75% and from 1.0% to 0.75%, respectively.

March 2013

- A Decision on credit risk management was adopted, which applies from 1 December 2013.

July 2013

- A Decision on reducing CB bill interest rate was adopted to cut the policy rate from 3.5% to 3.25%. At the same time, the interest rate on seven-day deposit facility was cut from 1.75% to 1.5%.

- A Decision amending the Decision on reserve requirement was adopted, which reduces the reserve requirement rate for banks' liabilities in domestic currency from 10% to 8% and increases the reserve requirement rate for liabilities in foreign currency from 13% of 15%. In addition, the amendments stipulate a reserve requirement rate of 0% for banks' liabilities to nonresident financial companies with contractual maturity of over one year, as well as for all liabilities to nonresidents with contractual maturity of over two years. A rate of 13% still applies to short-term liabilities to nonresident financial companies in foreign currency with contractual maturity of up to one year. To maintain the reserve requirement in denars and in euros relatively stable, the amendments increase the reserve requirement in euros that is fulfilled in denars from 23% to 30%.

October 2013

- A Decision amending the Decision on banks' liquidity risk was adopted. This decision reduces the proportion of time deposits assumed to outflow from banks, from 80% to 60%, and applies from 1 December 2013. This amendment makes more room for long-term bank lending to the real sector.

November 2013

- A Decision amending the Decision on reserve requirement was adopted, which exempts the NBRM from paying reserve requirement remuneration (previously, this remuneration equaled 1%

for denar reserve requirement and 0.1% for euro reserve requirement). The Decision is being applied since 1 January 2014.

- A Decision on CB bills was adopted, which introduces a methodology for determining the potential demand for CB bills. In accordance with the established mechanism, if there is a higher demand than the potential across the overall banking system, banks that bid higher amounts of their own liquidity potential will be required to place this difference in seven-day deposits.

February 2014

- A Decision on reducing interest rate on seven-day deposit facility from 1.5% to 1.25% was adopted.

April 2014

- A Decision amending the Decision on the methodology for determining capital adequacy was adopted, introducing two amendments in the current decision that are expected to contribute positively to the credit support of the commercial banks to the corporate sector. Namely, with this Decision (and in accordance with the amendments to the new EU Regulation no. 575/2013 on prudential requirements for credit institutions and investment companies), performance guarantees or warranties that guarantee completion of works, stand out as items with low-intermediate risk, and therefore take lower conversion factor (20%), instead of 50% as it has been so far. That would mean that in the calculation of capital adequacy, smaller part of these off-balance sheet items would be treated as balance sheet items, which could affect the improvement of capital adequacy and encourage lending to the corporate sector. There is another innovation motivated by the international practice of establishing funds by low-risk entities (central governments or multilateral development banks) whose main goal is funding development projects. These projects are mostly funded through one or more commercial banks, which also contribute funds by dividing the exposure into a defined ratio between the bank and the fund or by providing guarantees or other similar instruments used by the fund (warranty provider) to guarantee coverage of part of the credit risk in the event of default by the debtor. In order to cover these cases, this decision also introduces a more favorable regulatory treatment of the funds established by one or several central governments, multilateral development banks or public institutions. These funds will take 0% risk weight, and the requirement will be that the funding is executed by payment in stakes, i.e. on-balance sheet and off-balance sheet activities to be covered by the fund's equity.
-

September 2014

- In order to further channel banks' excess liquidity to the non-financial sector, in September the NBRM revised the mechanism for transfer of the demand for CB bills, which is above the banks' potential into another instrument, i.e. seven-day standing deposit facility. According to these changes, for the seven-day standing deposit facility that banks are obliged to allocate if on the CB bills auctions they demand an amount higher than the potential[32], an interest rate of 0% is determined. For the other assets that banks will voluntarily place into a seven-day standing deposit facility the regular interest rate will apply.

[32] For the method of determining the potential demand for CB bills see the Decision on CB bills, Official Gazette of the Republic of Macedonia No. 166/13) was submitted.

September 2014

- The National Bank of the Republic of Macedonia Council adopted the Decision amending the Decision on the reserve requirement, which extends the application of the non-standard measure for reduction of the base for the reserve requirement of commercial banks for the amount of new loans extended to net exporters and domestic producers of electricity. The main objective of the Decision is to provide further support to the two systemically important sectors of the economy. The current implementation of this measure has generated positive effects on the dynamics of lending and thus the overall economic growth, contributing to a reduction of the cost of funding of companies from both sectors, although with lower intensity than the potential. In such circumstances, and given the data that indicate some uncertainty about the pace of lending to the corporate sector in the next period, this Decision envisages continued application of this non-standard measure until 31 December 2015.

October 2014

- A Decision on reducing the interest rate on overnight deposit facility from 0.75% to 0.5% and on seven-day deposit facility from 1.25% to 1% was adopted.

March 2015

- A Decision on reducing the interest rate on overnight deposit facility from 0.5% to 0.25% and on seven-day deposit facility from 1% to 0.5% was adopted.

- The National Bank Council adopted the Decision amending the Decision on CB bills, which introduces a new manner of establishing the bids of banks at the auctions of CB bills. According to the Decision, the amount of supply of individual bank is calculated by applying its appropriate percentage share in the total supply of treasury bills, reduced by the amount of past due CB bills of the Macedonian Bank for Development Promotion AD Skopje. In order to ensure operational efficiency in conducting auctions of this type and greater transparency toward banks, before the auction the NBRM shall inform the banks on the maximum offer that can be submitted by each bank. This opportunity for setting the supply of banks is expected to stabilize the demand at the level of the amount offered, which eliminates the need for calculation of potential demand and subsequently it repeals the obligation for mandatory seven-day deposits for banks when demand at the auction exceeds the potential demand.

April 2015

- A new Decision on the credit of last resort which, besides the current possibility of approving credit of last resort to banks against a collateral of debt securities, foreign currencies and banks' claims on the National Bank, introduces the possibility of extending this credit also against pledging banks' claims on customers. This modality of the credit of last resort is planned to be activated if the bank does not have debt securities and foreign currencies. The Decision specifies the types of claims that are acceptable for the National Bank as collateral for the credit of last resort.

June 2015

- The National Bank Council adopted preventive measures for managing capital flows of the Republic of Macedonia to the Republic of Greece. Preventive measures pertain to restriction of capital outflows from residents of the Republic of Macedonia (natural persons and legal entities) to Greek entities based on newly concluded capital transactions, but not to a restriction of the outflows based on incoming payments for capital transactions already concluded. These measures limit capital outflows only to the Republic of Greece and to entities from the Republic of Greece (such as outflows for founding of a company, investing in securities, investing in documents for units in investment funds, investing in investment gold, financial credits, long-term loans, etc.) but not to block or in any way to impede current and future commercial operations with entities from the Republic of Greece. Current transactions remain free. Also, in order to maintain the security of foreign investors regarding the exercising of their rights to their property in the Republic of Macedonia, outflows based on realized dividends have not been restricted either. Furthermore, in order to secure the funds that domestic banks have in the banks in the Republic of Greece, Macedonian banks are required to withdraw all loans and deposits from banks based in the Republic of Greece and their branches and subsidiaries in the Republic of Greece or abroad, regardless of the agreed maturity. However, in order to allow smooth functioning of payment operations for the transactions that are not prohibited, an exception to this requirement has been made for the funds on the current (correspondent) accounts with those banks. Existing prudential and supervisory measures and limits for banks to investments in securities including Greek securities are supplemented by explicit ban on all residents to invest in Greek securities. Those are temporary protective measures, introduced to prevent the threat of any significant outflows of capital from the Republic of Macedonia to the Republic of Greece to cause significant disturbance to the equilibrium in the balance of payments and undermine the stability of the financial system.

August 2015

- The National Bank Council adopted the Decision on amending the Decision on reserve requirements that reduces the reserve requirement rate for the bank liabilities to natural persons in domestic currency with contractual maturity of over one year from 8% to 0%, with these liabilities obtaining the same treatment as the liabilities with maturity over two years, for which rate of 0% since 2012 has been applied. Having in mind that the amendment releases the banks from the reserve requirement for the natural persons' denar deposits with maturity exceeding one year, this measure is expected to have adequate influence toward larger supply of denar savings products with stimulative interest rates.

- The National Bank Council adopted the Decision on amending the Decision on CB bills that envisages adjustment of the mechanism of participation at the CB bills auction of the National Bank, where the main criterion will be the individual share of the banks in the total liabilities in domestic currency without currency clause of the banking system. With these amendments, the National Bank continues to support the natural persons' savings in domestic currency and on a longer run, which creates room for the banks for active credit support to the private sector.

December 2015

- The Council adopted the Decision amending the Decision on the methodology for determining the capital adequacy, introducing measures to slow the growth of long-term consumer loans. The measure increases capital requirements for banks on long-term consumer loans with maturity equal to or longer than eight years. Thus, the risk weight for claims on consumer loans with a contractual maturity equal to or longer than eight years, increases from 75% i.e. 100% to 150%. To avoid major shocks in the market of consumer lending, yet the growth rates to be reduced to a moderate level, this measure is aimed only at newly approved long-term consumer loans, i.e. loans with maturity equal or longer than 8 years approved after 1 January 2016. At the same time, this decision introduces higher capital requirement (risk weight of 75%) for the increase of overdrafts and credit cards in relation to 31 December 2015. The aim of this decision is to prevent the possibility of changeover to this type of borrowing as a result of the measure to decelerate consumer loans. Also, this Decision facilitates the access of legal entities. Namely, the capital requirement for guarantees issued by banks is reduced, which guarantees payment based on a certain business relationship of the client and banks' claims backed by commercial property that meets certain conditions. This way allows banks to allocate lower amount of capital for credit and guarantee operations with legal entities, including small and medium enterprises, which can cause reduction in the cost of banks and therewith, of clients for this type of operation.

- The National Bank Council adopted the Decision on amending the Decision on credit risk management, which requires starting from 1 January 2016, and by June 30 2016 to write-off all claims that have been fully booked for more than two years, and where the bank has identified and fully covered the credit risk of default at least two years before. According to the existing regulations, banks are required to fully reserve claims where the client defaulted at least 1 up to 5 years if there is a specific collateral, and the new measure requires from banks to write them off two years after their full provisioning. In addition, banks will still be allowed and required to take actions to collect these claims, although they are written off. The measure does not incur additional costs for banks since claims which are fully provisioned are written off, at least two years before.

- The National Bank Council decided to extend the application of <u>the non-standard measure to reduce reserve requirement base in denars of commercial banks for the amount of newly approved loans to net exporters and domestic producers of electricity</u> for two more years, untill the end of 2017.

- On 29 December 2015, the Decision on introducing special protective measures adopted by the National Bank Council on 28 June 2015 due to the debt crisis in Greece at that time, ceased being valid. The measures were adopted to protect against any disruptions in the balance of payments or the stability of the financial system of the Republic of Macedonia due to any significant capital outflows from Macedonia to Greece. They were temporary for a period of up to six months, with a possible extension of their application. The protective measures served their purpose and prevented major capital outflows from the Republic of Macedonia, yet not disturbing the business of domestic companies with Greek companies. They delivered equilibrium in the balance of payments and stability of the domestic banking system. The situation in Greece has been stabilizing for quite some time. The lenders continued to financially support Greece, which, in turn, pledged to apply economic and social reforms, and austerity measures. Therefore, after the expiry of six-month validity period of the protective measures on 28 December 2015, since 29 December 2015, this decision is no longer in use.

May 2016

- At the regular meeting of the NBRM's Operational Monetary Policy Committee held on 3 May 2016, it was decided the interest rate on CB bills to be increased by 0.75 percentage points, from 3.25% to 4%. The decision to tighten the monetary policy is a reaction to the increased demand for foreign currency and pressures on banks' deposit base, which were entirely due to the deteriorating expectations of economic agents, caused by the unstable political situation in the country. Thus, the change in the interest rate is a response to the action of factors of non-economic nature.

- The National Bank Council adopted the <u>Decision on reserve requirement</u>, which increased the reserve requirement rate for banks' liabilities in domestic currency with FX clause. The measure has been aimed at further encouraging the process of denarization of deposits in the domestic banking system. Given the negligible market share of these liabilities in the banks' balance sheets, the changes are exclusively for further maintenance of low propensity of the economic agents for placing this type of deposits in domestic commercial banks.

- In order to maintain and increase deposits in the domestic banking system, the National Bank Council reviewed and improved the terms for placing foreign currency deposits of domestic banks at the National Bank and adopted the Decision on foreign currency deposit with the National Bank of the Republic of Macedonia. Accordingly, starting from 13 May 2016, the banks can place foreign currency deposits at the central bank at higher interest rates compared to current negative interest rates prevailing in the international financial markets. It is expected that this measure will contribute to reduce the cost of domestic banks, which would accordingly contribute to higher interest rates on the deposits of their clients, domestic legal and natural persons.