

National Bank of the Republic of Macedonia
MONETARY POLICY AND RESEARCH DEPARTMENT



**Recent Macroeconomic Indicators
Review of the Current Situation**

February 2015

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 (November - January 2015) 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. The uncertainty remains, and recent indicators still point to increased future risks compared with October projections.

With regard to the Euro area, the latest high frequency indicators of growth and the slight decline in unemployment to 11.4% registered in December show a mild recovery of the economy, however insufficient for greater exploitation of the potential of the economy and reduction of the risk of prolonged deflation. This is confirmed by the preliminary data on inflation in the Euro area for January. Given the decline in the energy prices and weak demand, data show further decline of the price level to 0.6% (down from 0.2% in December on an annual basis) and reduction of core inflation to the historical minimum of 0.5 %. At the meeting held in January 2015, the ECB began with the announced "quantitative easing", in a volume twice higher than previously expected. Namely, at this meeting ECB announced the new expanded program for purchasing financial assets in the Euro area, which provides direct purchase of securities issued by private and public sectors, by the central bank. Thus, besides the two programs for purchasing asset-backed securities and covered bonds issued by financial institutions in the Euro area, denominated in euro, which the ECB started in the last quarter of 2014, the new program is planned to include purchasing of securities issued by the Euro area Member States, but also of certain European institutions. The program is expected to be implemented in the period from March 2015 to September 2016 with an option for its extension until sustainable convergence rate of inflation in the Euro area to the level of about 2% in the medium term is ensured. The program provides monthly purchasing of financial assets amounting to Euro 60 billion (including the purchase of asset-backed securities and covered bonds issued by financial institutions in the Euro area, denominated in euro), bringing the total amount the program to about euro 1,000 billion. This program provides further easing of the monetary policy by increasing the balance sheet of the ECB in order to support the process of economic recovery.

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 less intensive recovery of foreign demand, largely due to the weaker economic outlook in Serbia and in Germany. 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 in 2015. Another growth in the oil prices is expected in 2016, contrary to the expected stagnation in the October projections. Recent

movements in **metal prices** suggest somewhat more favorable changes in nickel and copper 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, compared to last month's assessments, these prices have been revised downwards. Frequent adjustments in the expectations about the prices of primary products confirm the high uncertainty regarding their future movements.

The comparison of the latest macroeconomic indicators with their projected dynamics within the October cycle of projections does not indicate major deviations in the individual segments of the economy. In terms of the indicators relevant for the monetary policy, in the absence of new data, it is re-ascertained that **inflation as of December is in line with the October projection.** In the fourth quarter, the general price level continued to decline on an annual basis, but at a slightly faster pace. However, the biggest single contribution to the decline was made by the energy component, reflecting the declining world oil prices. After a longer period of time, in the last quarter, core inflation also entered the negative zone. Food prices continue to decline, but at a slower pace than in the previous two quarters. On average for the whole of 2014, the price level fell by 0.3% due to the decline in the prices of food and energy and significantly slower growth in core inflation. Given the changes in the expectations regarding oil prices, currently there are downward risks to the projected inflation for 2015. However, one should bear in mind that there is great uncertainty about the future movements in world oil prices and possibility of sudden changes in this category. Also, in the meantime, upward risk factors appeared, i.e. adverse weather conditions in the domestic economy, but for the time being it is difficult to assess their effect accurately.

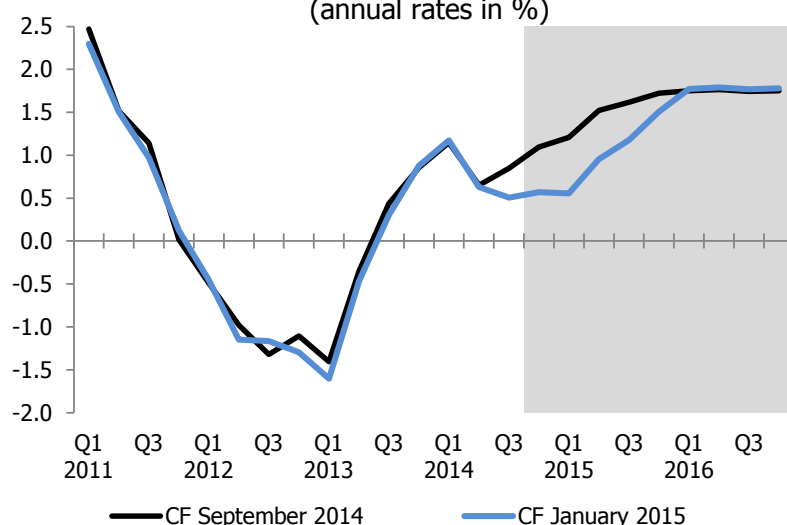
The latest data on foreign reserves show their moderate decline since the beginning of 2015 (excluding the effects of price and exchange rate differences and price changes of securities), which is in line with the expectations in the October projection. Analyzed through the factors of change, the decline in the reserves in this period is also a result of the transactions on behalf of the government. On the other hand, the movements of the foreign exchange market were favorable, and in January the NBRM continued to purchase foreign currency. The latest available indicators of the balance of payments as of November, confirm the findings of a lower current account deficit in 2014, with somewhat lower than expected financial inflows. Data on foreign trade as of December also lead to this conclusion, indicating a smaller trade deficit than projected, amid improved export performances mainly of the new export-oriented facilities. The analysis of foreign reserves adequacy indicators shows that they continue to move in a safe zone.

The latest high frequency data for the economic activity for the last quarter of 2014 point to further growth of the domestic economy, at probably a similar pace as in the previous quarter. The continuation of the economic growth in the last quarter is evident in most of the indicators by sector, with the exception of construction, which given the high comparison base still registers an annual decline. Movements in the indicators of economic activity registered so far, suggest the possibility of a slightly higher than expected growth in 2014. **In terms of monetary movements**, final data on the credit market in December confirmed the preliminary assessments for the further intensification of credit growth and greater allocation of loans to the corporate sector. These developments led to exceeding the projected quarterly growth for the fourth quarter, according to the October projection. Thus, the annual growth rate of total loans in December is 10%, which is above the projection for the fourth quarter of 8.7%. Regarding the deposit potential, in December

the monthly growth dynamics significantly intensified, making the deposits exceed the October projection for the last quarter. 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 point to 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. Since the beginning of the year, foreign reserves have registered a slight decline, which is in line with expectations. Foreign reserves adequacy Indicators remain in the safe zone. The risks from the external environment remain unfavorable and are further highlighted by the deteriorated perspectives for the economic growth in the Euro area and the persistent geopolitical tensions. Regarding inflation, as of December, it was in line with the October projection, with downward risks regarding the projection of the future dynamics of inflation due to the sharp decline in the prices of energy products. Indicators of economic activity for the last quarter of 2014 point to somewhat more solid performance than expected. The final data as of December confirm the assessments for higher credit growth than projected.

Foreign effective demand
(annual rates in %)



Source: "Consensus Forecast" and NBRM calculations.

The latest data and assessments point to slightly slower growth of foreign effective demand¹ in 2014 than expected in October ...

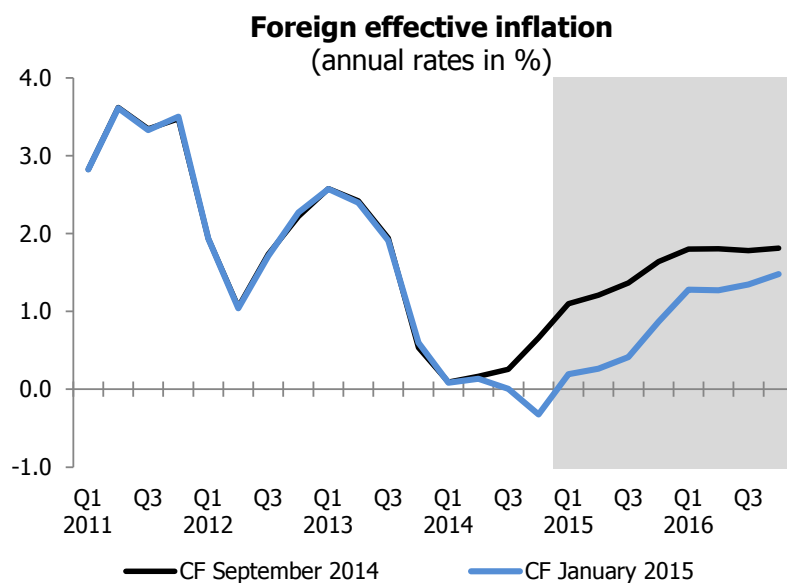
... which is now being assessed at 0.7%, as opposed to the October projection of 0.9%.

Such downward revision is almost entirely due to the adjustments made to the projections for the economic growth in Serbia and Germany, which is now estimated to be more negative, i.e. slower than the October assessment, respectively.

The less favorable expectations for the growth of these two most important trading partners, and to some extent the expectations for slower growth in Bulgaria, are the main determinants of the downward adjustment of the projection for the growth of the foreign effective demand in 2015, which was reduced from 1.5% in October to 1%.

On the other hand, the expectations for growth in foreign demand of 1.8% in 2016 were retained.

¹ 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 of the European System of Accounts 2010 (ESA 2010).



Source: "Consensus Forecast" and NBRM calculations.

The latest data indicate that the foreign effective inflation amounts to 0% in 2014, which is a downward adjustment of 0.3% compared with the October projection ...

...amid lower inflation than expected for the second half of 2014 with all of our import partners.

The downward revision of the foreign inflation in 2014 is mainly explained by the larger decline in the prices in Serbia² and in Bulgaria, as well as the lower inflation in Germany compared with the expectations.

In 2015, a significant downward revision of the assessment of foreign inflation was made, which is expected to remain low and amount to 0.4%, being more than three times lower than the October projection of 1.3%.

Moreover, all of our partners expect lower rates of inflation than projected in October ...

... with the revised projections for the consumer prices in Serbia, Germany, Croatia and Bulgaria having the greatest impact on the downward revision.

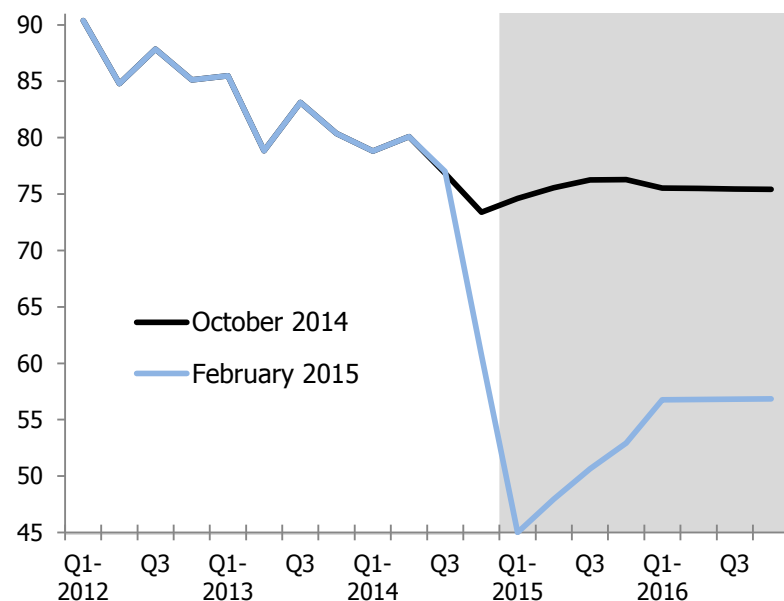
Foreign effective inflation is expected to accelerate to 1.4% in 2016, which is also a downward deviation compared to the October projection of 1.8%.

According to recent assessments of the price of oil, it is estimated that the fall in 2015 will be much sharper than expected in the October projection ...

... when it is expected that the supply of oil on world markets will remain high amid intensified production in the USA

² Inflation in Serbia is negative after the adjustment for the changes in the exchange rate. Without these adjustments, inflation in Serbia is positive.

Brent oil
(quarterly average, EUR/barrel)

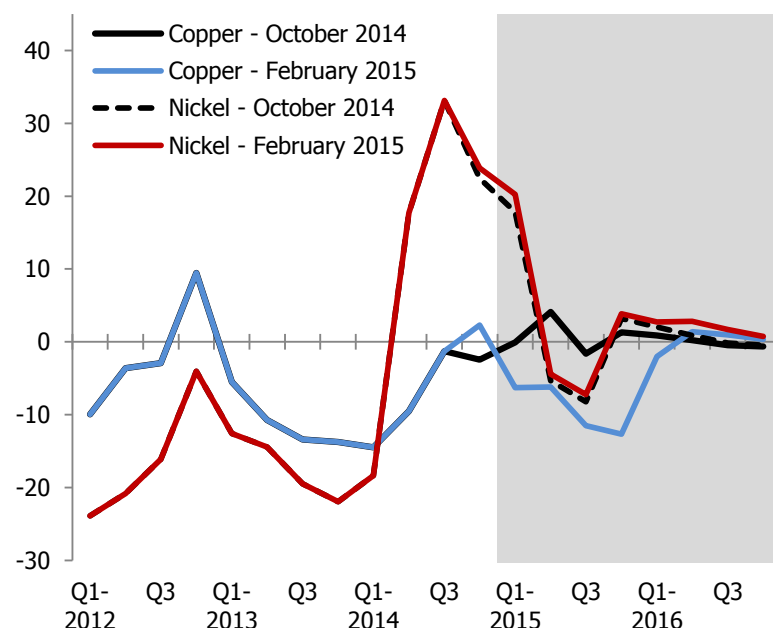


Source: IMF and NBRM calculations.

and exceeding the targeted producing limit of OPEC countries. The relatively low global demand and uncertainty about global economic growth are expected to produce an additional downward effect on the price of oil.

In 2016, oil price is expected to rise again, contrary to the expected stagnation in the October projections. However, its level would be lower than in the October projection. Such developments reflect the expectations for gradual balancing of the market, primarily through the adjustment of the supply from the USA, given the continuing low levels of oil prices.

Nickel and copper prices in EUR
(annual changes in %)



Source: IMF and NBRM calculations.

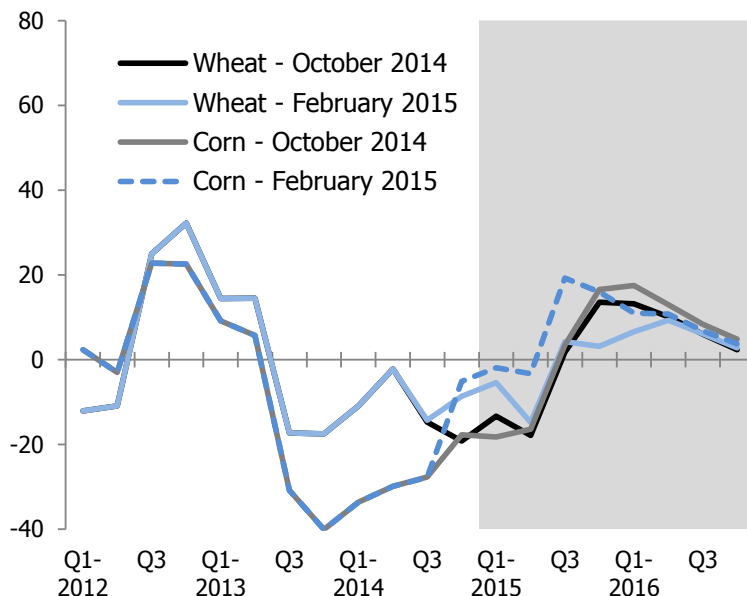
In 2015, divergent movements in metal prices in euros are expected, compared with the October projection.

Thus, according to the latest projections nickel price is expected to rise in 2015, slightly more than expected in October...

...while the price of copper will register a significant decline rather than previously expected minimal growth as a result of the economic slowdown in China and the Euro area and the still present surplus of this metal on world markets.

On the other hand, metal prices are expected to grow moderately in 2016, at a pace similar to that expected in the October projection.

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



Source: IMF and NBRM calculations.

With the latest assessments for 2015, an upward revision of the expected price changes of cereals in relation to the October projection was made.

The annual decline in the price of wheat is envisaged to be smaller than previously expected, while the price of corn is expected to grow rather than decline, as projected ...

....which is a combined effect of the limited supply of cereals on world markets because of the weaker harvest, on the one hand, and the expectations for depreciation of the euro, on the other.

The latest estimates for 2016 indicate a further increase in the prices of wheat and maize, which will still be moderately lower than anticipated in the October projection.

In the fourth quarter of 2014, the one-month Euribor was almost at the level of the October projection ...

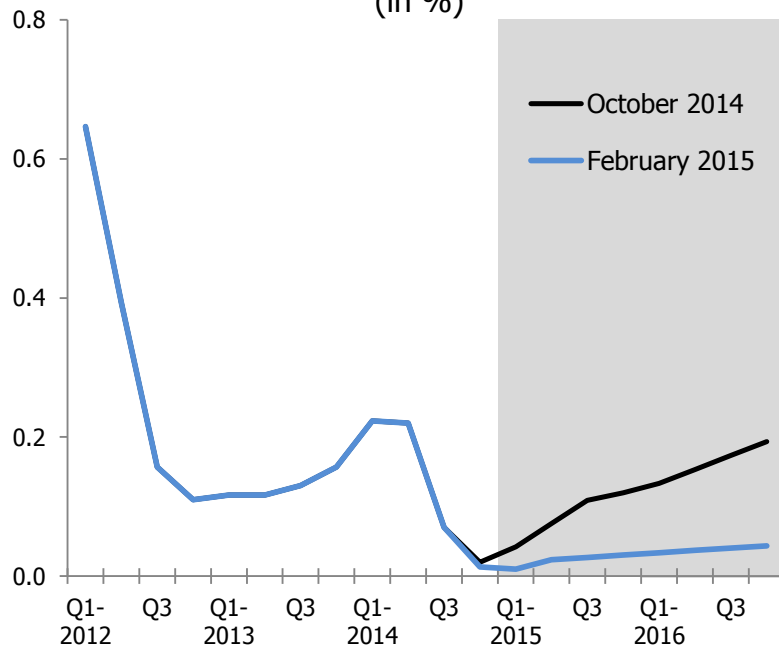
... so on an annual level, the average interest rate was 0.13% and was unchanged compared to the previous year.

For 2015 and 2016, a downward revision was made to the projection of the foreign interest rate, relative to the October assessment ...

... and it is expected to be 0.02% and 0.04%, respectively, compared to 0.09% and 0.16% in October ...

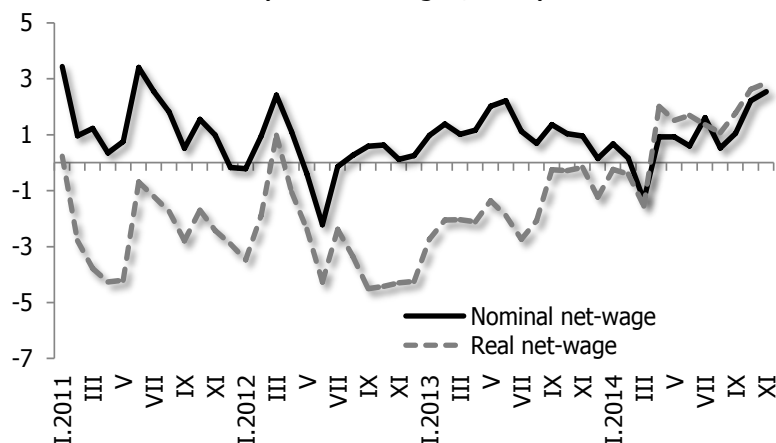
...which is largely a reflection of the measures for monetary policy easing of the ECB, especially the expanded asset purchase program (so-called quantitative easing) which was announced in January, and will start to be implemented from March 2015.

1-month Euribor
(in %)



Source: "Consensus Forecast" and NBRM calculations.

Average net-wage
(annual changes, in %)

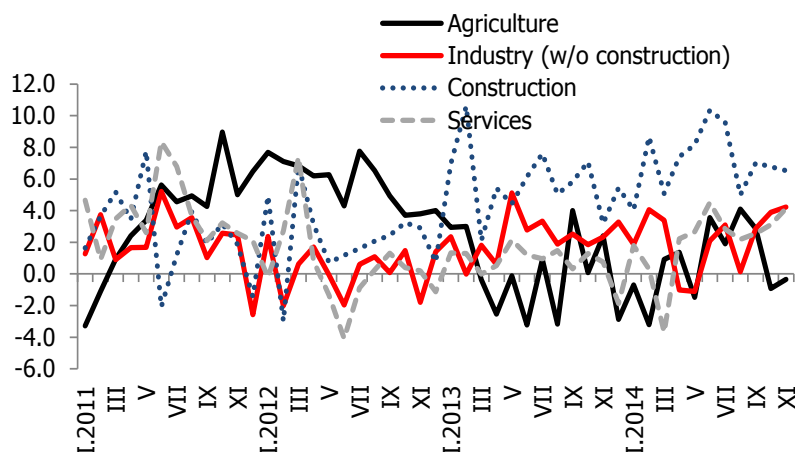


Source: SSO.

In November 2014, the average **net wage** recorded a nominal annual growth of 2.5%...

... which is an acceleration of 0.3 percentage points relative to the average net wage registered in October.

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



Source: SSO.

Almost all sectors registered upward movements in the wages...

... however, the fastest growth was registered in the wages of the sector "professional, scientific and technical activities", as well as wages in the mining and financial sectors.

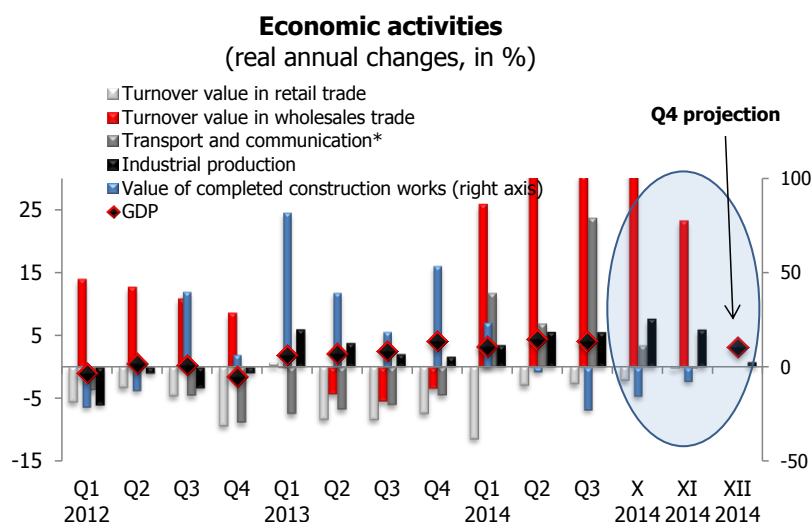
Also, the fast annual wage growth was registered in the sector "public administration and defense and compulsory social security", followed by education and "the activities of health and social care" (3.4%, 4.5%, and 4.5%, respectively), mainly as a base effect of the October increase in the wages of employees in public administration.

A decline was registered only in the wages in catering and agriculture.

In the first two months of the last quarter, nominal wages were, on average, more favorable relative to those anticipated with the October projection (expected growth of 1.4% in the fourth quarter).

Amid further decline in consumer prices and more dynamic nominal wage growth in November the positive annual dynamics of real wages intensified (growth of 2.9% in November, compared to 2.6% in October).

Real wage growth, on average in the first two months of the fourth quarter, was also slightly faster than expected in the October cycle of projections.



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

The indicative high-frequency data for the fourth quarter of 2014 indicate growth of the national economy at a similar pace as in the previous quarter, given the constant positive performance in most economic sectors.

In the fourth quarter, industrial production grew by 4.7% on an annual basis, which is a pace slower than that registered in the previous three-month period...

Growth is mostly associated with the production of motor vehicles, as well as production of machinery and devices, mainly in the segment of operation of the new facilities in the technological and industrial development zones.

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.³

Additionally, in the first two months of the last quarter, the turnover of inventories⁴ in the industry further intensified its annual dynamics.

In the first two months of the fourth quarter there was a slower real annual decline in **retail trade**, small slowdown in the fast double-digit growth in the **wholesale trade**, and virtually unchanged annual pace of growth in the **trade in motor vehicles. These trends** indicate favorable developments in the trade sector in this period, but probably at a slower pace relative to the movements in the previous quarter ...

... a conclusion that can be drawn also from the assessment of the managers in

³ SSO's Business Tendency Survey in manufacturing industry.

⁴ Inventories turnover is a ratio between trade and inventories 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.

retail trade⁵ for a more significant increase in the amount of inventories in the third quarter compared to the same period last year...

...which amid deteriorated expectations for the orders in the last quarter ...

... is assessed as an additional indication of a possible slowdown in the positive dynamics of this sector by the end of the year.

In the first two months of the fourth quarter performances in the **catering** are also **positive** and point to annual growth of the realized turnover in real indicators, with almost unchanged dynamics.

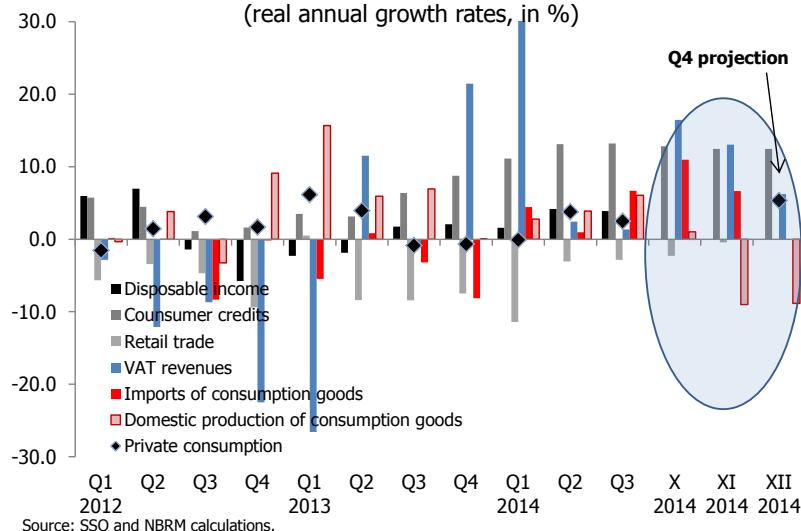
At the same time, the data for the first two months of the fourth quarter for **rail transport, as the only available indicator in the area of transport so far**, send **divergent signals** regarding the possible movements in the last quarter ...

... given the growth in the transport of passengers, amid simultaneous decline in the area of freight rail traffic.

On the other hand, after the fall registered in the previous two quarters, that comes after nearly two years of intensive strengthening of construction activity, the data on completed construction works in the first two months of the fourth quarter further point to an **annual reduction of the construction activity**, however at almost twice slower pace.

⁵ SSO's Business Tendency Survey in retail trade.

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



Available high-frequency indicators of aggregate demand also point to further economic growth in the last quarter of 2014, which is consistent with the expectations in the October projection.

Indicators of **private consumption** are favorable and indicate its increase in the last quarter...

... as a result of the faster annual growth of real wages in October and November ...

... continuing steady pace with double-digit growth rates of lending to households in the fourth quarter

... and maintaining the growth of paid pensions and private transfers (although at a slower pace).

The accelerated growth of net revenues from VAT and the imports of consumer goods also point to an increase in household consumption ...

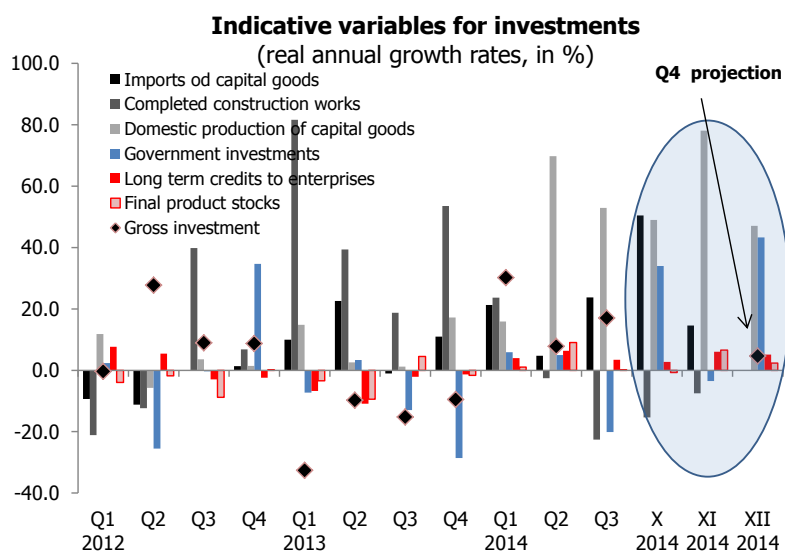
... while domestic production of consumer goods recorded an annual decline, versus the growth in the previous quarter...

...and the decline in retail trade continued in the first two months of the second quarter, although at a slower pace...

Recent indicators of **investment activity**, in general, point to investment growth in the last quarter ...

... against the backdrop of significantly faster growth in the imports of capital products and in the domestic production of capital goods ...

...while accelerated growth in the last



quarter was registered also in the long-term lending to the corporate sector and in the inventories of finished products.

Favorable movements in the last quarter were registered also in the government capital expenditures, which grew significantly, as opposed to the decline in the previous quarter.

On the other hand, unfavorable changes were observed in construction activity and in the inflows of foreign direct investment (although they decline at a slower pace compared to the previous quarter).

The available nominal **foreign trade** data show rising trade deficit in the last quarter compared to the same period last year ...

... in line with the expectations from the October projection for widening of the trade balance, although with less intensity than expected.

Budget performances for the last quarter point to higher **public consumption**, contrary to the assessments for its decline, as projected in October...

The indications of growth in the public consumption are associated with the intensified growth in the expenditures for goods and services, as well as the expenditures for wages...

... and they are additionally influenced by the growth of the transfers for health care⁶, versus their fall in the previous quarter.

⁶ Most of the transfers for health care relate to expenditures for goods and services.

EXTERNAL SECTOR

In the last quarter of 2014, **the deficit in the trade in goods with foreign countries increased by 3.8% on an annual basis**, amid faster growth of exports compared to the imports of goods ...

... which is in line with the expected widening of the trade deficit in the fourth quarter, according to the October projection. However, the deteriorated deficit in this period was lower than expected.

Exports of goods registered an annual growth of 14.6% during the last three months of the year, amid further increased use of the new export oriented facilities ...

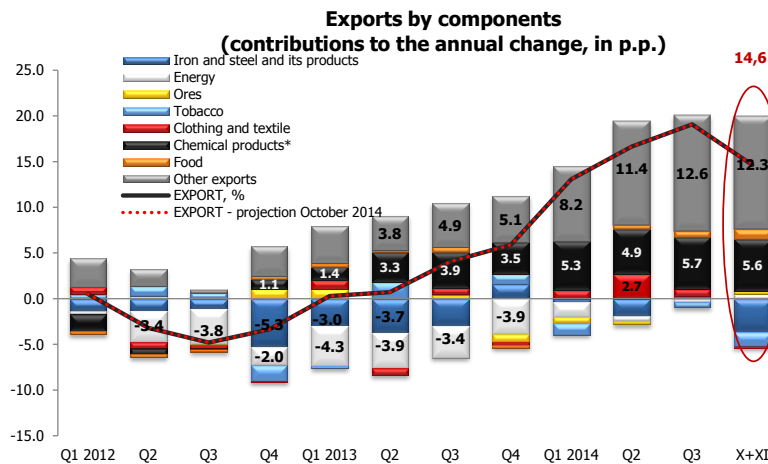
... and a small positive contribution was given by the other export industries, with the exception of exports of iron and steel, tobacco and textiles and clothing, which recorded an annual decline.

Compared with the projection, realized export in the last quarter was higher relative to the expected for the fourth quarter. The positive deviation is almost entirely due to the improved export performance of the new facilities, while more significant downward deviation was registered in the exports of iron and steel.

In the fourth quarter, **imports** achieved an annual growth of 10.8% in the fourth quarter, which was mostly due to the increased imports of raw materials for the new industrial facilities and to a smaller extent to the higher import of iron and steel and vehicles...

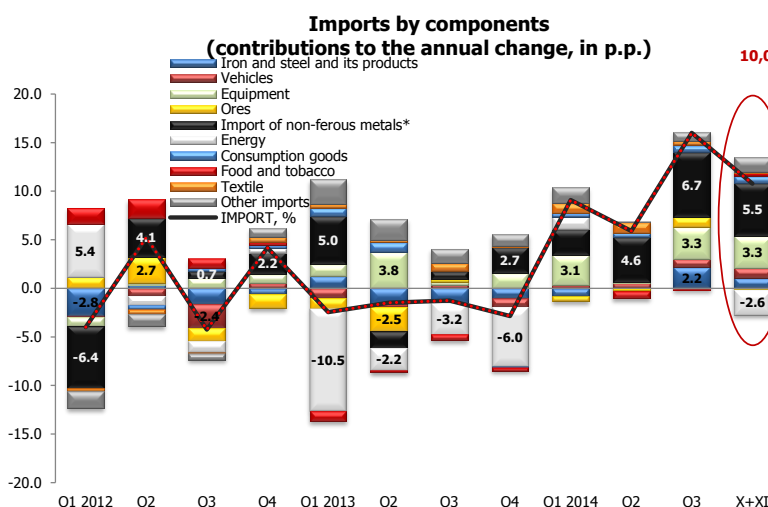
... while imports of energy fell again on an annual basis. This change in energy imports, largely reflects the reduced imports of oil products, which is mostly a result of the decline in the world oil prices, coupled with lower imported quantities.

Imports in the last quarter are somewhat higher than projected for the fourth quarter. Within the individual import



Source: NBRM.

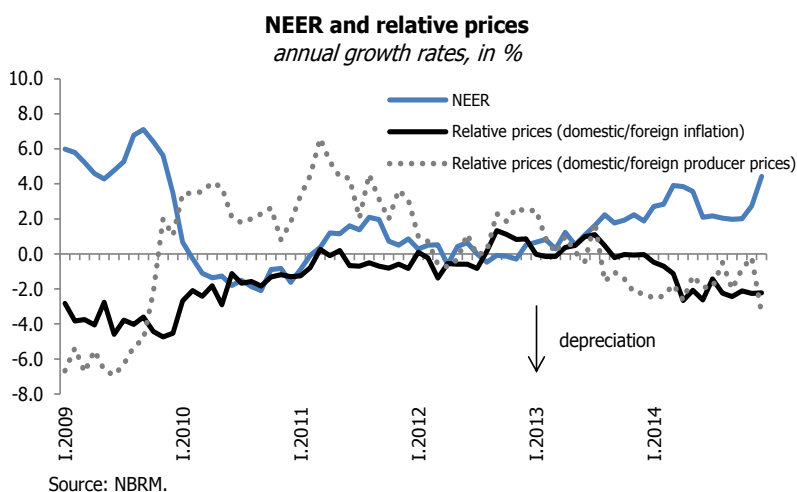
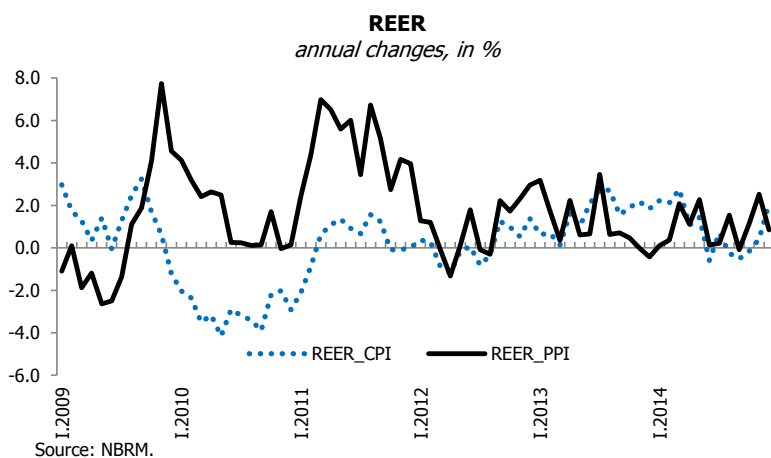
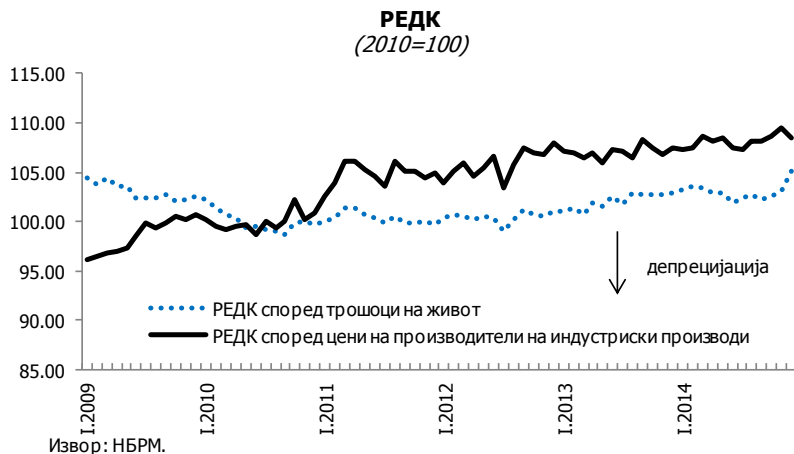
* The following data depict the overall exports of one major export capacity in the free industrial zone.



Source: NBRM.

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

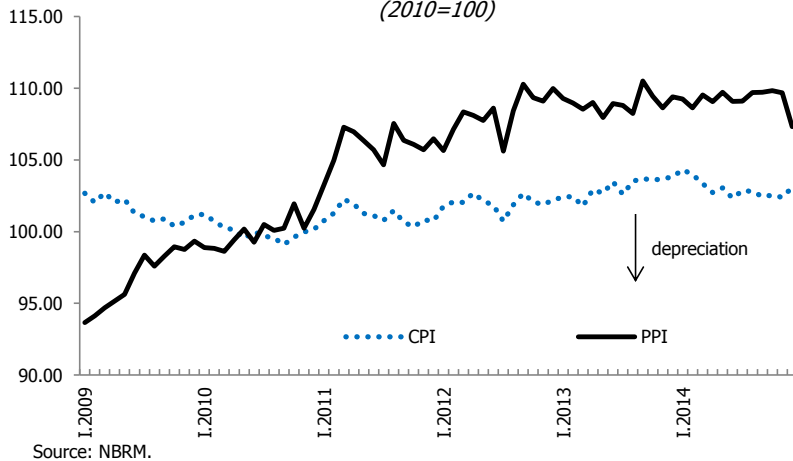
components, there are certain deviations from the projection. The largest upward deviation is achieved in the import of raw materials for the new export capacities, while a more significant downward deviation was registered in energy imports.



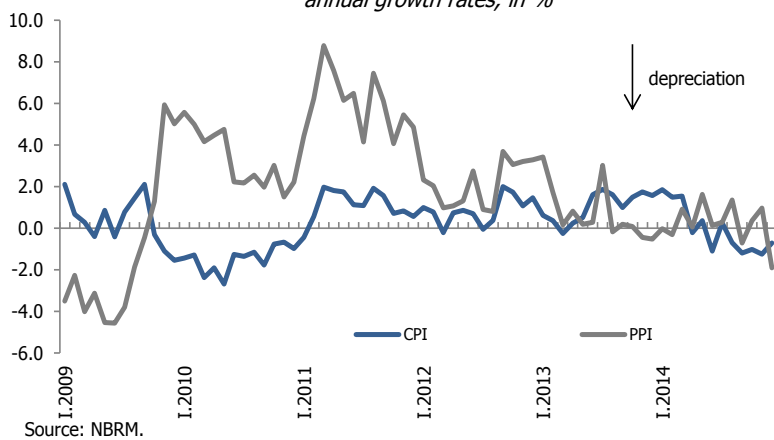
In December 2014, price competitiveness indicators of the domestic economy registered mild deterioration on an annual level. Compared with the same month of the previous year, the REER deflated by consumer prices appreciated by 2.1%, after three months of decline, while the REER deflated by producer prices slightly appreciated (by 0.8%) on an annual basis.

The further appreciation of the nominal effective exchange rate (by 4.4%) on an annual basis, primarily as a result of the prolonged depreciation of the Russian ruble and Ukrainian hryvnia against the denar, caused upward pressures on both REER indices. On the other hand, the growth of foreign consumer prices, as opposed to the slight annual decline in domestic prices, as well as sharper decline in domestic versus foreign prices of industrial products, led to a decline in the relative prices by 2.2% and 3.4% respectively.

REER, excluding primary commodities
(2010=100)

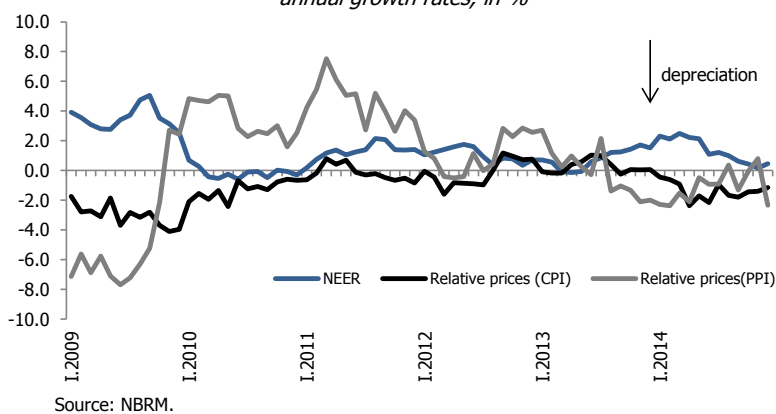


REER, excluding primary commodities
annual growth rates, in %



The analysis of the movement of the REER indices calculated with weights based on the foreign trade without primary products⁷, indicates slight improvement in the domestic price competitiveness. The REER deflated by consumer prices depreciated by 0.7% on an annual basis, while the REER deflated by producer prices depreciated by 1.9% on an annual basis.

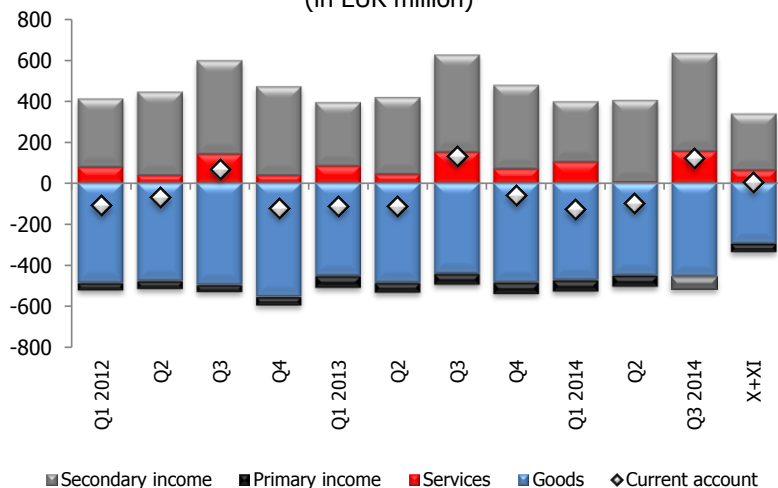
NEER and relative prices, excluding primary commodities
annual growth rates, in %



The improvement in both REER indices is entirely due to the annual decline in relative prices, i.e. the growth of the foreign consumer prices, as opposed to the small annual decline in the domestic prices (of 1.2%), and the sharper decline in the domestic versus foreign producer prices (2.3%). NEER appreciation continued in December (0,5%), with the annual change again being driven by the depreciation of the Serbian dinar against the denar.

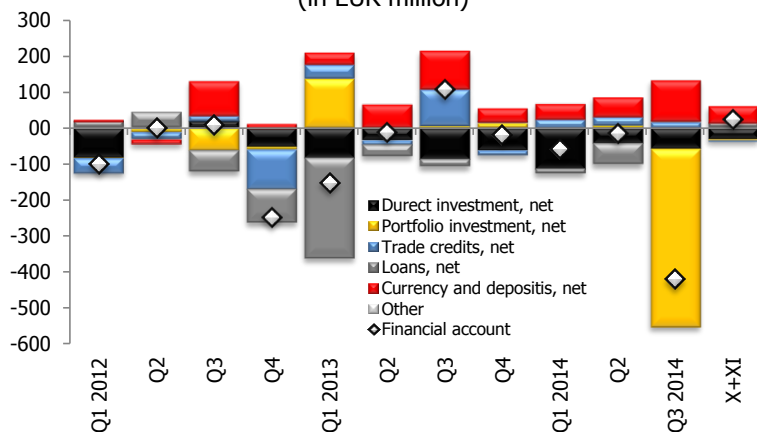
⁷ Primary products that are not included in the calculation are: oil and oil derivatives, iron and steel, ores and imported raw materials for the new industrial capacities in the free economic zones.

Main components of the current account
(in EUR million)



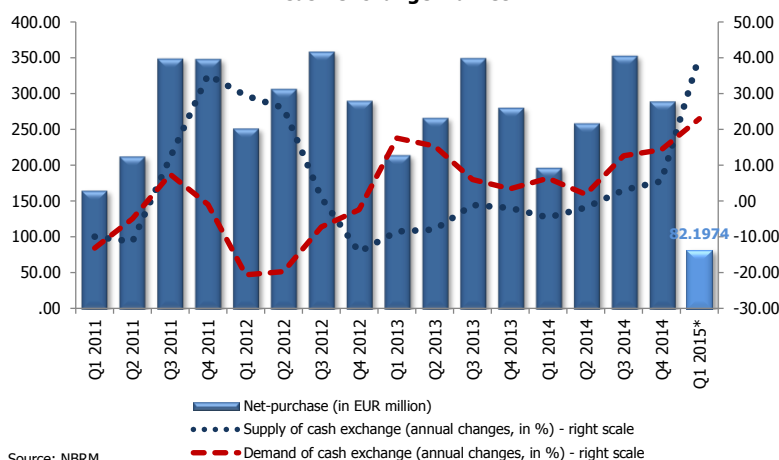
Source: NBRM.

Financial account components
(in EUR million)



Source: NBRM.

Cash exchange market



Source: NBRM.

In the period October-November 2014, the balance of payments current account registered a surplus of Euro 5.7 million (or 0.1% of GDP), contrary to the expectations for a deficit in the fourth quarter, according to the October projection.

In terms of individual components, better than expected was the smaller trade deficit ...

... while the primary and secondary income are generally in line with the October expectations.

In October and November, net outflows in the amount of Euro 25.6 million (or 0.3% of GDP) were made through the financial account, while according to the October projection, for the last quarter of the year net inflows are expected⁸.

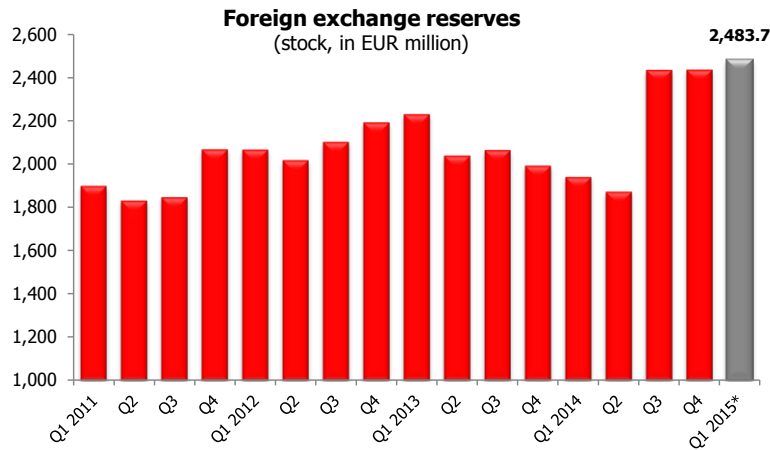
For the most part, the downward deviation relative to the October projection is due to weaker performances in direct investments (smaller net incurrence of liabilities than expected) and smaller net-inflows of trade credits. Other components of the financial account did not register major deviations relative to the October expectations.

Recent data on currency exchange operations, as of January 2015 indicate significant increase in the supply and demand for foreign currency on an annual basis.

Net purchase on the currency exchange market in January 2015 totaled Euro 82.2 million, which is an annual increase of 16.5%.

⁸ 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.

EXTERNAL SECTOR

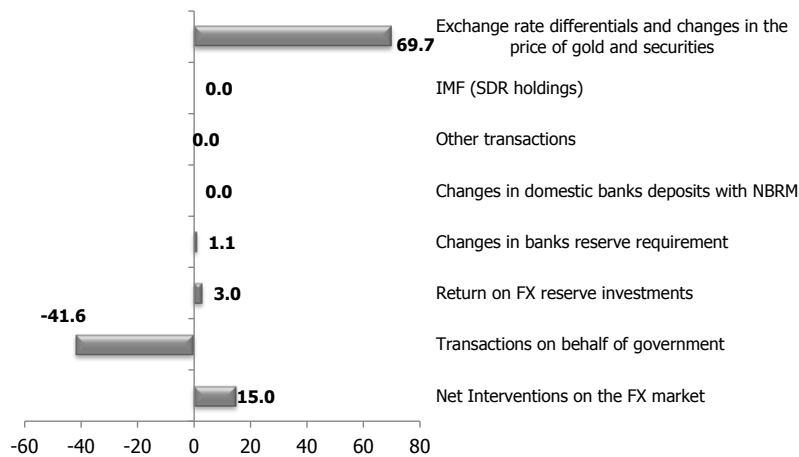


* Latest available data as of 05.02.2015.

Source: NBRM.

As of 31 January 2015, gross foreign reserves were in the amount of Euro 2,483.7 million, which is an increase of Euro 47.3 million compared to the end of the previous year. The increase in foreign reserves was due to the currency changes and changes in the price of gold and the net purchase of foreign currency by the NBRM on the foreign exchange market, while transactions on behalf of the government acted in the opposite direction.

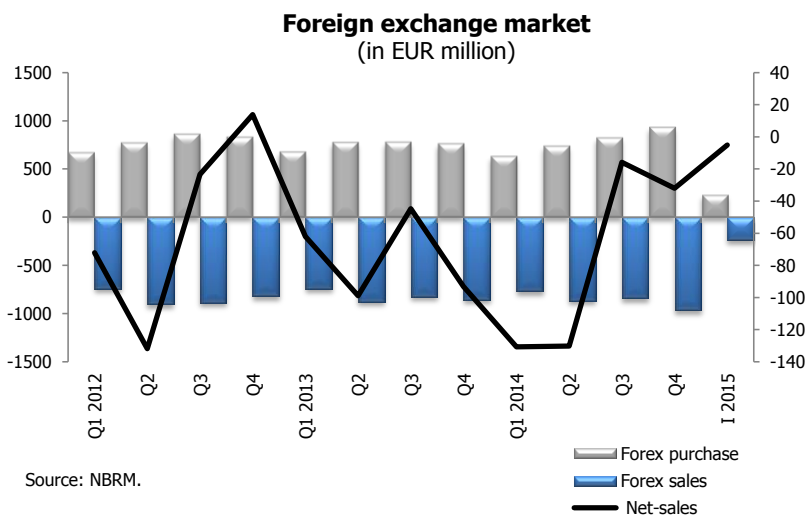
Factors of change of the foreign reserves in January 2015 (in EUR million)



Source: NBRM.

In January 2015, the foreign exchange market of banks registered a net sale of Euro 5 million, which is by Euro 27 million lower compared to the net sale realized in January 2014. This annual change is a result of the annual growth in the supply (of 12.6%) as opposed to the decline in the demand for foreign currency (of 0.3%).

The analysis by sector suggests that better annual performances are mainly due to lower net sales of companies and higher net purchase of exchange offices, compared with the performances of these categories in the same period last year.



Source: NBRM.

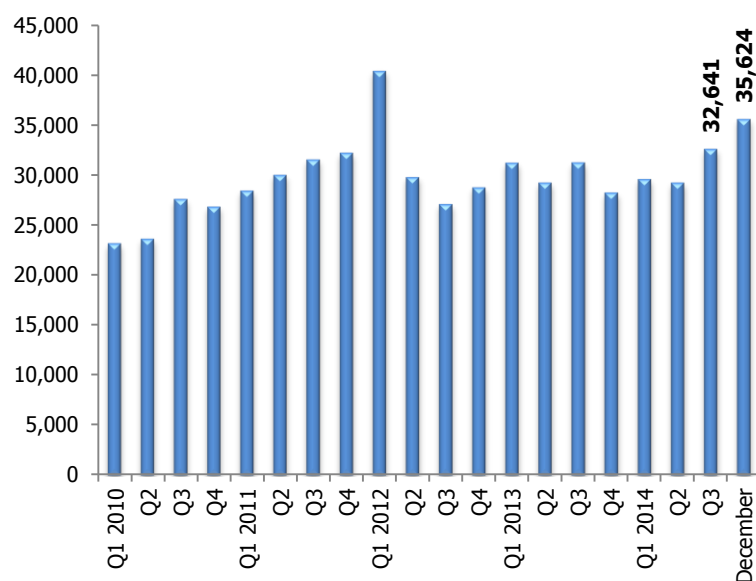
Data as of December show liquidity withdrawal through monetary instruments relative to the end of the third quarter, which is twice slower compared with the expectations for the fourth quarter within the October projection ...

... at a time when the net foreign assets of the NBRM registered a significantly smaller decline than the one registered for this period amid reduced total government deposits with the NBRM relative to the end of the third quarter, in line with the expectations.

Against such a background, deviations in monetary instruments in the last quarter are largely explained by the significantly faster growth of reserve money than projected for this period.

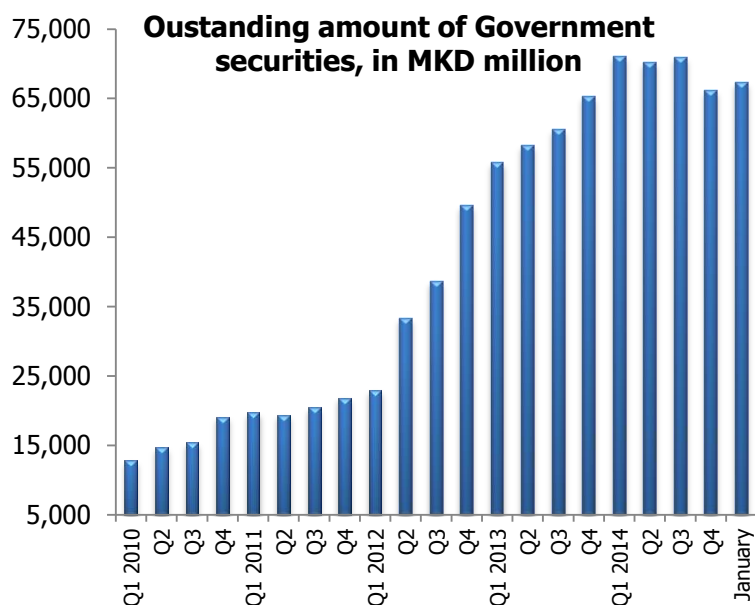
According to the latest available data, in December, in the Budget of the Republic of Macedonia a deficit of Denar 3,009 million was registered. On a cumulative basis, for the period January to December, the budget deficit amounted to Denar 22,134 million (or 4.25% of GDP⁹), exceeding the projected budget deficit for 2014 in accordance with the Supplementary Budget by approximately Denar 2,500 million. In terms of its financing, in December the budget deficit was mainly financed by withdrawing deposits from the account with the NBRM, and on the basis of government securities. Based on foreign borrowing, in December outflows on a net basis were realized, according to the regular servicing of liabilities based on external debt.

Monetary policy instruments, in MKD million



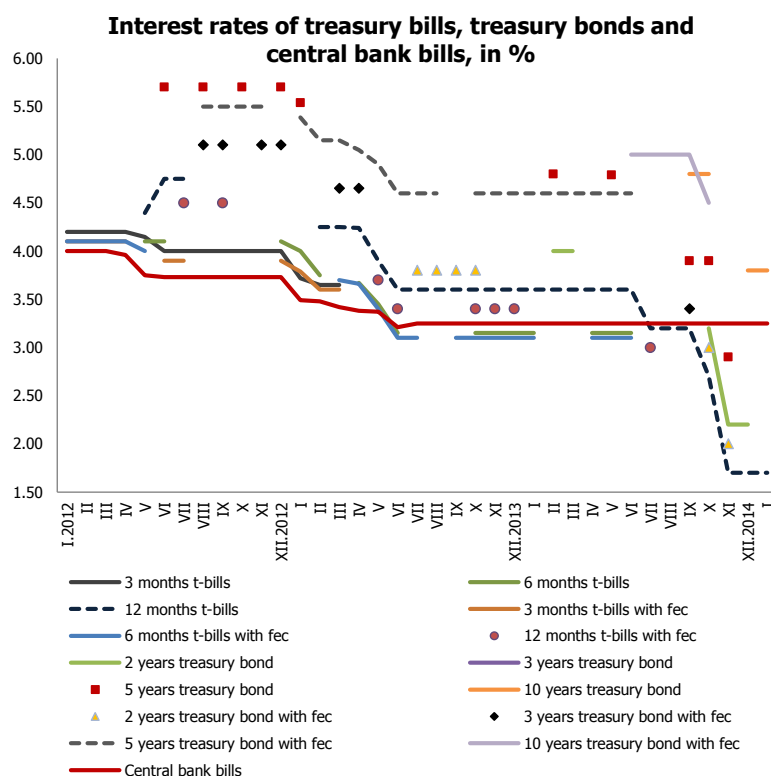
Source: NBRM.

⁹ The calculation uses the projection of the NBRM for the nominal GDP. According to the projection of the Ministry of Finance the budget deficit for the period was 4.2% of GDP.



The stock of government securities on the domestic market at the end of January amounted to Denar 67,315 million, and compared to December 2014 it is higher by Denar 1,153 million.

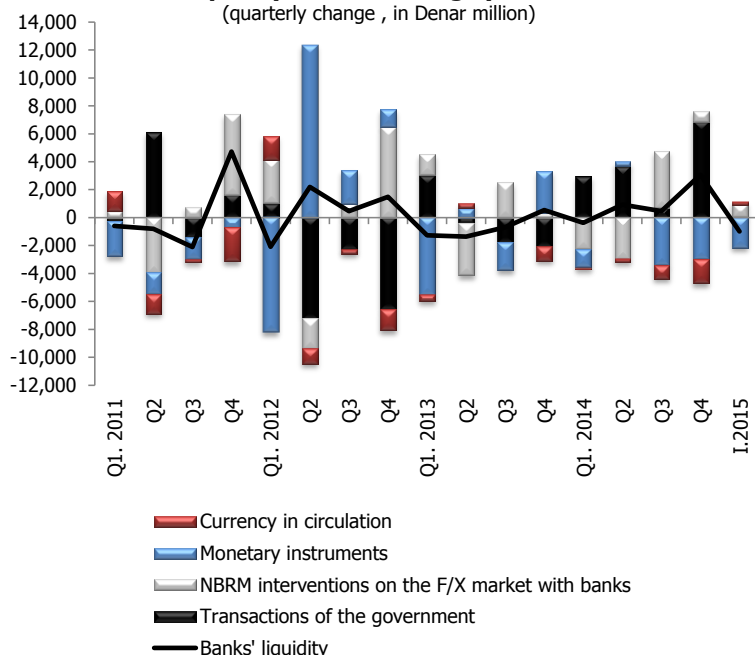
Source: NBRM.



Interest rates on government securities on the auctions held in January ranged from 1.7% for the 12-month treasury bills, 2.65% for the 3-year government bonds without foreign currency clause and 3.5% for the 10-year government bonds with foreign currency clause, up to 3.8% for the 10-year government bonds without foreign currency clause. Part of the government securities issued in January were with lower interest rates compared to previous auctions, while part of the interest rates were unchanged.

Source: NBRM.

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



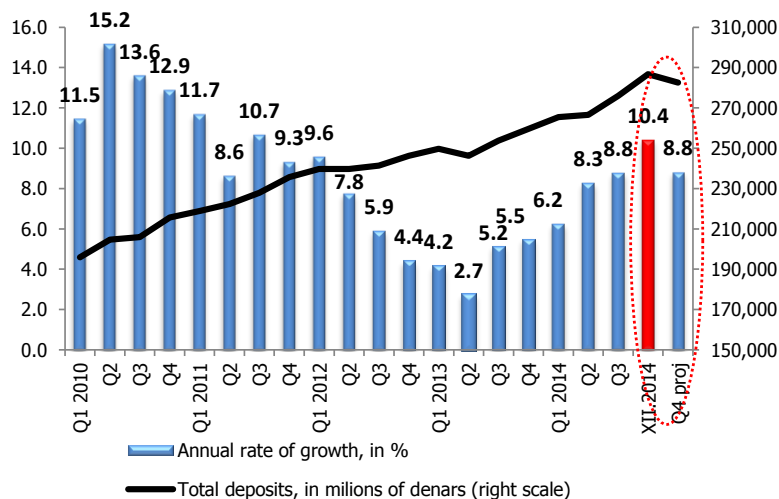
*Positive change- liquidity creation, negative change- liquidity withdrawal.
Source: NBRM.

Regarding the flows of creating and withdrawing liquidity, in January liquidity was mostly created through the net purchase of foreign currency on the foreign exchange market, i.e. through the NBRM interventions on the foreign exchange market with the market makers, which acted towards creating liquidity. Currency in circulation, and in a very small part government transactions, also gave a small contribution in this regard. Liquidity was withdrawn through monetary instruments, entirely through the deposit facility. Against such background, in January the total liquidity declined on a monthly basis.

At the end of December, reserve money registered growth compared to the end of September, with significantly higher intensity than expected ...

... amid registered increase in both components, the currency in circulation, and especially banks' total liquid assets, at a pace faster than expected for the fourth quarter according to the October projection.

Total deposits



*Includes demand money
Source: NBRM.

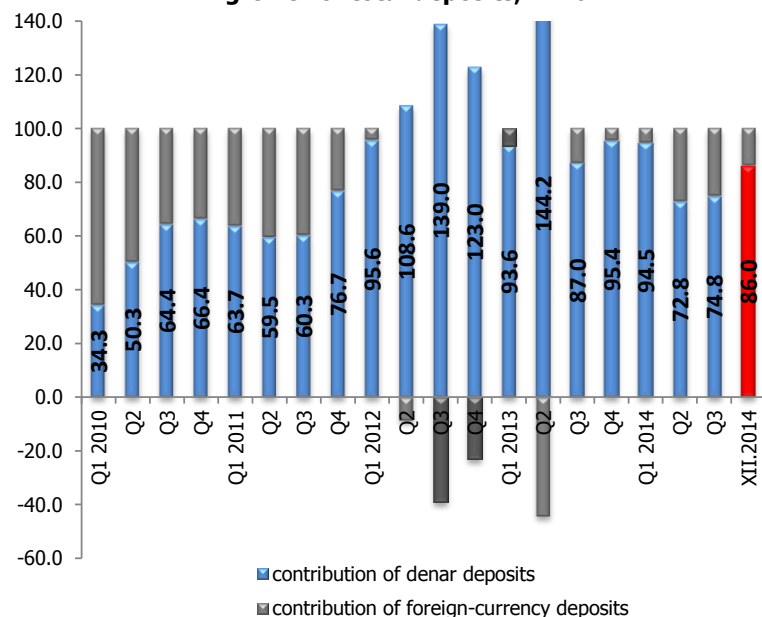
During December, there was further expansion of the deposit base at a significantly accelerated pace compared to the previous month. Deposit flows recorded in this period were four times higher than the growth in November and represent historically most intensive monthly increase in total deposits (if one excludes the effect of the euro conversion in December 2001). Realized growth was due to the almost identical increase in corporate and household deposits, amid strong credit growth, while in one part these performances (primarily in the corporate sector) may be associated with the higher budget spending at the end of the year (especially on the basis of capital expenditures¹⁰).

At the end of December, the annual growth rate of total deposits equaled

¹⁰ In December, almost 20% of total realized capital expenditures in 2014 were realized.

10.4%, which is above the growth of 8.8% projected for the last quarter of 2014. The total deposits were by Denar 4,108 million higher than the level projected for the last quarter of 2014 according to the October projection, indicating a significant exceeding of the projected deposit base for the fourth quarter, mainly due to the December performances.

Contribution of denar and foreign currency deposits to the annual growth of total deposits, in %

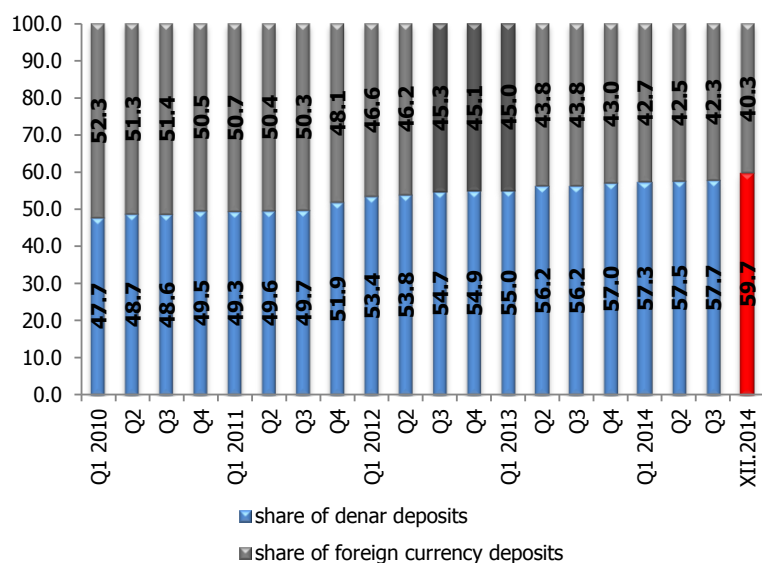


The annual growth of total deposits still stems mainly from the increased denar deposits, amid moderate positive contribution of foreign currency deposits. December is the third month in a row in which further moderate reduction of deposits in foreign currency was registered...

Source: NBRM.

*Includes demand deposits.

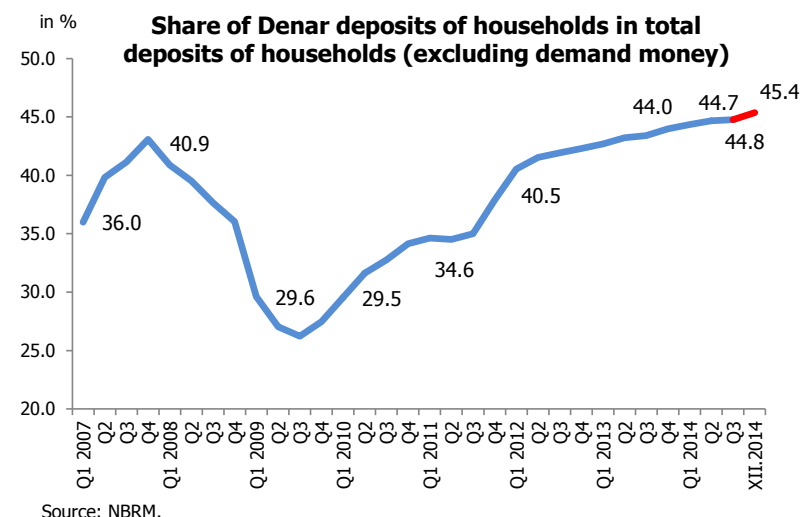
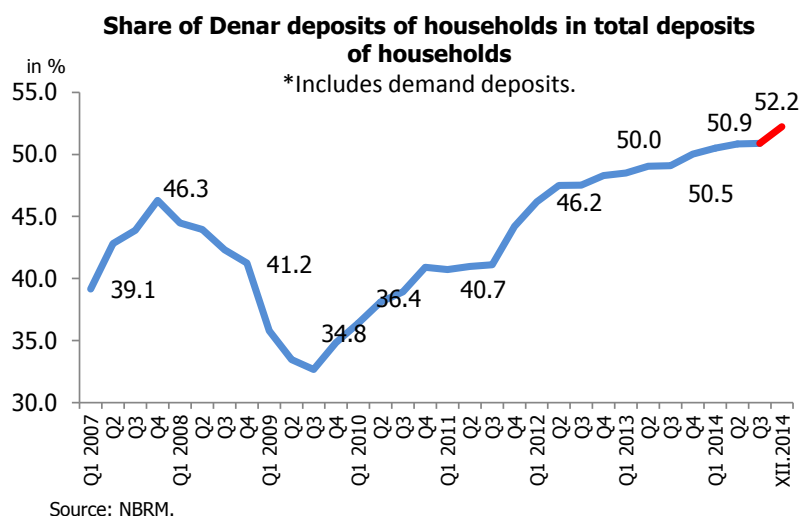
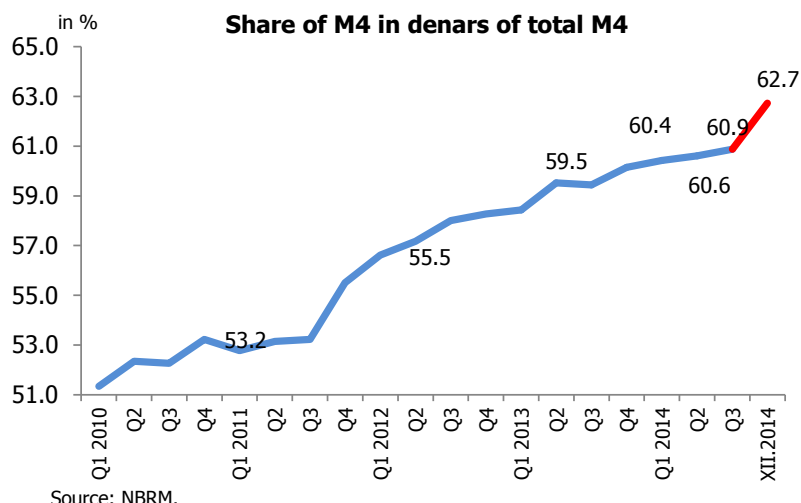
Share of denar and foreign currency deposits in the total deposits (in %)



...resulting in a slight reduction in their share in total deposits amid further increase of the share of deposits in domestic currency.

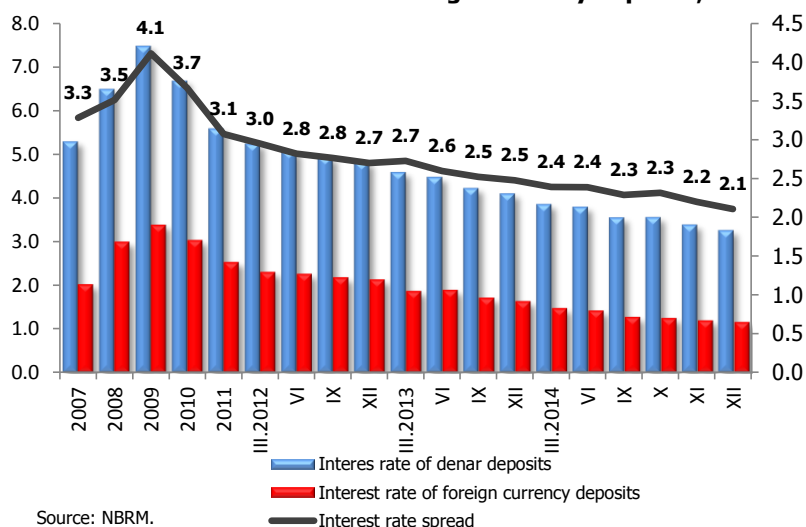
Source: NBRM.

*Includes demand deposits.



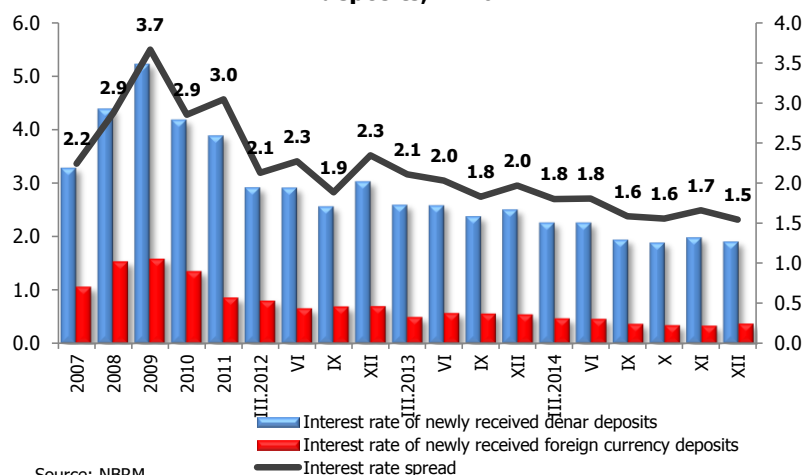
During December there was a significant acceleration of the monthly growth of total household deposits, which was predominantly led by the increased savings in local currency amid moderate growth also of the deposits in foreign currency. These developments have contributed to increasing the share of Denar deposits in total household deposits (accounting for 52.2%).

Interest rates on denar and foreign currency deposits, in%



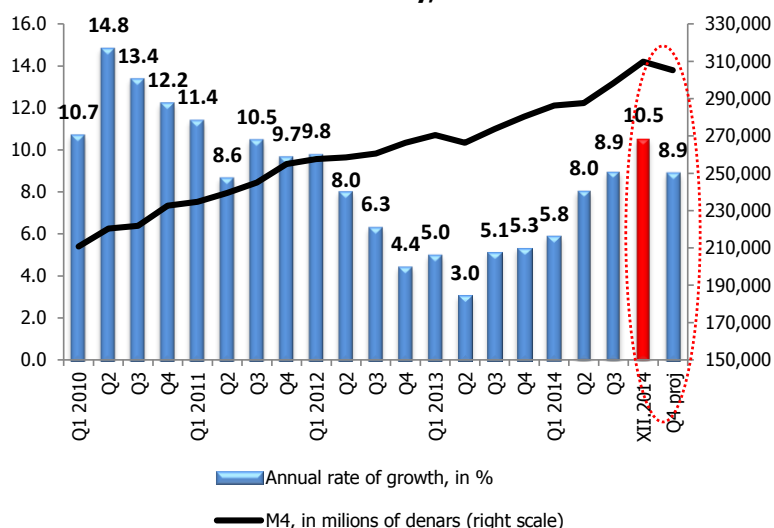
Source: NBRM.

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



Source: NBRM.

Broad money, M4

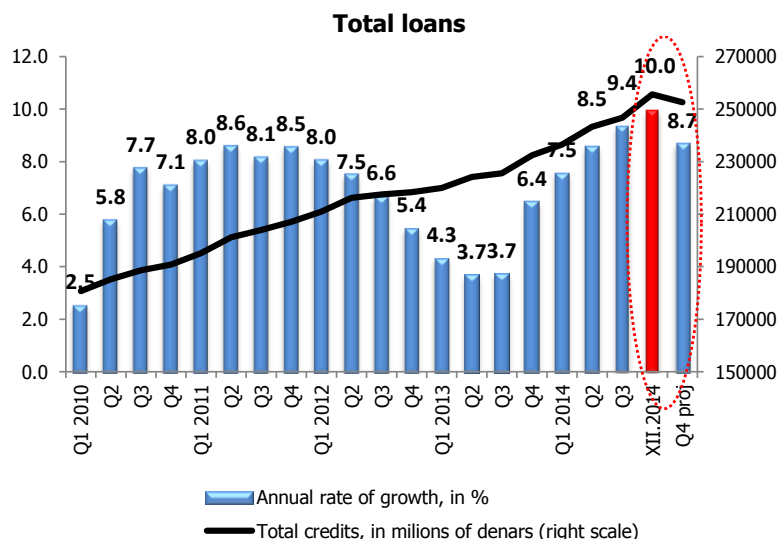


Source: NBRM.

During December, the interest rate spread between denar and foreign currency interest rates remained stable with minimal narrowing compared to the previous month, as a result of the relatively stable movements of the yields from total denar and foreign currency savings. Amid slight decline in the interest rate on Denar deposits and minimal rise in the yields from foreign currency savings, newly received deposits registered narrowing of the interest rate spread between them of 0.2 percentage points.

According to the data as of December, the broad money registered a significantly accelerated pace of growth compared to the previous month due to the simultaneous increase in total deposits and currency in circulation. Thus, at the end of the year, the annual growth rate of the broad money supply equaled 10.5%, which is above the projection for the fourth quarter of 2014 (projected annual growth of 8.9%). The money supply was by Denar 4,601 million higher than the level projected for the last quarter of 2014.

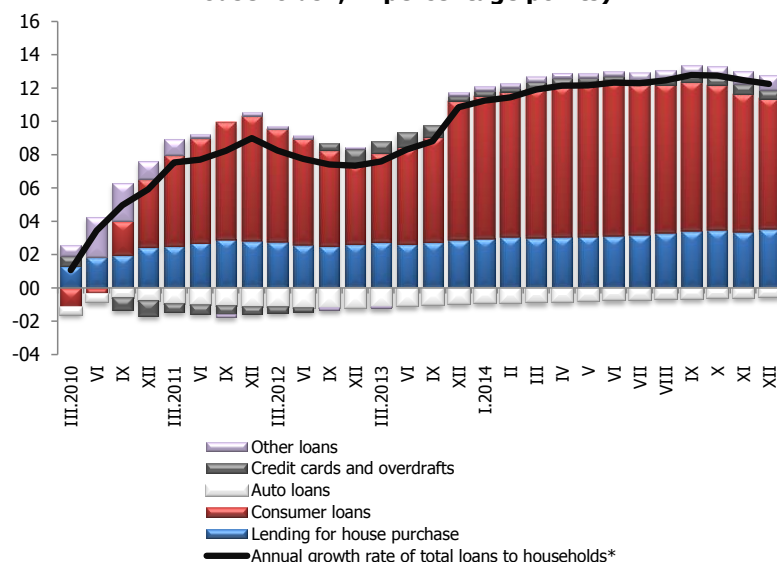
MONETARY SECTOR



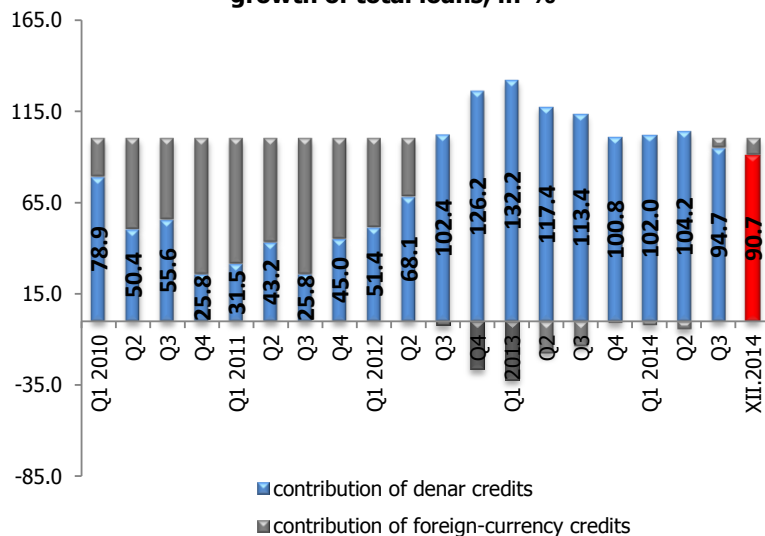
The monthly growth of total loans extended to the private sector continued in December at a faster pace compared to the previous month. The credit flows recorded in this period were by 1.6 times higher than those registered in November and represent the most intensive monthly credit growth since the start of the crisis. Such movement of credit activity is primarily due to the increase in loans to enterprises, which have been the main driver of the total monthly growth for the second month in a row (accounting for 72% and 87% in the monthly increase in November and December, respectively).

At the end of December, the annual growth rate of total loans equaled 10.0%, which is above the annual growth of 8.7% projected for the last quarter of 2014. Total loans were by Denar 3,007 million higher than the level projected for the last quarter of 2014.

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



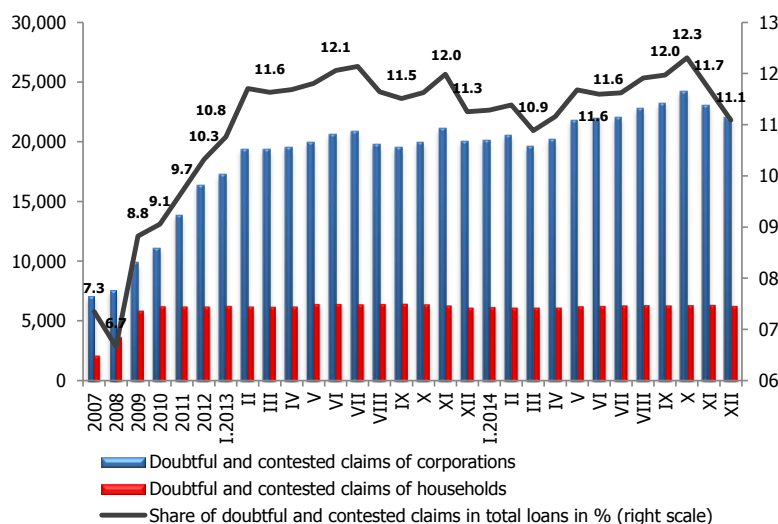
Contribution of denar and foreign currency loans to the annual growth of total loans, in %



Registered annual growth of total loans is still mostly a result of the growth of denar loans, amid moderate positive contribution of foreign currency loans. December is the second month in a row in which moderate monthly acceleration of loans in foreign currency is registered.

Source: NBRM.

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

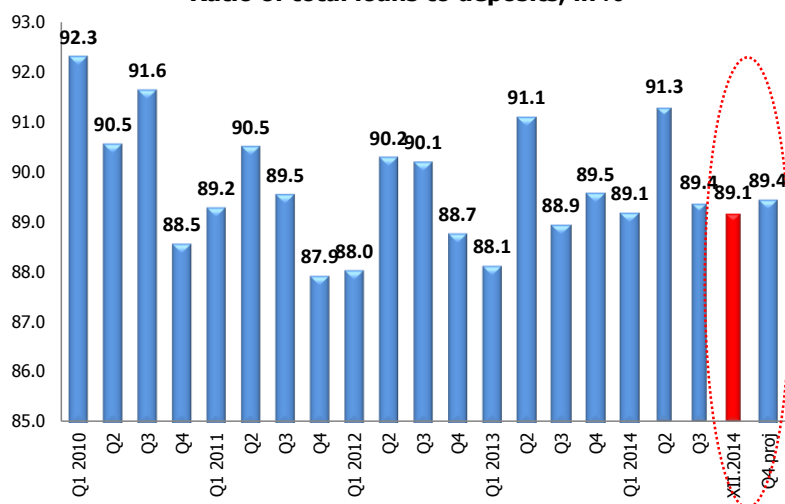


During December, there was a monthly reduction of doubtful and contested claims for the second month in a row, mainly due to the further reduction of non-performing loans to companies. Thus, the share of doubtful and contested claims in total loans was 11.1% versus 11.7% in November. On an annual basis, total non-performing loans have further increased at a slightly faster pace compared to the previous month, which in large part can be explained by the base effects in the corporate sector¹¹.

Source: NBRM.

¹¹ In December 2013, the non-performing loans to companies decreased on a monthly basis, following the monthly growth registered in November. In 2014, a decline was registered in both months.

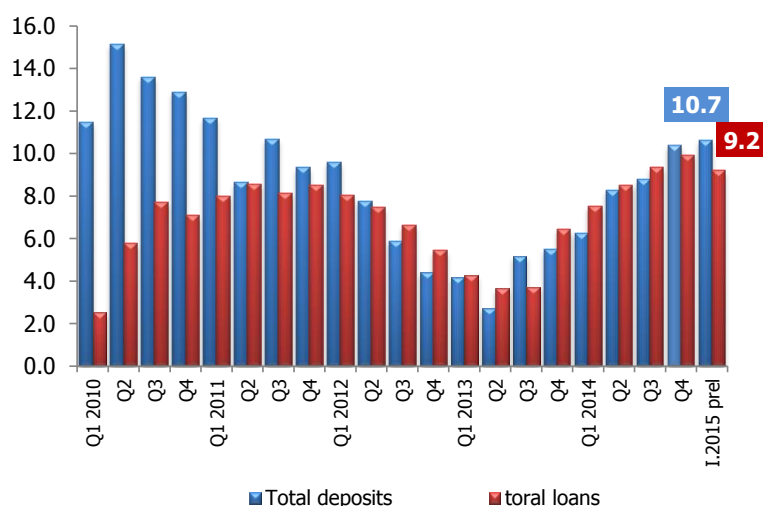
Ratio of total loans to deposits, in%



Source: NBRM.

At the end of December, the utilization of the deposit potential for lending to the private sector slightly decreased due to the higher deposit base relative to the growth of the lending activity. Realized ratio is slightly lower than the level projected for the fourth quarter, according to the October projection.

Total loans and deposits, annual changes, in %



Source: NBRM.

Preliminary data as of January 2015 point to further increase in the total deposits at a significantly slower pace compared to the previous month when an unusually fast growth was achieved. Compared with the January performances in previous years, the monthly growth in January 2015 was solid, indicating further retention of positive trends in total savings in the banking sector. Growth of total deposits in January was driven by the increased savings of households and other financial institutions, while corporate deposits declined moderately on a monthly basis.

On an annual basis, total deposits in January increased by 10.7%. As for total loans, preliminary data as of January show a decline on a monthly basis, contrary to the fast growth in December. The reduction in total loans was due to the lower level of loans to companies, which is not unusual for the first month of the year and indicates possible temporary nature of such changes. Loans to households continued to grow in January, at a similar pace as in the previous month. **In January, total loans increased by 9.2% on an annual basis.**

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 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% 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 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 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 potential¹², 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

¹²For 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).

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.