

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
MONETARY POLICY AND RESEARCH DEPARTMENT



Recent Macroeconomic Indicators
Review of the Current Situation

December 2014

Recent Macroeconomic Indicators

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 (October-November 2014) and to make a comparison with the latest macroeconomic projections (October 2014). This will determine the extent to which the current situation in the economy corresponds to the expected movements of the variables in the previous cycle 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.

The global economic environment has not undergone major changes compared to the period of the last assessments. However, during this period there have been some changes that indicate increased future risks compared with the October projections. This primarily concerns the Euro area, where the latest economic indicators confirmed the indications for slower economic growth than previously expected (0.2% real growth in the third quarter). ECB does not perceive such slower performances as temporary, and therefore in the most recent December projections it made a significant downward adjustment to the forecasts for the economic growth in the period 2014-2016¹. Deteriorated assessments for the growth of the economy are a result of a downward correction of both the domestic and the net export demand. Despite such revisions, the risks to the growth projections remain mostly downward. They are associated with the weak economic growth of the Euro area, which may have a negative impact on the confidence of the entities, and especially on the private sector investments. Present geopolitical risks may also act in this direction. The potentially insufficient progress in implementing structural reforms is further assessed as a key factor that may limit the growth also in the forthcoming period. In terms of inflation, the first assessment of the Eurostat is that the annual inflation rate in the Euro area in November was 0.3%, representing a moderate slowdown compared with October (0.4%). In circumstances of lower energy prices and deteriorated outlook for economic growth, in December the ECB made a downward revision also of the assessments for inflation for the period 2014-2016². Against such a backdrop, in December, the ECB decided to keep the policy rate unchanged. However, in the communication of the Central Bank it was indicated that the implementation of non-standard measures continues, which denotes loosening of the monetary conditions in the forthcoming period and increasing the balance of the ECB approximately to the level of early 2012. Furthermore, the ECB announced that early next year it will reassess the effects of the monetary stimulus and if it finds it necessary it will intervene with additional unconventional measures.

Observed from a viewpoint of the individual quantitative external environment indicators for the Macedonian economy, the assessments regarding the foreign effective demand for the period 2014-2015 registered minor changes relative to the October projection. The new assessments indicate somewhat less intensive recovery of external demand, largely due to the weaker economic outlook in Germany and in Serbia. There are no changes in the expectations for growth in foreign demand in 2016. **The changes in the expectations for the prices of primary products move in different directions.** Latest developments and assessments for the **world oil prices** further indicate lower price levels of this energy product in relation to the October expectations, and thus less pressure on inflation and terms of trade. Recent movements in **metal prices** suggest somewhat more favorable developments, which are more pronounced in nickel compared with the October projections. Regarding the **food prices**, recent data on the prices of cereals point to higher price levels for these products, indicating somewhat higher import pressures through this channel on domestic inflation and terms of trade, compared with the October projections. However, one should

¹ According to December assessments, the growth is expected to be 0.8%, 1% and 1.5% for 2014, 2015 and 2016, respectively, while in September the expected growth was 0.9%, 1.6% and 1.9%, respectively, for 2014, 2015 and 2016.

² In December, the anticipated growth in inflation is 0.5% in 2014, 0.7% in 2015 and 1.3% in 2016, while in September the inflation expectations were 0.6% for 2014, 1.1% for 2015 and 1.4% for 2016.

bear in mind that the presence of the geopolitical tensions in the world still creates great uncertainty about the future movements in the prices of primary products.

The comparison of the latest macroeconomic indicators with their projected dynamics within the October cycle of projections does not indicate major deviations in some segments of the economy. In terms of the indicators relevant for the monetary policy, inflation data for October are in line with the October projection. In October, the general price level continued to decline on an annual basis, but at a slower pace. On average, in the first ten months of the year, the price level fell by 0.3%. In October, core inflation on an annual basis remained in the negative zone, but the registered decline is somewhat smaller relative to that registered in September. Regarding the projection, the inflation performance is in line with the October projection, with downward deviations in food prices, while the deviations in the prices of energy and in core inflation are in the opposite direction. Amid almost equal initial conditions and divergent movements in import prices relative to those previously expected, **the risks in the inflation projection are assessed as balanced.**

According to the latest available data for the fourth quarter of 2014, foreign reserves (adjusted for the price and exchange rate differences and price changes of securities) registered a small decline, which is currently smaller than expected with the October projection. For most part this reduction was due to the NBRM's interventions on the foreign exchange market by selling foreign currency and the net outflows created by the transactions on behalf of the government. The number of available external sector indicators for the fourth quarter is still limited, making it difficult to forecast the performances and to identify accurately the factors of changes in foreign reserves. From the indicators of the external sector, available are the data on the net purchase from currency exchange operations as of October, which currently point to somewhat higher net inflows from private transfers compared to the projections. Data on foreign trade as of October point to a trade deficit within the expectations for the fourth quarter. However, the evaluation period is very short and therefore reliable conclusions in this domain cannot be drawn. The analysis of foreign reserves adequacy indicators shows that they continue to move in a safe zone.

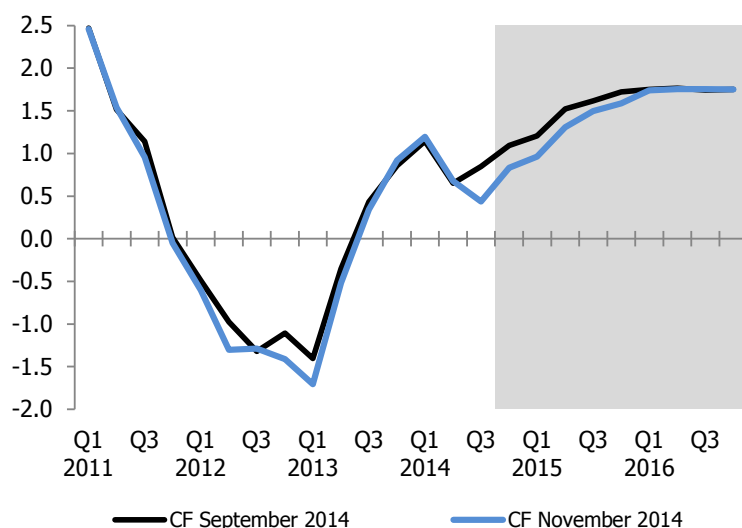
Indicative high-frequency data for the third quarter of 2014 point to **further growth of the domestic economy, but at a slightly slower pace**, which is in line with the expectations in the October projections. **Regarding the monetary developments**, in October, data on the credit market show further solid growth in loans on a monthly basis, indicating continuation of the favorable trends from September, when the monthly growth intensified, after a relatively weak performance during July and August. New loans in October were mostly extended to households (about 70%), amid further growth also in the loans to the corporate sector. Regarding the projection for the period until the end of the year, as of October about 28% of the projected growth for the fourth quarter was achieved. Thus, the annual growth rate of total loans in October was 9.7%, while the October projection for the end of the fourth quarter envisages an annual growth of 8.7%³. In terms of the deposit potential, in October deposits continued to grow, but at a slower pace compared to September. However, one should bear in mind that for the time being we have data on the performance in only one month of the quarter. Additionally, since the beginning of the year there has been great volatility in deposit flows by month, so we assess that it is still too early to draw any reliable conclusions regarding the deposit growth. The latest assessments about the **EURIBOR indicate its lower level in the 2015-2016 period, compared to the October projection.**

The latest macroeconomic indicators and assessments do not indicate major changes in the conclusions about the environment for conducting monetary policy and about the risks, compared to the assessments provided in the October projections. However, analyzing

³ The lower growth rate for the end of 2014 is largely due to the base effect, given that in November and December 2013, a significant acceleration of the credit activity of the private sector was registered, when the total growth in that period was Denar 6,120 million.

the indicators of foreign reserves adequacy, they remain in a safe zone. The risks from the external environment remain unfavorable and are further highlighted by the deteriorated perspectives for the economic growth on the Euro area and the persistent geopolitical tensions. Regarding inflation, as of October it was in line with the October projection, with balanced risks around the projection of the future dynamics of inflation. Economic activity indicators suggest that, as expected, the economy will continue to grow also during the third quarter of 2014, however at somewhat slower pace. New credit flows are solid, and the growth registered in October was little less than one third of the growth projected for the last quarter. Data from the monetary sector are still limited, which prevents drawing reliable conclusions about the dynamics of credit and deposit growth.

Foreign effective demand
(annual rates of change in %)



Source: "Consensus Forecast" and NBRM calculations.

According to the December assessment, the growth of foreign effective demand will amount to 0.8% in 2014, which is a minimum downward revision compared with the October projection of 0.9%⁴.

This downward deviation mostly comes from Germany, whose economic growth will be lower than expected in October, taking into account the performances in the previous three quarters ...

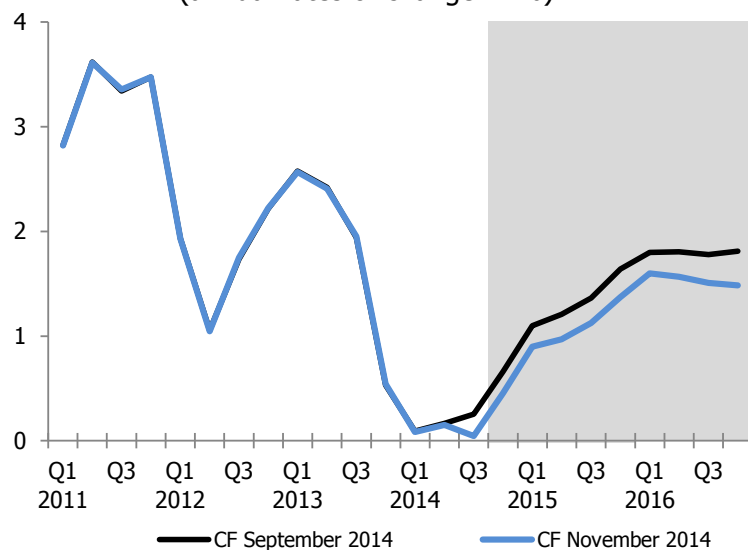
... and from Serbia, which is estimated to register deeper recession this year due to the adverse effects of the floods in May.

Downward revision was made also to the projection for 2015, when growth of foreign demand of 1.3% is expected, contrary to the growth of 1.5% expected with the October projection ...

... mainly due to the deteriorated expectations for the developments in the German economy.

On the other hand, in 2016 further fast growth in the foreign effective demand of 1.8% is expected, which is in line with the October projection.

Foreign effective inflation
(annual rates of change in %)



Source: "Consensus Forecast" and NBRM calculations.

Foreign effective inflation was revised downward throughout the entire projection period.

It is now expected that in 2014 foreign prices will register minimal slower growth of 0.2%, instead of 0.3% as projected in October...

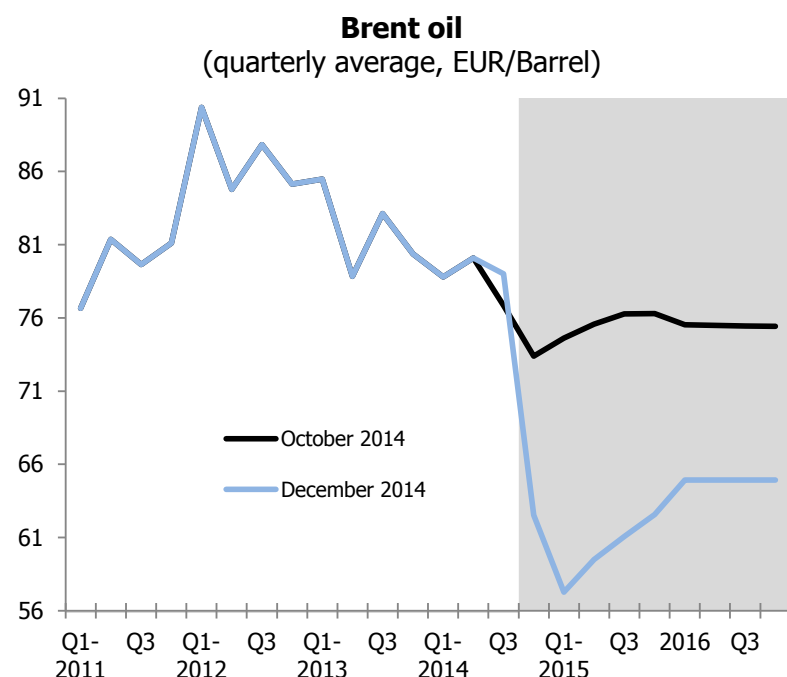
... primarily due to the higher negative contribution of the inflation in Serbia.

Due mainly to the expectations for lower consumer prices in Germany and Serbia, now lower foreign inflation for 2015 is projected ...

...where it is expected that the rate will be 1.1%, versus 1.3% in the October projection.

The projection for the foreign

⁴ Revisions to historical data partly reflect the use of the new series for the countries included in the calculation, which are prepared according to the methodology European System of Accounts (ESA 2010).



Source: IMF and NBRM calculations.

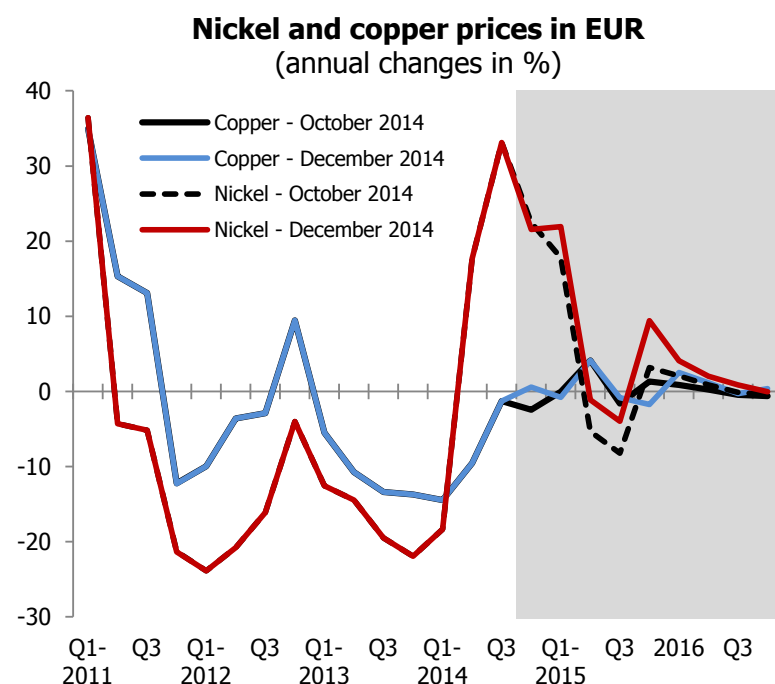
effective inflation in 2016 was also revised downward from 1.8% in October to 1.6%.

The projected price of "Brent" oil in the fourth quarter of 2014 is significantly lower than in the October projection (Euro 62.5 versus Euro 73.4 per barrel) ...

... which is primarily a result of the decision of OPEC not to reduce the production volume in the future⁵. Additional factors that contribute to the decline in the price of oil are the continued increase in the supply, the still weak demand and the strong exchange rate of the US Dollar.

Thus, annually, in 2014 and 2015 sharper decline in the price of oil compared with the October projection is expected...

... while in 2016 prices are expected to remain stable and grow to some extent. However, also in 2016 oil prices remain significantly lower than expected in the October cycle of projections (Euro 64.9 versus Euro 75.4 per barrel).



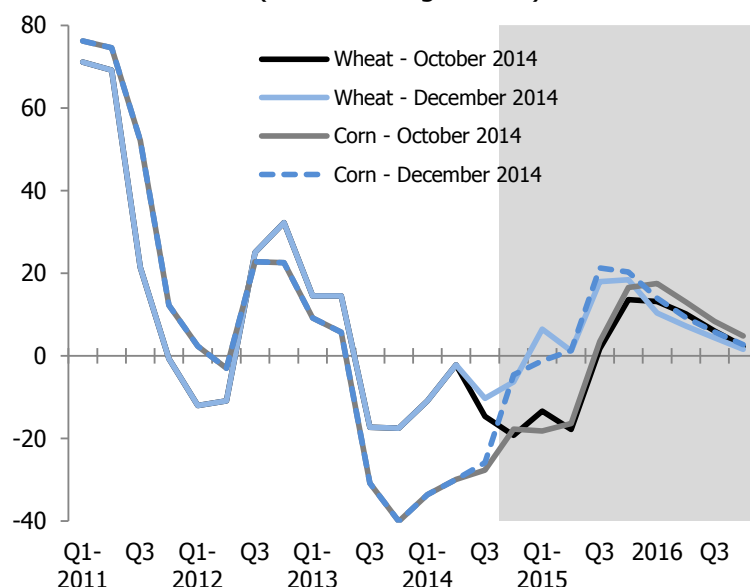
Source: IMF and NBRM calculations.

Regarding the movement of metal prices in the last quarter of 2014, the latest estimates point to moderately slower growth in the price of nickel and a small rise, rather than decline, in the price of copper compared with the October projection. However, recent movements in metal prices suggest somewhat more favorable movements in the next two years, which are more pronounced in nickel compared with the October projections.

In terms of the movement of the price of copper, in 2015 it is expected to register slower growth compared to the expected according to the October projections, which is associated with the increased production capacity and still low demand from China. The projection for 2016 was minimally revised upward.

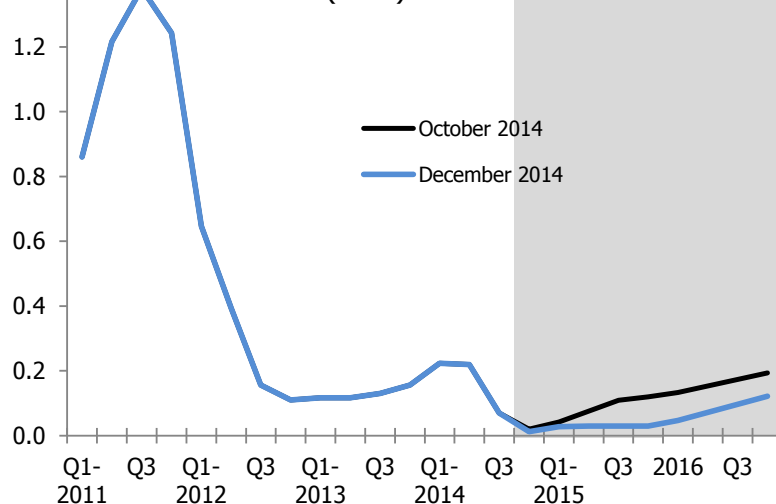
⁵ <http://www.bbc.com/news/business-30223721>

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



Source: IMF and NBRM calculations.

1M Euribor
(in %)



Source: "Consensus Forecast" and NBRM calculations.

During 2015, the prices of nickel are expected to grow at a higher rate because of the assessments for further retention of export restrictions by Indonesia, and an upward revision of the growth was made also for 2016.

Estimates for the fourth quarter point to a smaller decline in the price of wheat and corn compared with the October projection ...

... which also lowered the expected decline in the prices of these crops for the whole of 2014.

Upward revisions were made also for 2015, whereby it is expected that wheat and corn will achieve price growth, rather than a decline as expected in the October projection ...

... as a result of the reduced world production of cereals, as well as the current unfavorable weather conditions in the United States which is further expected to affect the production of these crops.

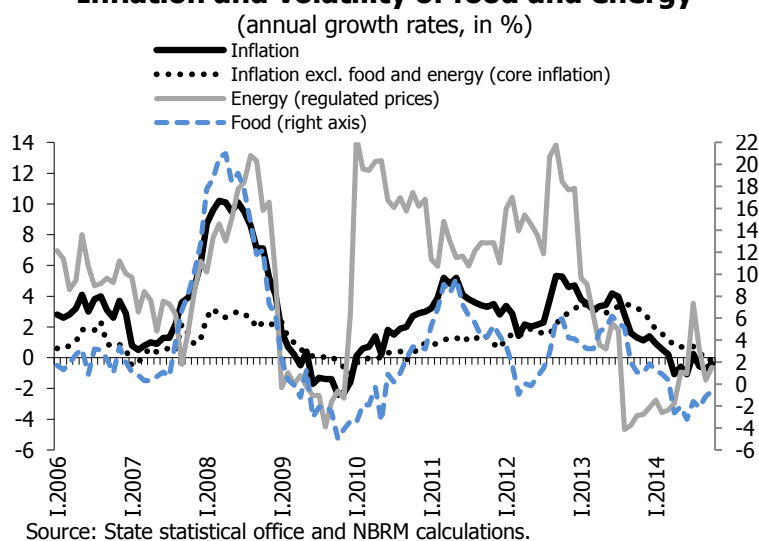
For 2016, the estimates suggest moderately lower rise in prices of cereals compared with the October projection.

In the fourth quarter, the foreign interest rate EURIBOR was slightly lower than the October projection.

Downward revisions have been made also in terms of the expectations for the level of the foreign interest rate for the next period, i.e. it is estimated to be 0.03% in 2015 and 0.08% in 2016 (versus 0.09% in 2015 and 0.16% in 2016 in the October projection) ...

... mainly due to the expectations for continued accommodative monetary policy of the ECB also during the next year.

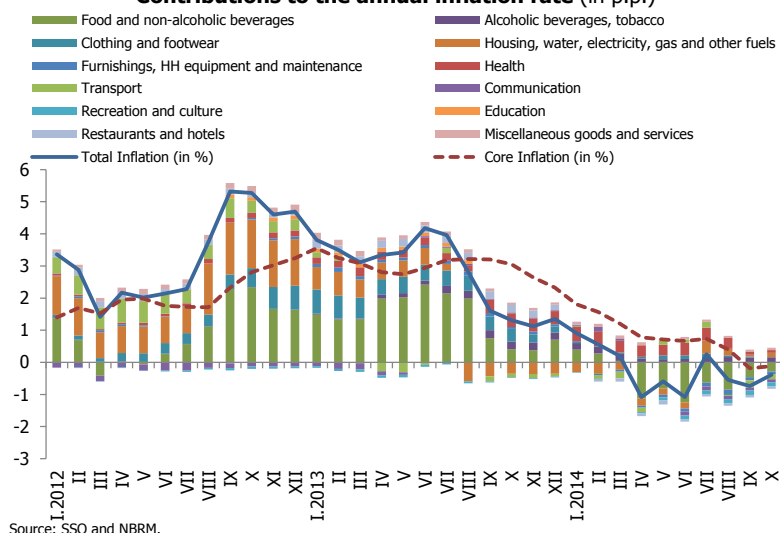
Inflation and volatility of food and energy



In July 2014, consumer prices rose by 0.2% on a monthly basis...

... amid growth in food prices and core inflation⁶.

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



The annual decline in the general price level in October was 0.4%, and it is slightly milder relative to the decline registered in the previous month ...

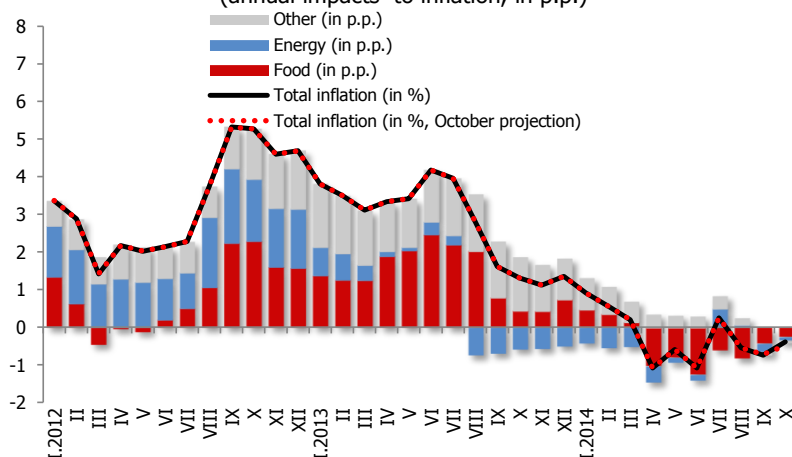
... which is in line with the expected price movement in the October cycle of projections ...

... with small deviations of the projected relative to the registered movement in all three components of inflation. Moreover, deviations in the food prices are downward, while in the prices of energy and in core inflation deviations are upward.

⁶ Categories with the largest individual contribution to the increase of the October CPI are the following: fresh vegetables (monthly price increase of 4.9%) and footwear (monthly price increase of 2.4%).

Inflation rate

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



In October, monthly increase in core inflation rate of 0.4% was recorded (compared to September, when core inflation remained unchanged) ...

... while on an annual basis the decrease in core inflation continued, and in October it was 0.1% (compared to the fall of 0.2% in September).

The annual decline in core inflation is mainly explained by the fall in the prices of IT equipment, accommodation services and communications.

External input assumptions for 2014 and 2015, which are included in the projection have been revised in a different direction.

Thus, according to the latest information lower foreign effective inflation is expected by the end of 2014 and during 2015.

At the same time, the assessments for the price of oil in 2014 and 2015 registered a downward correction ...

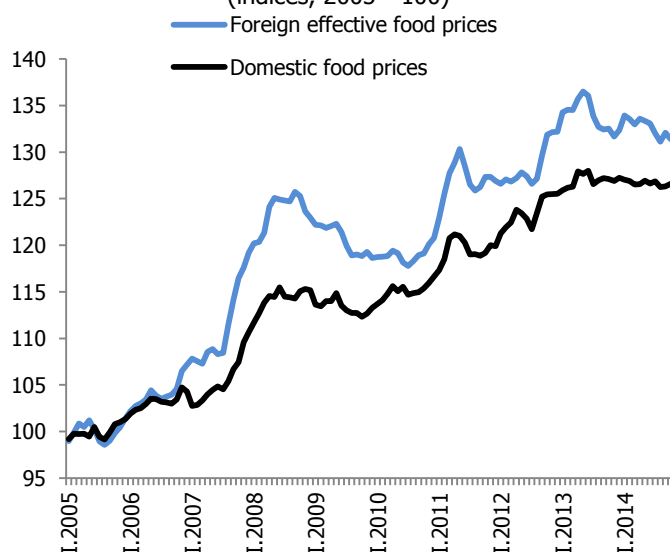
... reflecting the OPEC decision not to reduce the volume of production in the forthcoming period⁷, as well as the continuous increase in the supply, the still weak demand and the strong exchange rate of the US Dollar.

On the other hand, the latest estimates for the prices of the internationally traded primary products point to upward adjustments in the prices of cereals compared with the signals obtained from the October cycle of projections, i.e. prices are expected to decline in 2014 and rise in 2015.

Such a change in the expected movements in the prices is a result of the reduction in the world production of wheat and corn, as well as the current

Foreign effective food prices* and domestic food prices

(indices, 2005 = 100)



* 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.

⁷ <http://www.bbc.com/news/business-30223721>

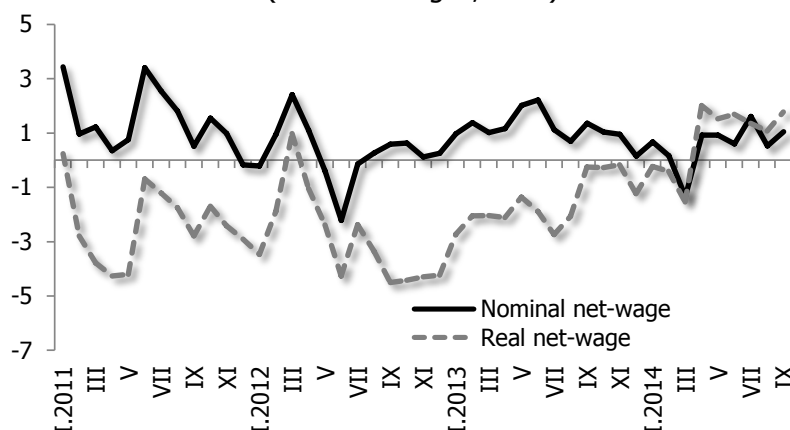
unfavorable weather conditions in the USA, which are expected to affect the production of these crops.

In view of the projected movement of the prices in the forthcoming period, revisions of the external input assumptions point to balanced risks ...

... in circumstances of downward adjustments in the expected movement of energy and foreign prices on the one hand, and upward revisions of the prices of cereals on the other.

An additional factor that increases the uncertainty about the future movement of domestic prices are the still present geopolitical risks.

Average net-wage
(annual changes, in %)



Source: SSO.

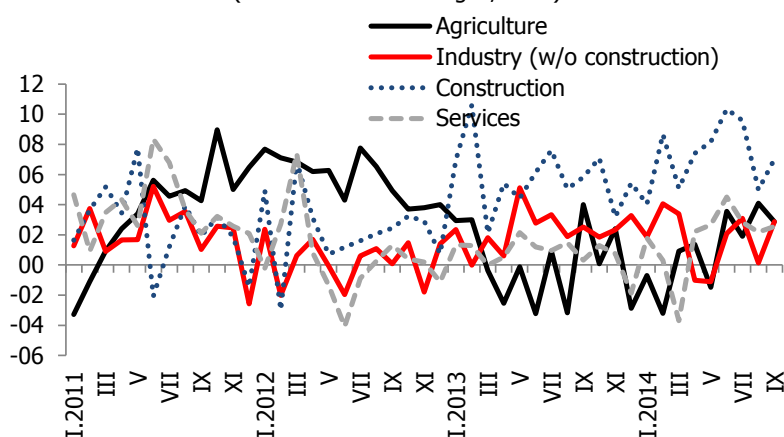
In September 2014, the average **net wage** registered a nominal annual growth of 1%, which is a moderate acceleration of the positive dynamics registered in the previous month.

Most of the activities registered upward movements in the wages ...

... but, somewhat more dynamic growth was registered in the wages in the activity "arts, entertainment and recreation" and in the wages in the construction and mining sector ...

... while a decrease was registered only in the wages in catering and education.

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



Source: SSO.

On average, in the third quarter, net wages registered nominal annual growth of 1.1%, which is slightly less than expected in the October projection (of 1.3%).

In September, real wages increased by 1.8%, amid reduced domestic prices.

Thus, the real annual wage growth in the third quarter amounted to 1.4% ...

... a pace that is slightly slower than expected in the October cycle of projections.

The indicative high frequency data for the third quarter of 2014 point to further annual growth of the domestic economy, given the continued positive performance in most economic sectors.

... but at a slightly slower pace.

In the third quarter, industrial production grew by 5.5% on an annual basis, equally as in the previous three-month period ...

... where the new foreign facilities (primarily the production of motor vehicles), as well as the production of food products gave the largest contribution to growth.

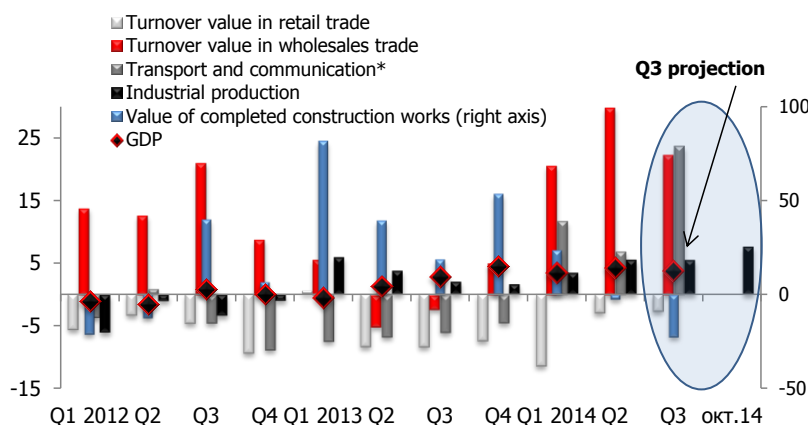
According to the signals obtained from the Business Tendency Survey in manufacturing industry, this outturn is mostly associated with the growth in the export orders and increased utilization of industrial capacities⁸...

... and additionally, in the third quarter, an annual increase was recorded also in the turnover of inventories⁹ in the industry, which also points to increased profitability of the business entities in this sector.

⁸ SSO's Business Tendency Survey in manufacturing industry.

⁹ Inventories turnover is a ratio between trade and turnover of finished products in the industry. Higher value of this indicator points to faster inventory turnover, which on its part is an indication of reduced costs for storage, as well as reduced expenditures for insurance of the goods, which in turn is finally reflected in the increased profitability of the companies in this sector.

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.

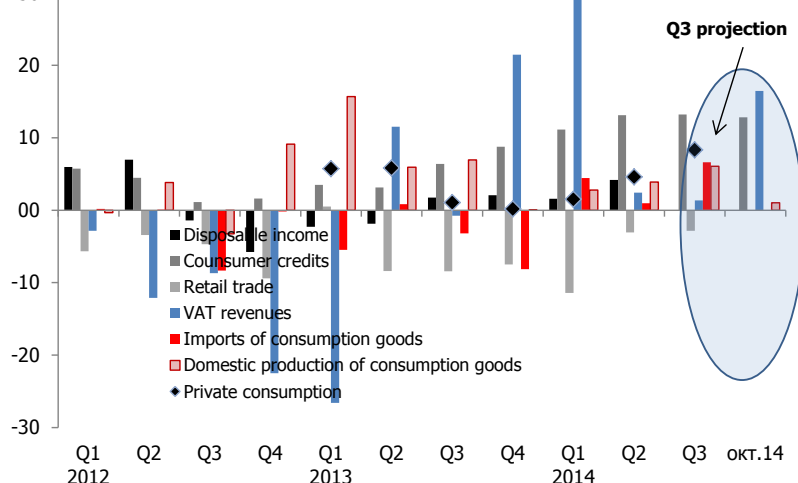
In the third quarter, favorable developments were registered also in the trade sector amid still high, double-digit growth in the wholesale and positive developments in the trade in motor vehicles, for the first time since the beginning of the year. Retail trade continued to decline, although at a slower pace compared to the second quarter.

In the third quarter, faster growth was registered also in the activity in **transportation**, which is generally improving, i.e. applies to all types of transport.

Growth in the turnover was registered also in **catering**, although the pace of growth is slightly slower compared to the previous quarter.

After the small decline registered in the second quarter, which comes after nearly two years of intensive strengthening of the construction activity, **the data on completed construction works in the third quarter point to a further reduction of the construction activity.**

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



Source: SSO and NBRM calculations.

Available high-frequency indicators of aggregate demand create expectations for continued growth in the third quarter, in line with the estimates from the October cycle of projections.

Private consumption is expected to remain in the zone of positive annual changes in the third quarter...

... amid growth in the real wages and transfers (although at a slower pace compared to the previous quarter), and growth in pensions ...

... while additional support was provided by the solid growth of household loans, which is marginally higher than that in the second quarter.

Growth of private consumption was also indicated by the accelerated growth in the imports of consumer goods and in the domestic production of consumer goods.

On the other hand, the available high frequency data for the investment activity in the third quarter recorded divergent movements, which increases the **uncertainty about the assessment of the movement of the investment activity in the third quarter.**

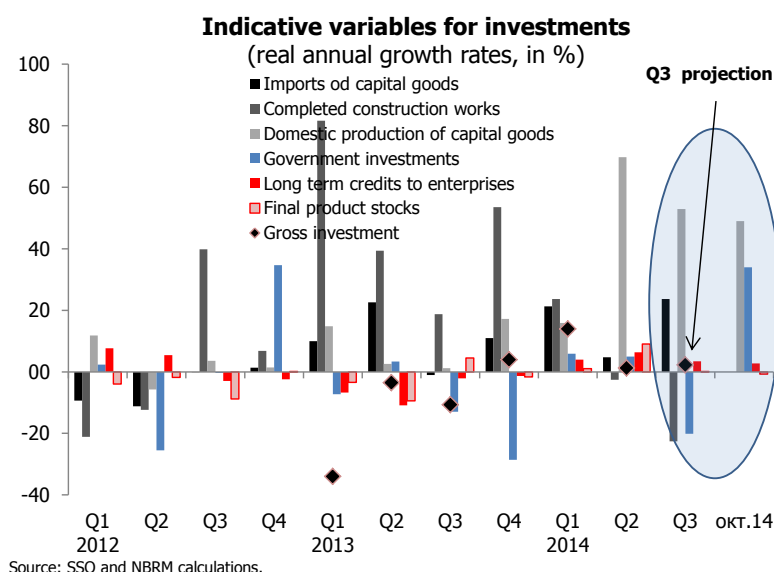
In the third quarter, there was a significant deepening of the annual decline in the completed construction works ...

... and a decline in budget capital expenditures (in comparison to the small growth registered in the previous quarter).

On the other hand, in the third quarter there was a significant intensification of the import of goods on the basis of investment ...

... and growth, although slower compared to the second quarter, was registered also in the domestic production of capital goods and the long-term lending to the domestic corporate sector.

Nominal data on **foreign trade** show narrowing of the deficit in the third quarter which is in line with the expectations from the October projection for narrowing of the trade balance.



Budget performances in the third quarter point to expectations for a decline in public spending in this period, which corresponds to the estimates from the October cycle of projections ...

... caused by the annual decline in the transfers for health care¹⁰, as well as the category other transfers.

Estimates for the fourth quarter are based on very few available data, which in turn creates space for greater uncertainty about the findings.

Namely, **industrial production growth** of 7.5% annually registered in **October on the one hand ...**

and weakened perceptions of the managers of the manufacturing sector regarding the production volume in the next quarter, on the other ...

... could be considered indicative **of an annual increase in the activity of this sector in the last quarter of the year, but at somewhat slower pace.**

Observed by sector, the October acceleration of the industrial activity is mostly associated with the manufacturing of tobacco products, with the increased activity in the field of production of motor vehicles, which mainly reflects the operation of the new facilities in the technological and industrial development zones, as well as with the increased production of electricity.

Available high frequency data on **private consumption point to a continuation of the positive trend also in the fourth quarter, but with room for a slightly lower intensity...**

¹⁰ Most of the transfers for health care relate to expenditures for goods and services.

... a conclusion based mainly on the somewhat slower pace of growth in lending to households registered in October ...

... as well as on the more substantial slowing of the positive dynamics of domestic production of consumer goods.

Additionally, the entering in the zone of positive annual change of government expenditures for capital investments in October, creates **prospects for a more favorable environment in terms of the investment activity in the last quarter of the year.**

October data on foreign trade indicate stronger prospects for widening of the trade deficit in the last quarter of the year ...

... which is also already anticipated in the October cycle of projections.

Budget performances in October currently provide prospects for upward deviation in public consumption, compared with the estimates, according to which the annual decline in public consumption is expected to intensify in the fourth quarter.

The more favorable indications regarding the public consumption are associated with the accelerated growth in the expenditures for goods and services, as well as the expenditures for wages...

... and are further influenced by the switch of the transfers for health care to the zone of positive annual changes in October.

In October, despite the fast export growth, the accelerated annual growth of import activity led to an **annual widening of the foreign trade deficit by 4.3% ...**

... which is consistent with the expected dynamics of the trade deficit in the fourth quarter, according to the October projection.

Exports of goods registered an annual growth of 24.2% in October, which still reflects the increased use of the new export oriented facilities ...

... all other categories also had a small positive contribution, with the exception of the annual decline realized in the exports of iron and steel.

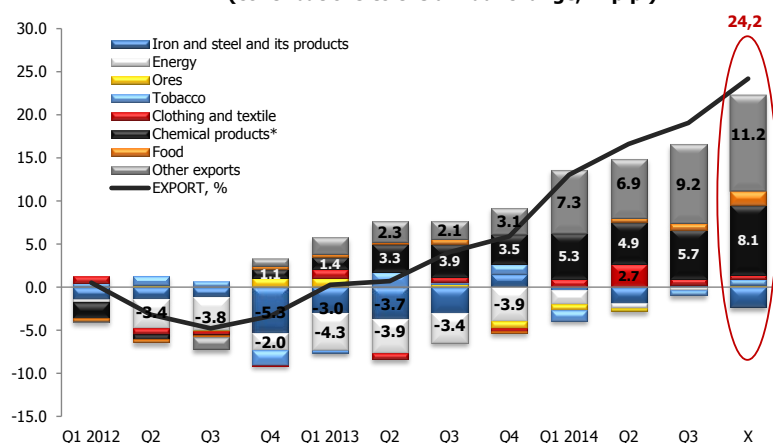
Compared with the projection, realized export in October gives an indication of improved export performance relative to the expected for the fourth quarter. The positive deviation primarily reflects the improved export performances of the new facilities.

Imports achieved an annual growth of 16.9% in October, which is mostly due to the increased imports of raw materials for the new industrial facilities and the import of equipment and machines ...

... while imports of energy fell on an annual basis.

Imports registered in October give an indication of worse than projected import performances for the fourth quarter. The largest upward deviation was registered in the import of raw materials for a major capacity from the free economic zone and in the import of equipment and machinery, while other import categories are largely in line with the expectations.

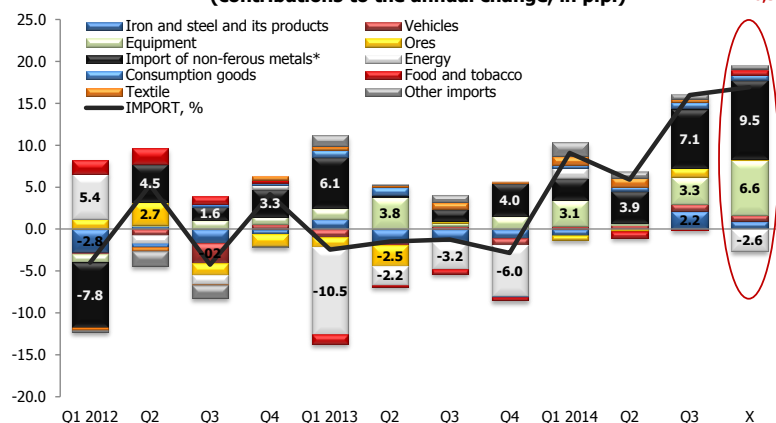
Exports by components
(contributions to the annual change, in p.p.)



Source: NBRM.

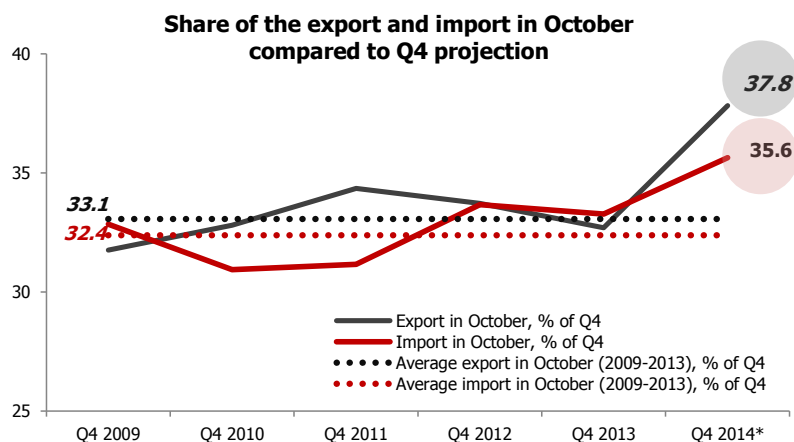
* The following data depict the overall exports of one major export capacity in the free industrial zone.

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.

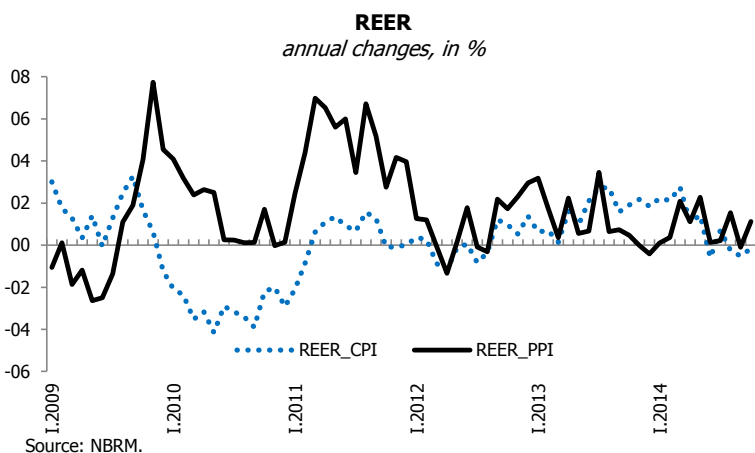


Source: NBRM.

* Share of the export/import in October in the projected export/import for Q3-Q4 2014, projection October 2014.

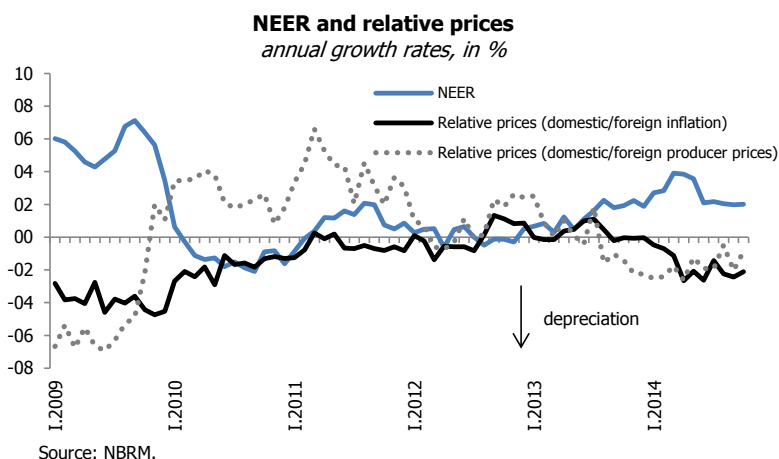
In October, the exports and imports are slightly higher than expected and in comparison with the historical average, but they generally point to achievements in the **trade balance that are within the expectations for the fourth quarter, according to the October projection**. Also, the data refer only to one month and are not sufficient to enable drawing a reliable conclusion.

Latest developments in world stock exchange prices indicate more favorable expectations for the price of nickel and are unchanged relative to the price of copper, on average, for the current and next year. Additionally, the latest expectations for the prices of crude oil suggest significantly sharper annual decline in the price expressed in euros for the analyzed period, which again indicates more favorable terms of trade by the end of the current year and in the next year.



Source: NBRM.

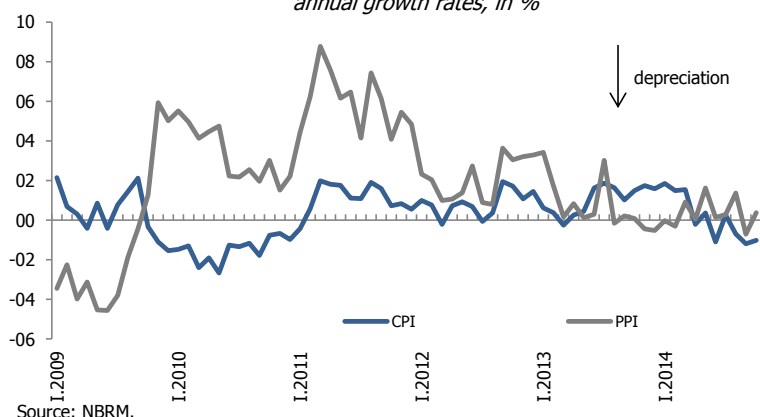
In October 2014, price competitiveness indicators of the domestic economy registered divergent movements on an annual level. Compared with the same month of the previous year, the REER deflated by consumer prices again depreciated slightly by 0.3%, while the REER deflated by producer prices appreciated by 1.1% on an annual basis.



Source: NBRM.

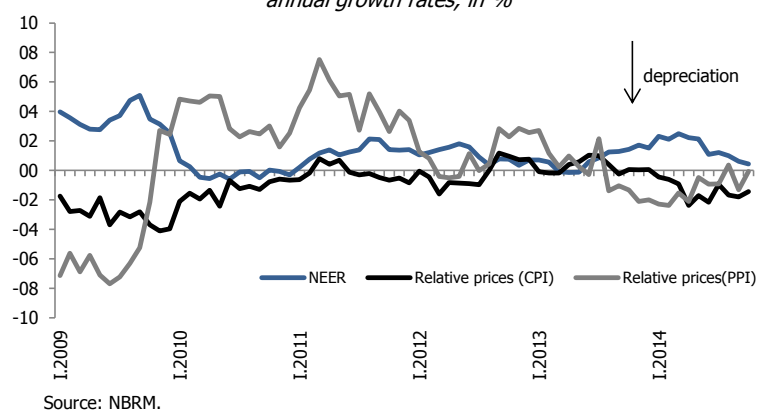
The further appreciation of the nominal effective exchange rate (by 2%) on an annual basis, as a result of the prolonged depreciation of the Ukrainian hryvnia, Russian ruble and Turkish lira against the denar, caused upward pressures on both REER indices. On the other hand, the growth of foreign consumer prices, as opposed to the moderate annual decline in domestic prices, as well as faster growth in foreign versus domestic prices of industrial products, led to a decline in relative prices by 2.2% and 0.8% respectively.

REER, excluding primary commodities
annual growth rates, in %



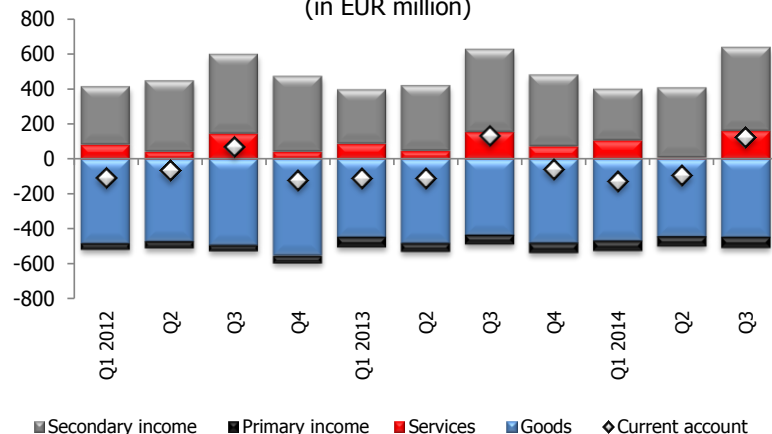
The analysis of the movement of the REER indices calculated with weights based on the foreign trade without primary products¹¹, indicates similar movements in the domestic price competitiveness. The REER deflated by consumer prices depreciated by 1% on an annual basis, while the REER deflated by producer prices appreciated by 0.4%.

NEER and relative prices, excluding primary commodities
annual growth rates, in %



Relative CPI registered an annual decline of 1.4%, driven by the decline in domestic prices, contrary to the annual growth of foreign prices. Slight annual decline was registered also in the relative prices of industrial products (of 0.1%), driven by the faster growth of the foreign relative to the growth in domestic prices of industrial products. NEER appreciation continued in October, with the annual change again being driven by the depreciation of the Turkish lira and the Serbian dinar against the denar.

Main components of the current account
(in EUR million)



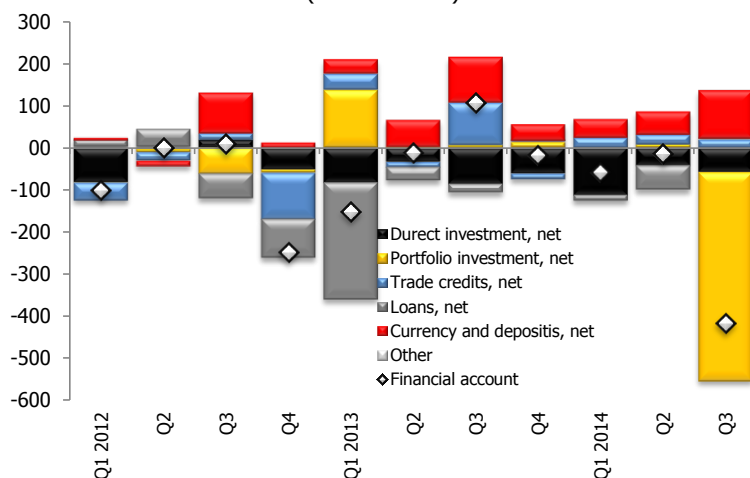
In the third quarter of 2014, the balance of payments current account registered a surplus of Euro 125.3 million (or 1.5% of GDP), which is higher than expected according to the October projection.

In terms of individual components, better than expected performances were the smaller deficit in the foreign trade in goods and services and the somewhat higher than expected surplus in secondary income ...

... while the deficit in primary income was slightly higher than expected.

¹¹ Primary products excluded from the calculation include: oil and oil derivatives, iron and steel, ores and imported raw materials for the new industrial capacities in the free economic zones.

Financial account components
(in EUR million)



Source: NBRM.

In the third quarter, net liabilities in the amount of Euro 417.3 million (or 4.9% of GDP) were created in the capital and financial account, which were lower than projected for the third quarter of the year.

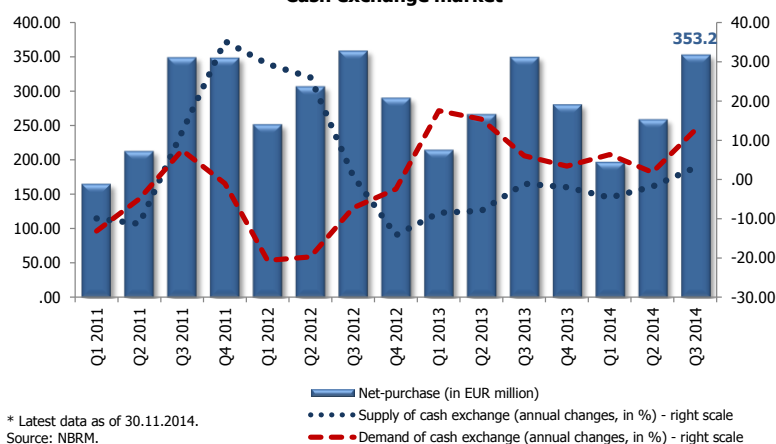
Downward deviations from the October projection mainly resulted from the net creation of assets with commercial loans, versus the expectations for net creation of liabilities in this category, as well as the weaker performances in direct investment.

On the other hand, currency and deposits recorded a lower than the planned net creation of liabilities. Other components of the financial account are in line with the October expectations.

Recent data on currency exchange operations, as of October 2014 indicate a continuation of the annual increase in the supply of and demand for foreign currency.

Realized net purchase on the currency exchange market in October 2014 was Euro 105.7 million, representing an increase of 5.9% compared to the previous year.

Cash exchange market

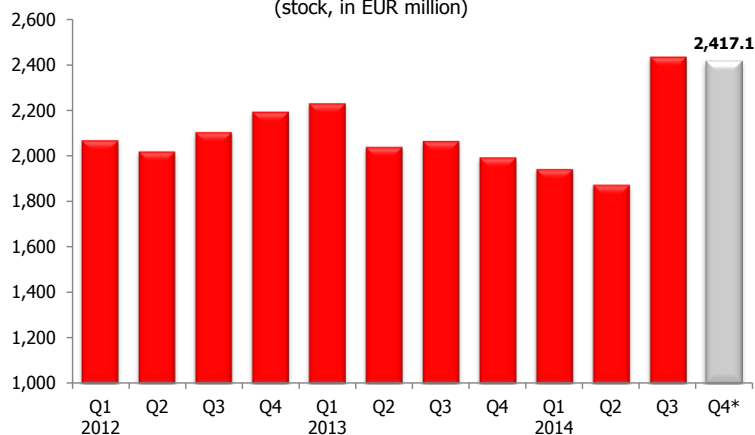


* Latest data as of 30.11.2014.

Source: NBRM.

According to the latest data available from the currency exchange market, net inflows of private transfers in the fourth quarter of 2014 are expected to be somewhat higher than planned in accordance with the October projection.

Foreign exchange reserves
(stock, in EUR million)

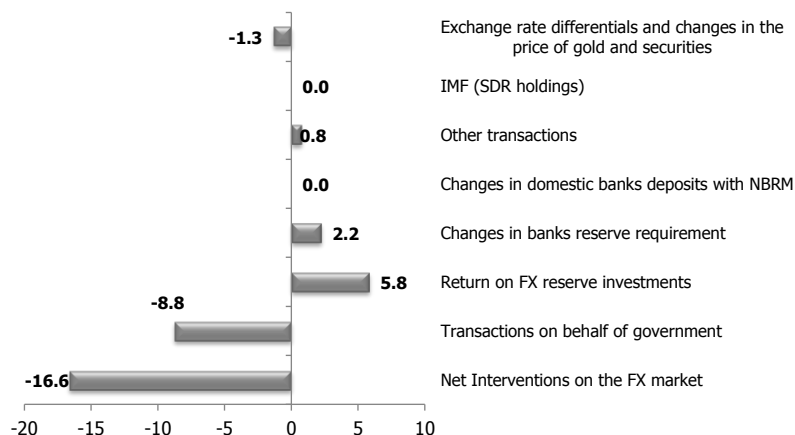


* Latest data as of 30.11.2014.

Source: NBRM.

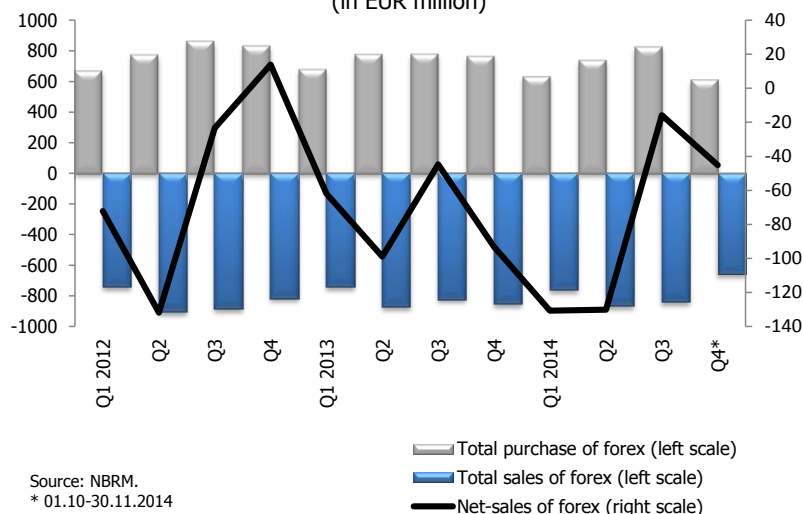
As of 30 November 2014, gross foreign reserves were in the amount of Euro 2.421.2 million, which is a decline of Euro 13.8 million compared to the end of the third quarter of 2014. The decline in foreign reserves was mostly due to the net sale of foreign currency by the NBRM in the foreign exchange market and the transactions on behalf of the government, which were partially offset by the positive movements in the currency changes and changes in the price of gold and the NBRM transactions.

Factors of change of the foreign reserves in the third quarter (in EUR million)



Source: NBRM.

Forex market
(in EUR million)



Source: NBRM.

* 01.10-30.11.2014

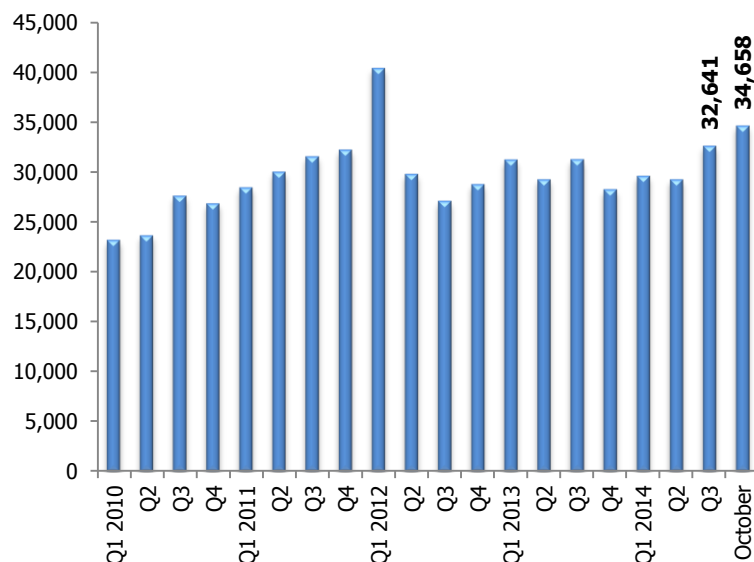
In the period 1 October - 30 November 2014, the **foreign exchange market** with the banks registered a net sale of Euro 49.8 million, which is lower than the net sale of Euro 71.6 million realized in the same period last year. This annual change is a result of the faster annual growth in the supply relative to the growth in the demand for foreign currency (of 30.7% and 21.7%, respectively).

The analysis by sector suggests that better annual performances are due to the non-residents sector¹², where a significantly higher net purchase was realized on an annual basis, amid a significant annual increase in the net sales by companies.

¹² The higher supply by non-residents for the most part reflects the purchase of foreign currency in the amount of Euro 71 million as a result of the change in the ownership structure of one domestic company.

Data as of October show liquidity withdrawal through monetary instruments relative to the end of the third quarter, which is within the October projection for the fourth quarter ...

Monetary policy instruments, in MKD million

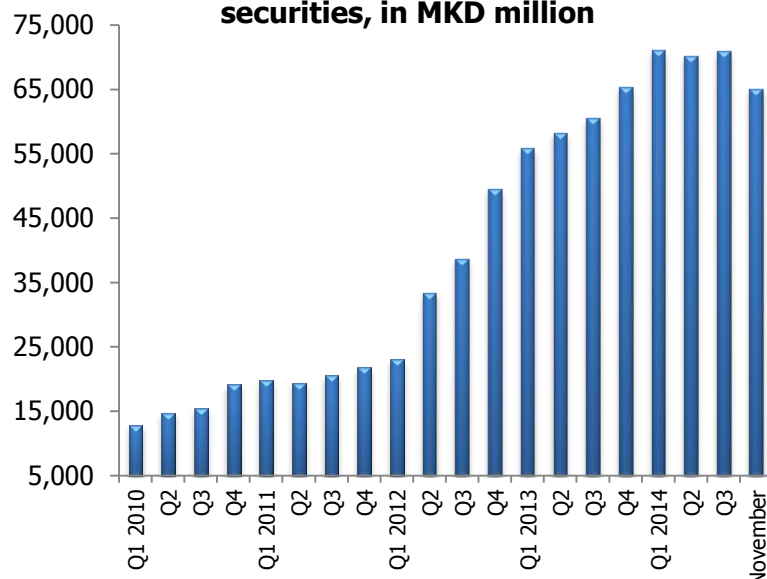


Source: NBRM.

... at a time when the net foreign assets of the NBRM registered a small decline and amid reduced total government deposits with the NBRM relative to the end of the third quarter, which is consistent with the pace projected for the fourth quarter.

According to the latest available data, in October, in the Budget of the Republic of Macedonia a deficit of Denar 656 million was registered. On a cumulative basis, for the period January to October, the budget deficit amounted to Denar 18,110 million (or 3.5% of GDP¹³), representing 92.4% of the projected budget deficit for 2014 in accordance with the supplementary budget. In terms of its financing, in October the budget deficit was financed by withdrawing deposits from the account with the NBRM, while the Government made net payments on the basis of government securities.

Outstanding amount of Government securities, in MKD million

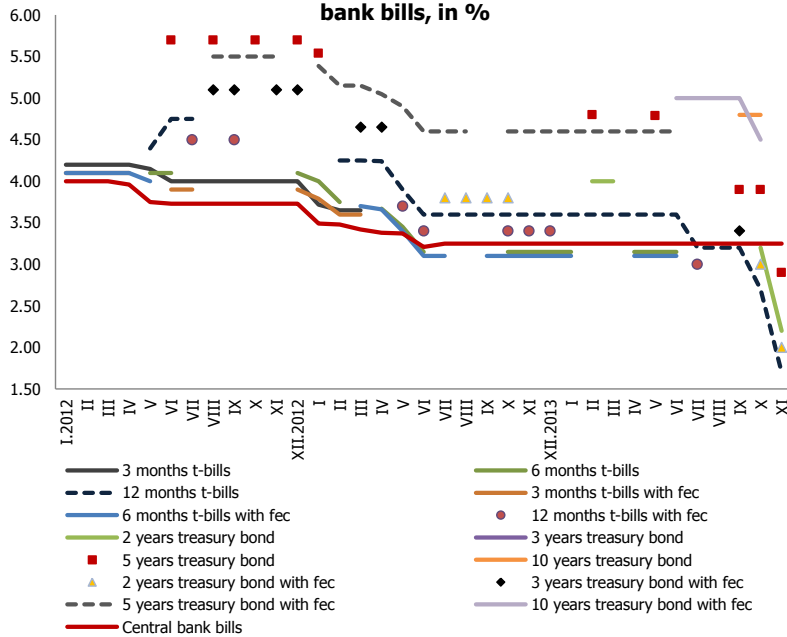


Source: NBRM.

The stock of government securities in the domestic market amounted to Denar 64,956 million at the end of November and compared to September 2014, it is lower by Denar 5,959 million. On a cumulative basis, as of November, net repayment of government securities in the amount of 363 million was registered.

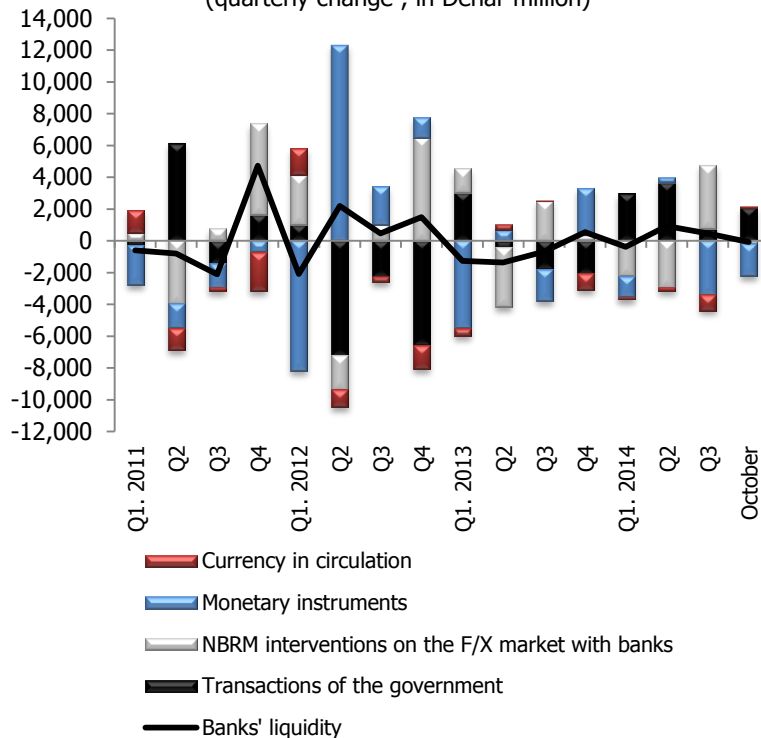
¹³ For the calculations the NBRM's projection for the nominal GDP was used. According to the projection of the Ministry of Finance the budget deficit for the period was 3.4% of GDP.

Interest rates of treasury bills, treasury bonds and central bank bills, in %



Source: NBRM.

Liquidity of the banking system*
(quarterly change, in Denar million)



*Positive change- liquidity creation, negative change- liquidity withdrawal.

** Refers to July and August.

Source: NBRM.

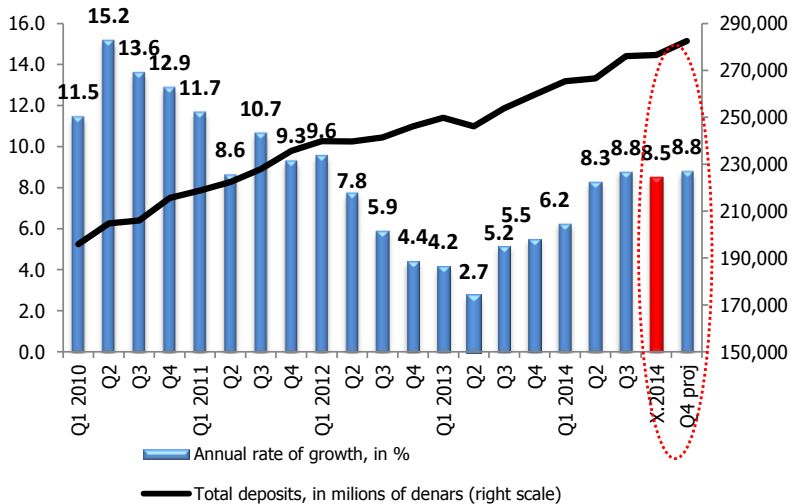
Interest rates on government securities on the auctions held in November ranged from 1.7% for the 12-month treasury bills, 2% and 2.2% for the 2-year government bonds with and without foreign currency clause, respectively, up to 2.9% for the 5-year government bonds. All types of government securities issued in November were with lower interest rates compared with the previous auctions.

Regarding the flows of creating and withdrawing liquidity, in October liquidity was created through government transactions, while liquidity withdrawals were made through monetary instruments. In such circumstances, in October the total liquidity recorded a slight decline.

In late October, reserve money registered a slight decline compared to the end of September, which is contrary to the expectations for their growth in the fourth quarter ...

... amid registered decline in the currency in circulation, and growth of banks' total liquid assets, as opposed to the expected growth of the two components in the fourth quarter, according to the October projection.

Total deposits

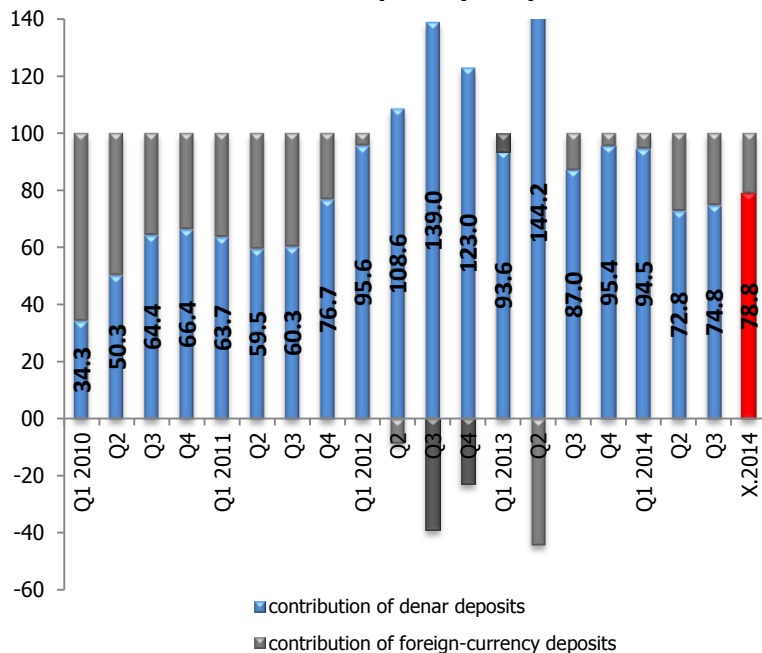


*Includes demand money
Source: NBRM.

Total deposits continued to grow in October, but at a significantly slower pace compared with September. Analyzed by sector, the monthly increase is fully a result of the growth of household deposits amid moderate reduction in corporate deposits.

The annual total deposits growth rate was 8.5%, while the latest October projection for the fourth quarter of 2014 forecasts growth of 8.8%. The achieved growth of the deposit base in October (of Denar 547 million) is 8% of the projected quarterly increase for the last quarter of 2014.

Contribution of denar and foreign currency deposits to the growth in total deposits (in %)

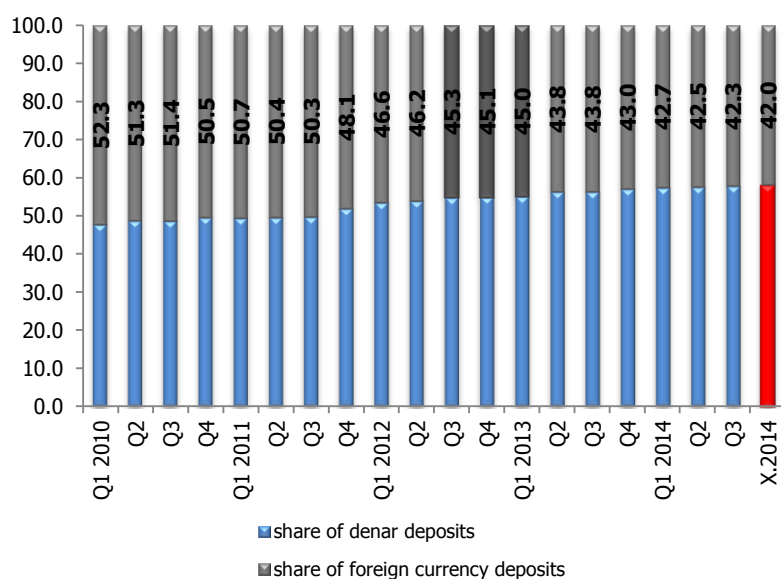


Source: NBRM.

Realized annual deposit growth largely remains driven by increased Denar deposits, but foreign currency deposits also act in this direction (contribution of 21% of the total annual growth). During October, foreign currency deposits registered moderate reduction on a monthly basis.

*Includes demand deposits

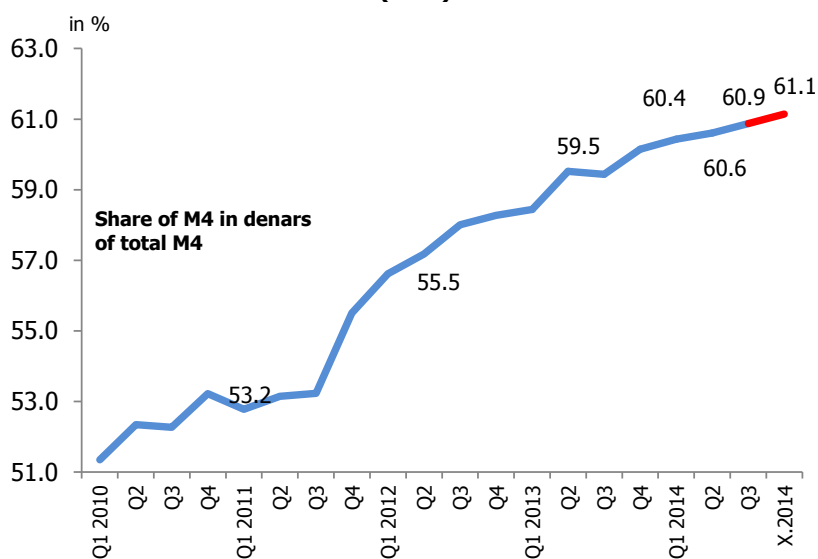
**Share of denar and foreign currency deposits in the total deposits
(in %)**



According to the data as of October, the currency structure of total deposits remains stable, and the deposits in domestic currency still have greater share in the deposit base.

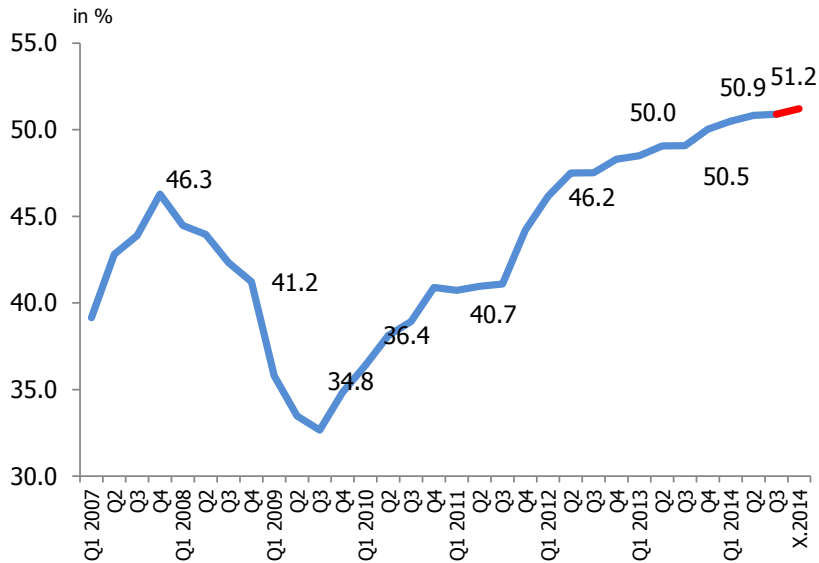
Source: NBRM.
*Includes demand deposits.

**Share of M4 in denars in total M4
(in%)**



Source: NBRM.

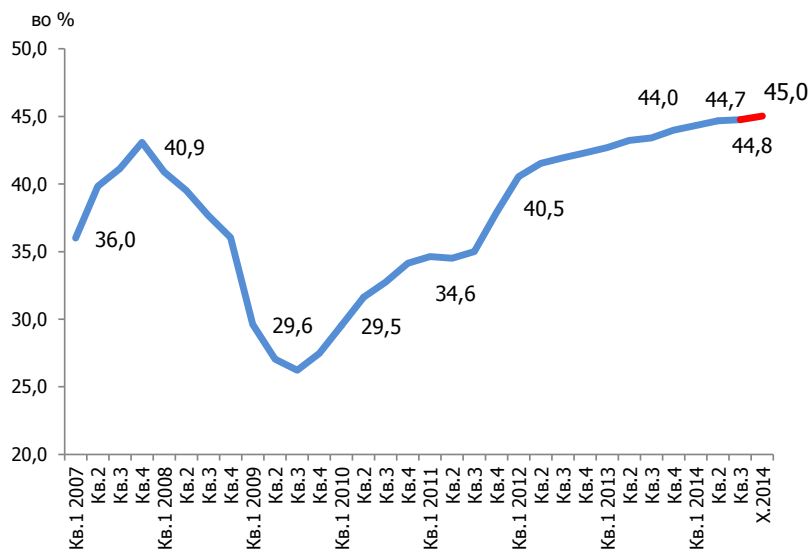
Share of denar deposits in the total household deposits, in %



Source: NBRM.

*Includes demand deposits.

Share of denar deposits in the total household deposits (excluding demand deposits), in %

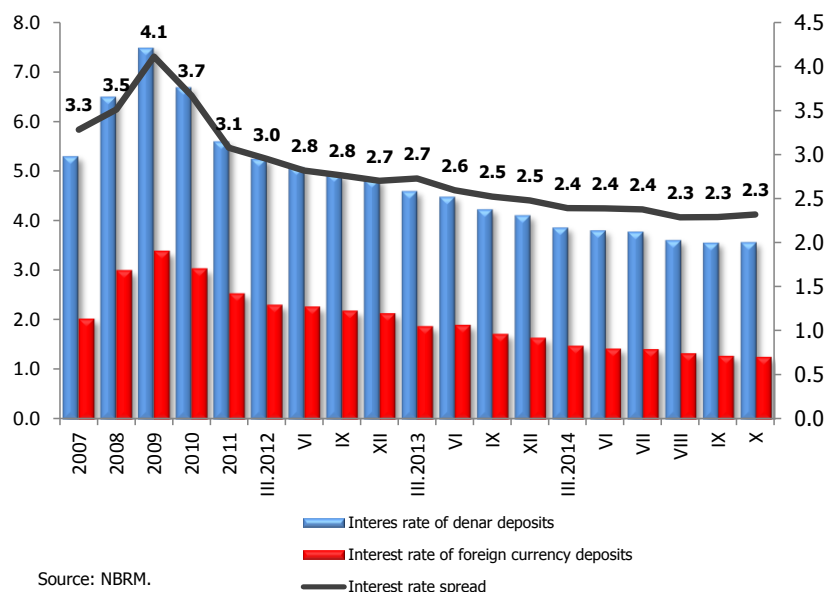


Извор: НБРМ.

The achieved growth of total household deposits in October is solely due to the increase of Denar deposits ...

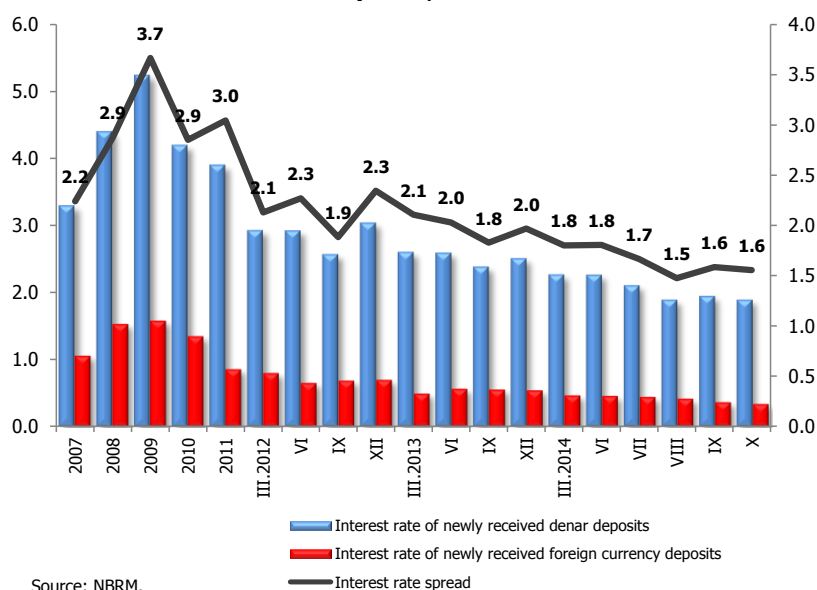
... which led to a slightly higher share of the deposits in domestic currency in the total household deposits (accounting for 51.2%).

Interest rates on denar and foreign currency deposits, in%

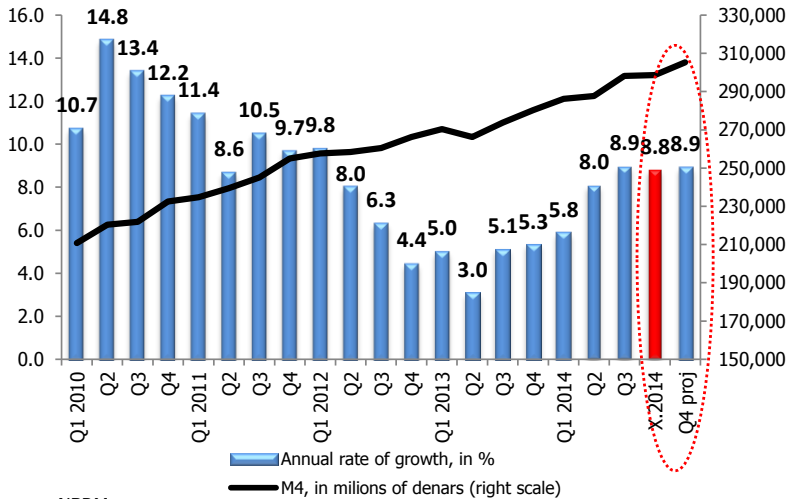


During October, interest rates on Denar and foreign currency deposits (total and newly received) remained unchanged compared to the previous month, indicating the stabilization of the interest rate spread between Denar and foreign currency savings.

Interest rate of newly received denar and foreign currency deposits, in %



Broad money, M4

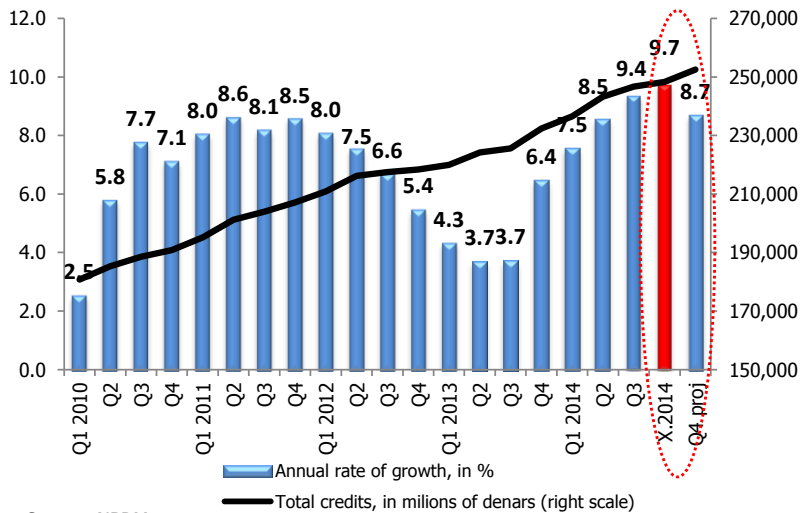


Source: NBRM.

According to the data as of October, the broad money supply increased, which is consistent with the expectations for growth of the money supply in the last quarter according to the October projection ...

... with the realized growth as of October being around 7% of the growth projected for the fourth quarter.

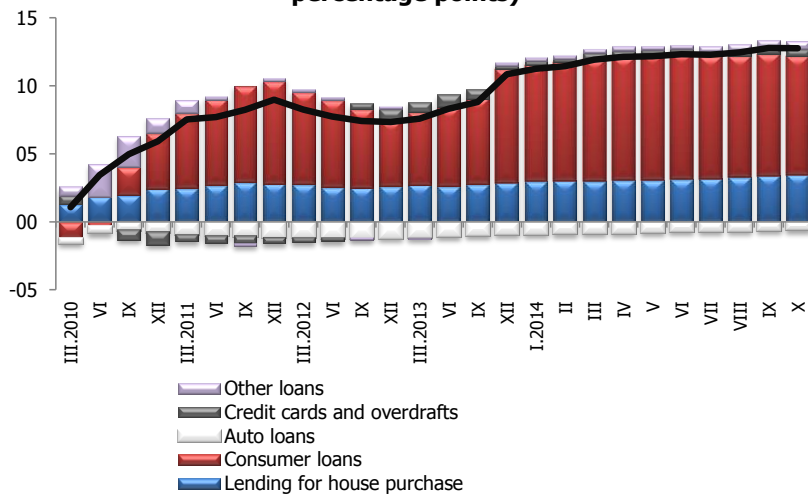
Total loans



Source: NBRM.

According to the data as of October, further favorable movements were registered on the credit market. The achieved growth was somewhat slower, but still close to the growth registered in September, when acceleration of the monthly growth was registered (an increase of Denar 2.077 million, versus the relatively weak performance in the previous two months, July and August of Denar 660 million, on the average). By sectors, loans to households continued to be the main driver of the monthly increase in total loans (explaining 70% of the total growth), but corporate loans also gave positive contribution.

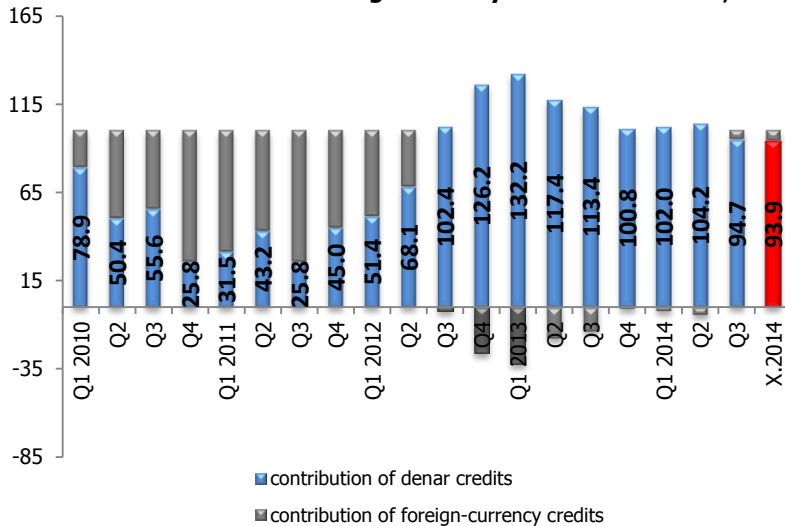
**Loans of banks and savings houses extended to households
(contribution to the annual change of loans to households*, in percentage points)**



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

The annual growth rate of total loans at the end of October amounted to 9.7%, while the October projection for the end of the fourth quarter envisages an annual growth of 8.7%¹⁴. During October, total loans increased by Denar 1,659 million representing approximately 28% of the expected growth by the end of the year.

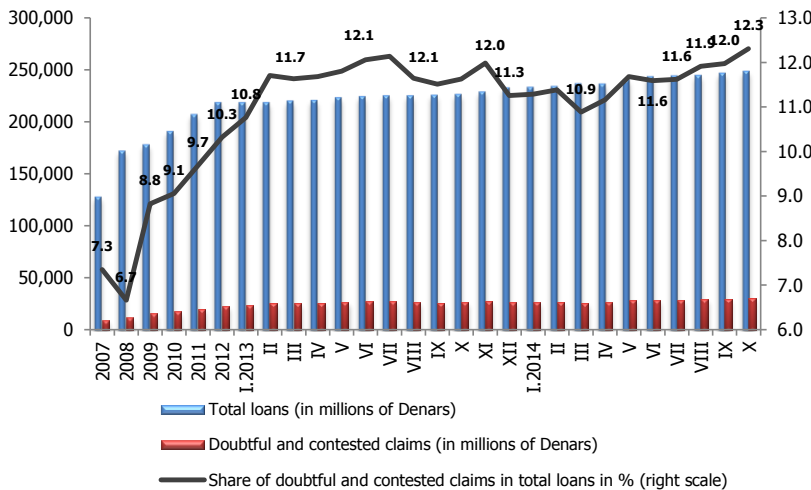
Contribution of denar and foreign currency loans to total loans, in %



The annual increase in total loans remains largely a result of the growth of the Denar loans. Foreign currency loans retained the moderately positive contribution to the total annual growth in loans.

Source: NBRM.

Share of doubtful and contested claims in total loans, in %



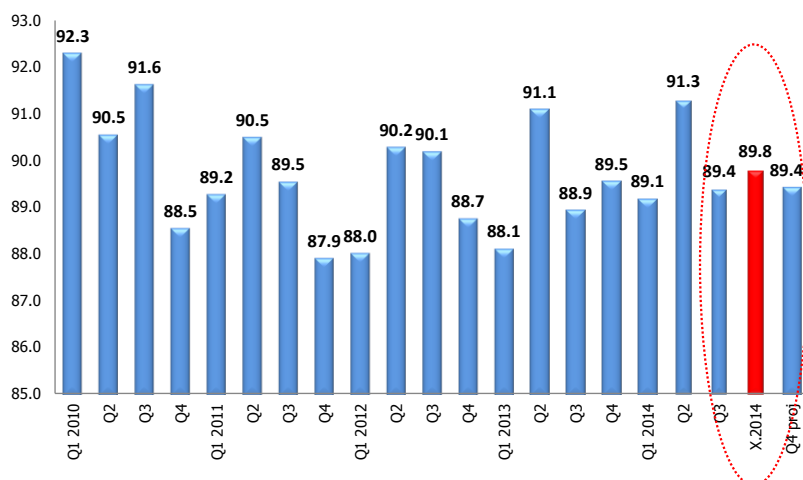
Source: NBRM.

During October, total doubtful and contested claims continued to increase at an accelerated pace compared to the previous month which contributed to the slight increase in the share of doubtful and contested claims in the total loans¹⁵ (to 12.3%). Such movements are entirely driven by the further growth of non-performing loans to the corporate sector.

¹⁴ The lower growth rate for the end of 2014 is largely due to the base effect, given that in November and December 2013, a significant acceleration of the credit activity of the private sector was registered, with the total growth in that period being in the amount of Denar 6,120 million.

¹⁵ The indicator refers to the total loans to the financial and non-financial sector.

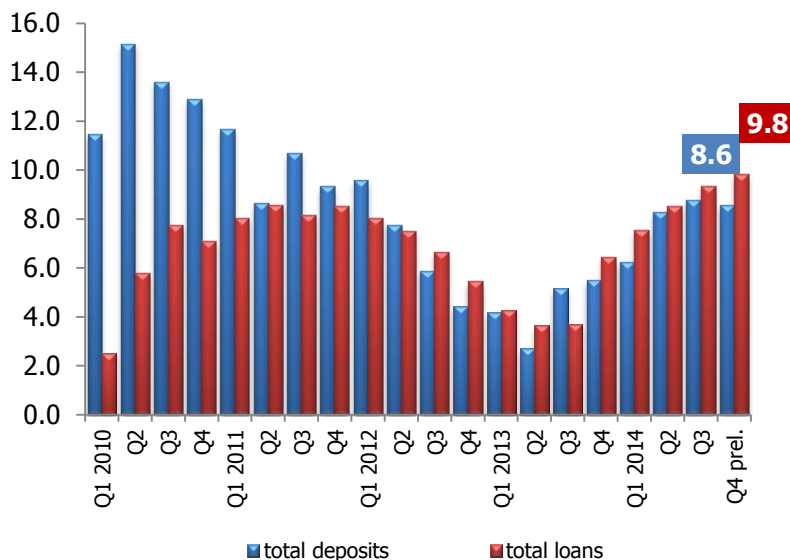
Ratio of total loans to deposits, in%



Source: NBRM.

The utilization of the deposit potential in lending to the private sector at the end of October is a little higher than that registered in the third quarter. These developments are a result of the faster monthly growth of total loans compared to the moderate growth of the deposit base. The ratio between total loans and deposits is also higher than the level expected within the October projection for the end of 2014.

Total loans and deposits, annual changes, in %



Source: NBRM.

According to the preliminary data, the total deposits growth continued in November with significantly higher intensity compared to the previous month. Household deposits continued to generate solid growth amid registered growth also of corporate deposits on a monthly basis. Deposits of other financial institutions also contributed to the accelerated growth in total deposits in November. Their monthly growth explains about 45% of the growth in total deposits. In total loans, preliminary data as of November show intensified lending activity compared with the previous month. A specific feature is the enhanced credit support to companies, given that about 72% of the newly extended loans in November were placed with the corporate sector. In such circumstances, according to the preliminary data, the annual growth rate of total loans in November was 9.8%, amid growth in total deposits of 8.6% annually.

Annex 1 Timeline of the changes in the setup of the monetary instruments of the NBRM and selected supervisory decisions adopted in the period 2013-2014

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 has been applied since 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 the seven-day deposit facility was cut from 1.75% to 1.5%.
- A Decision amending the Decision on the 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% to 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 management was adopted. This decision reduces the proportion of time deposits assumed to flow out 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 the 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 the interest rate on seven-day deposit facility from 1.5% to 1.25% was adopted.

April 2013

- 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 changes in the new EU Regulation no. 575/2013 on prudential requirements for credit institutions and investment companies), performance guarantees or warranties that guarantee some work done, stand out as items with low-intermediate risk, and therefore lower conversion factor (20%) is provided for them, 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 a 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 subjects (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 covering 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 potential¹⁶, 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.

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 December 31, 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.

¹⁶ 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