

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



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

January 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 - December 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, the uncertainty remains, and recent indicators confirm the previous expectations for increased future risks compared with October projections. These findings relate mainly to the Euro area, where the latest high frequency indicators confirm the expectations for possible slower economic growth by the end of the year. Namely, in November, the monthly data on the industrial output of the three largest European economies Germany, France and Spain are in the "negative" zone. In the same direction are the initial inflation assessments of the Eurostat for December. According to the assessments, December annual inflation rate in the Euro area enters the "negative" zone for the first time after 2009, and equals 0.2%, as an effect of the fall in the prices of energy and poor utilization of the free capacities in the economy, which generates growing deflationary pressures. Given such economic conditions, it is becoming increasingly certain that at the beginning of the year, the ECB will intervene with additional unconventional measures, which will lead to an increase in the of the ECB's balance sheet approximately to the level of early 2012, as announced at the last December meeting. **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 were slightly changed relative to the October projection.** The new assessments indicate somewhat 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 are divergent.** 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 2014 and 2015. Another growth in the oil prices is expected in 2016, contrary to the expected stagnation in the October projections. However, despite the expectations for a rise in oil prices, they will still be below the level expected in the October projections, as well as below the price level of the last few years. Recent movements in **metal prices** suggest somewhat more favorable changes in nickel and copper prices 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 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 the individual segments of the economy. In terms of the indicators relevant for the monetary policy, inflation data as of December are in line with the October projection. Namely, in the fourth quarter, the general price level continued to decline on an annual basis, but at a slightly faster pace (decline in the prices of 0.4% versus

0.3% in the third quarter), due to the reduction of all inflation components. However, the biggest single contribution was made by the energy component, reflecting the declining world oil prices. In this direction was the influence of the core inflation, which in the fourth quarter entered the negative zone on an annual basis, for the first time after 18 quarters. 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. Regarding the projection, the inflation performance is in line with the expectations in all price components. 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 the possibility of sudden changes in this category.

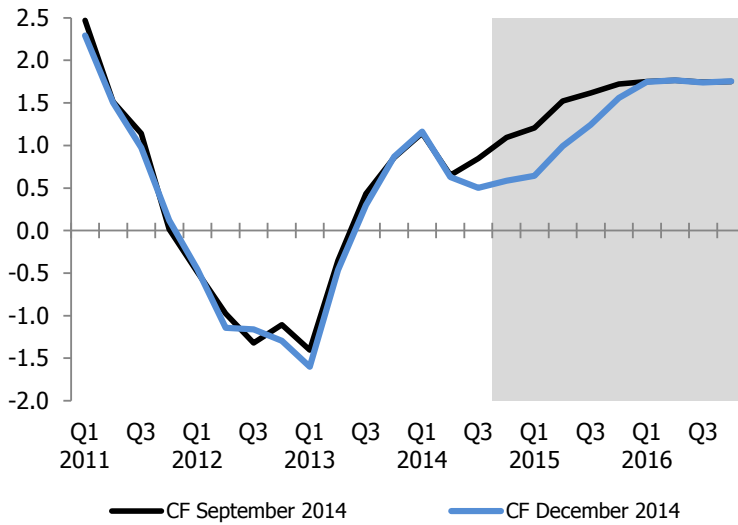
According to the latest available data for the fourth quarter of 2014, foreign reserves (adjusted for the price and exchange rate differences and price changes of securities) registered a decline, however lower than expected with the October projection. Analyzed through the factors of change, the decline in the reserves is a result of the transactions on behalf of the government, mainly related to external debt repayment. The movements in the foreign exchange market were favorable, and in the last week of December a high amount of foreign currency was purchased. The available external sector indicators for the fourth quarter are still insufficient, making it difficult to obtain an accurate picture of the deviations in the position of the balance of payments compared with the projections. Data on foreign trade as of November point to improved export performance and smaller trade deficit than projected, while the net purchase from currency exchange operations as of December, points to a movement of private transfers slightly higher in comparison with the projection. On the other hand, as of October, the balance of payments signals smaller than expected financial inflows in the economy, especially relating to the net inflows through direct investments. 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.

Published data on GDP for the third quarter indicated somewhat faster economic growth than anticipated. Analyzed by sector, the growth is dispersed, and in terms of the demand, the growth structure in this quarter is slightly more favorable than expected. Namely, according to the expectations, both the domestic demand and exports are generators of the growth, but the impetus from investments is stronger than expected, as opposed to the weaker effect of private consumption. Indicative high-frequency data for the last quarter of 2014 point to **further growth of the domestic economy, likely at 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. **In terms of the monetary movements, preliminary ten-day data on the credit market in December** showed further intensification of credit growth on a monthly basis, thereby a continuation of the favorable trends from September. As in November, most of the new lending in December was again directed to the corporate sector, with the loans to companies accounting for 87% of the growth in total loans. 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 accelerated significantly (equally supported by the growth of both household and corporate deposits), with the deposits also exceeding 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 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. Foreign reserves are in line with the expectations and 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 balanced risks regarding the projection of the future dynamics of inflation. Indicators of economic activity show a bit faster growth than the one projected in the third quarter, and the latest indicators suggest that this dynamics will be retained in the last quarter. Preliminary data as of December show exceeding of the projected credit growth.

Foreign effective demand
(annual rates of change in %)



Source: "Consensus Forecast" and NBRM calculations.

The latest projections point to slightly lower 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%.

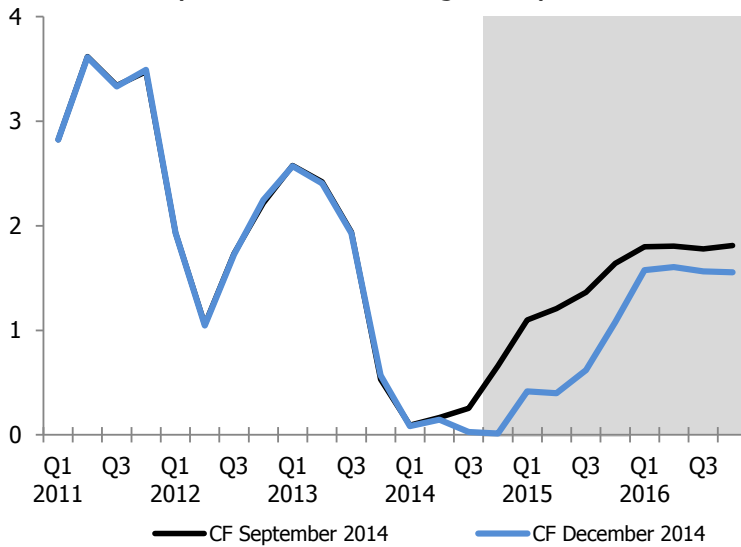
Such downward revision is almost entirely due to the adjustments made to the projections for the economic growth in Serbia and Germany, which is now estimated to be more negative, i.e. lower than the October assessment.

The less favorable expectations for the growth of these two most important trading partners for our country, resulted in a downward adjustment also of the assessment for the growth of the foreign effective demand in 2015, which was reduced from 1.5% in October to 1.1%.

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

¹Revisions 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 2010 (ESA 2010).

Foreign effective inflation
(annual rates of change in %)



Source: "Consensus Forecast" and NBRM calculations.

It is estimated that the foreign effective inflation will amount to 0.1% in 2014, which is a downward adjustment compared with the October projection of 0.3%...

... amid lower inflation in the third quarter and substantial downward revisions to the projections for inflation in the fourth quarter in almost all of our import partners.

The sharper decline in the prices in Serbia² and Bulgaria, as well as the lower than expected inflation in Germany contributed the most to the downward adjustment of foreign inflation in 2014.

In 2015, a significant downward revision of the assessment of foreign inflation was made, which is expected to remain low and amount to 0.6%, being more than twice lower than the October projection of 1.3%.

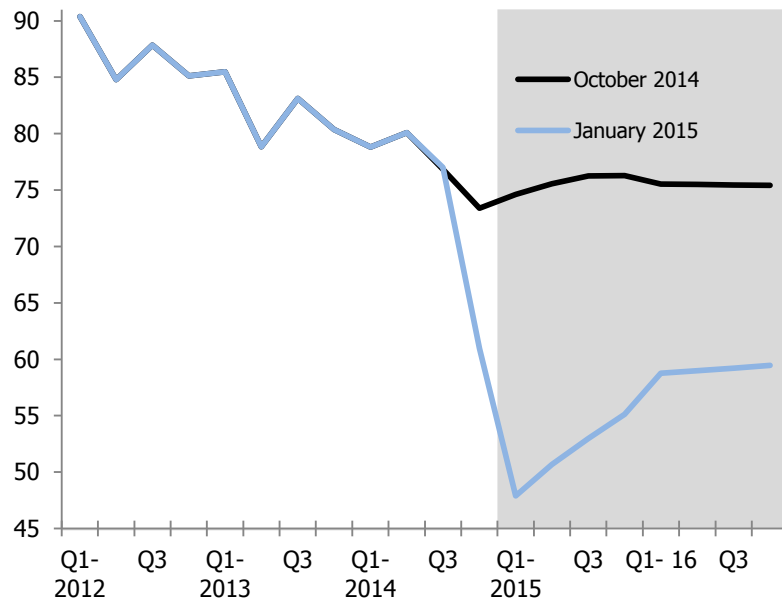
Moreover, all of our import partners expect lower rates of inflation than projected in October ...

... with the expectations for lower consumer prices in Serbia and Germany having the greatest impact on the downward revision.

Foreign effective inflation is expected to accelerate to 1.6% in 2016, which is also a downward deviation compared to the October projection of 1.8%.

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.

In 2014, there was a sharper decline in oil prices compared with the October projection ...

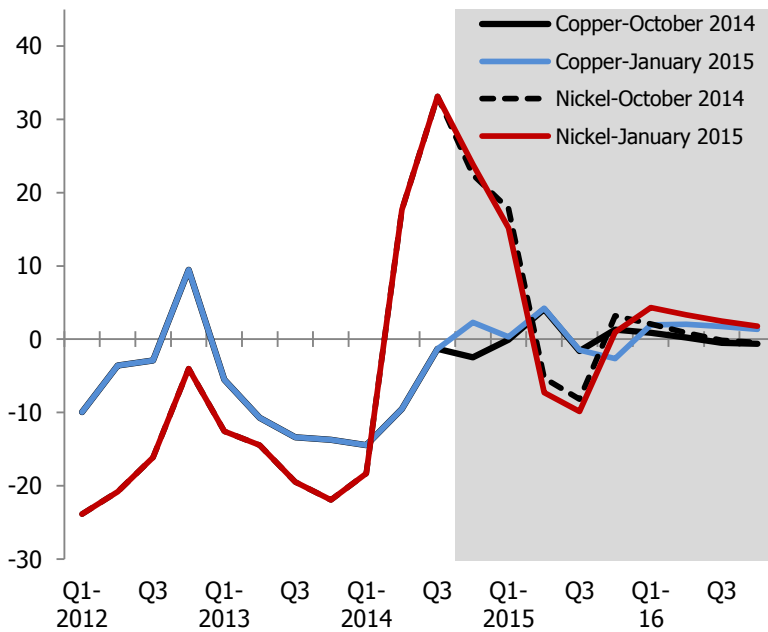
... with this difference stemming from the drastic drop in oil prices in the last quarter of 2014, which occurred as a result of the decision of OPEC to maintain its share of the global oil market and to accept lower prices until market is balanced again.

Higher production by OPEC countries, complemented by rapid growth in the supply of shale oil from the USA, creates an oversupply of oil on the market ...

... which in circumstances of slow recovery in demand led to a significant downward revision of the expected decline in oil prices in 2015. If it is materialized, it would be the sharpest decline since the one registered in 2009.

On the other hand, in 2016 oil prices are expected to grow again, although to a level that would be lower both in comparison with the October projection and in comparison with the previous few years.

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



Source: IMF and NBRM calculations.

It is estimated that in the last quarter of 2014, metals registered higher than anticipated prices expressed in euros ...

... resulting in a faster growth in the price of nickel and lower decline in the price of copper for 2014 as a whole.

In 2015, divergent movements in metal prices are expected.

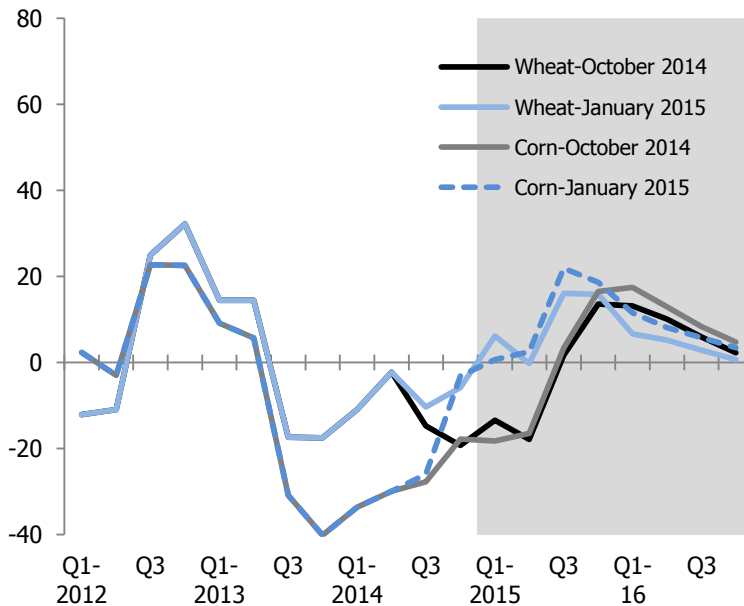
Thus, now it is expected that the price of nickel will fall rather than rise, as expected in October ...

... which is consistent with the projections for moderate slowdown in the Chinese economy and the growth in the global supplies of nickel ...

... while the price of copper will register slower growth than projected, amid weaker demand for this metal and expected surplus on the supply side.

On the other hand, metal prices will register growth in 2016, which is expected to be higher than expected in October.

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



Source: IMF and NBRM calculations.

In the fourth quarter, the decline in the prices of cereals was significantly lower than projected in October ...

... owing to the higher demand for maize, reduced production estimates in the United States, as well as the concerns about the impact of the adverse weather conditions in the United States, Australia and the Black Sea on the wheat crop.

Hence, the decline in the prices was slightly lower also on an annual level.

Weather conditions in Russia, Ukraine and parts of the Southern Hemisphere are not assessed as favorable for the development of winter crops, which could have negative effects on crop yields.

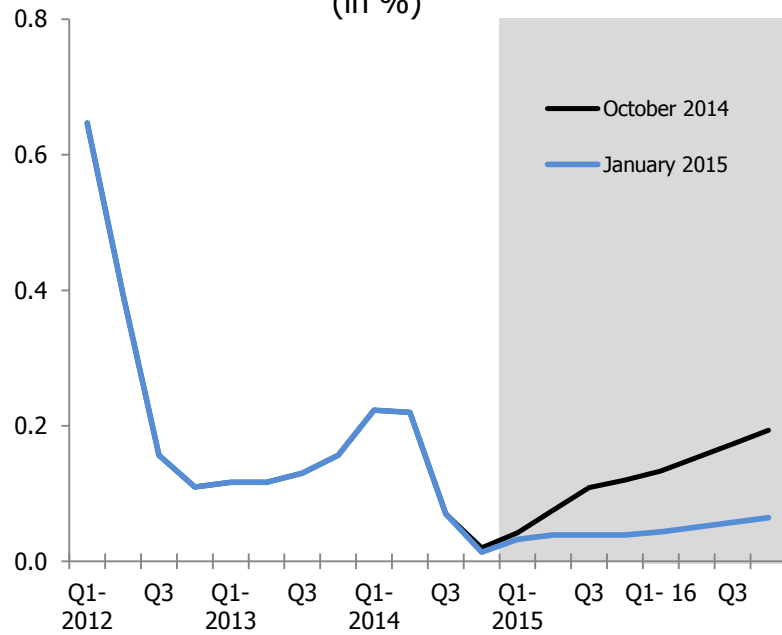
Hence, it is now expected that in 2015, growth rather than a decline in the price of wheat will be registered ...

... and identical are the expectations for the price of maize.

It should be noted that the growth of cereal prices in euros is largely influenced by the exchange rate of the euro, which is expected to depreciate significantly this year.

It is expected that in 2016 the prices of primary food products will continue to grow, but at a slower pace than in the October projection.

1M Euribor
(in %)



Source: "Consensus Forecast" and NBRM calculations.

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

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

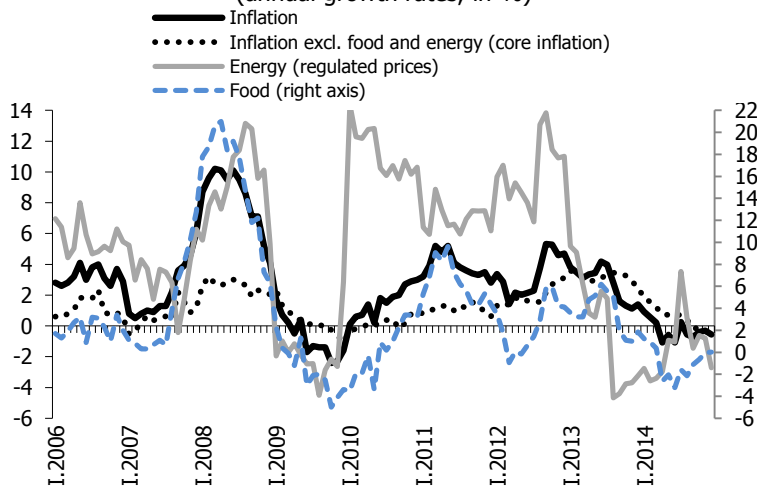
In 2015 and in 2016, a downward revision was made to the projection of the foreign interest rate, relative to the October assessment ...

... and now it is expected to be 0.04% and 0.05%, respectively, compared to 0.09% and 0.16% in October ...

... which is largely a reflection of the implementation of the ECB measures for monetary policy easing, as well as the expectations for undertaking additional measures, primarily purchasing assets from the private non-financial sector (so-called quantitative easing).

Inflation and volatility of food and energy

(annual growth rates, in %)



Source: State statistical office and NBRM calculations.

In December 2014, consumer prices remained unchanged compared to the previous month, with a small positive contribution of food prices, which was completely offset by the decline in the price of transport, in line with falling world oil prices³.

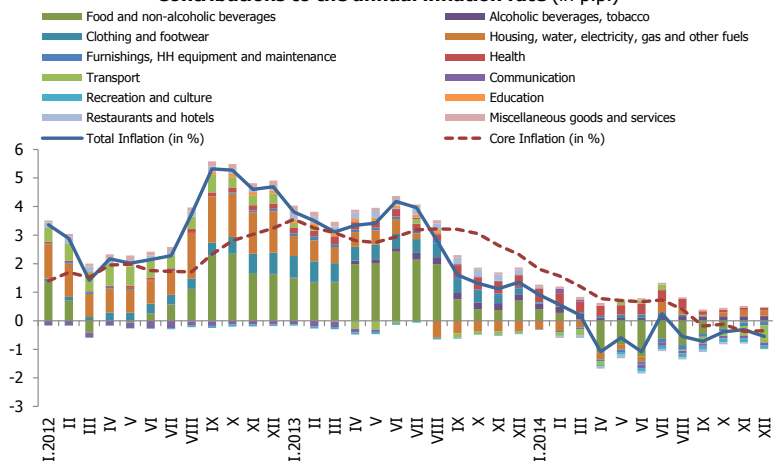
The annual decline in the general price level in December was 0.5%, and it is slightly sharper relative to the decline registered in the previous month ...

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

... amid significant downward deviation in the energy component of inflation. Core inflation is slightly lower than projected, while food prices registered upward deviation. However, deviations in these two components are smaller compared with the deviations in energy prices.

On a cumulative basis, prices fell by 0.3%, with the lower food prices having the largest contribution to the cumulative decline.

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

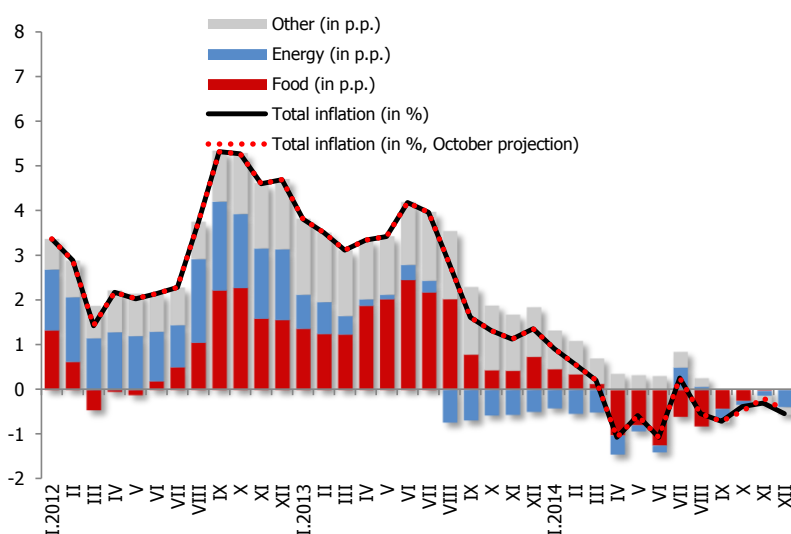


Source: SSO and NBRM.

³ Categories with the greatest individual contribution to the December price level include vegetables (monthly price increase of 8.7%) and liquid fuels and lubricants (monthly price decline of 5.4%).

Inflation rate

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



Source: SSO and NBRM.

In December, **core inflation was unchanged on a monthly basis** (versus the drop in November) ...

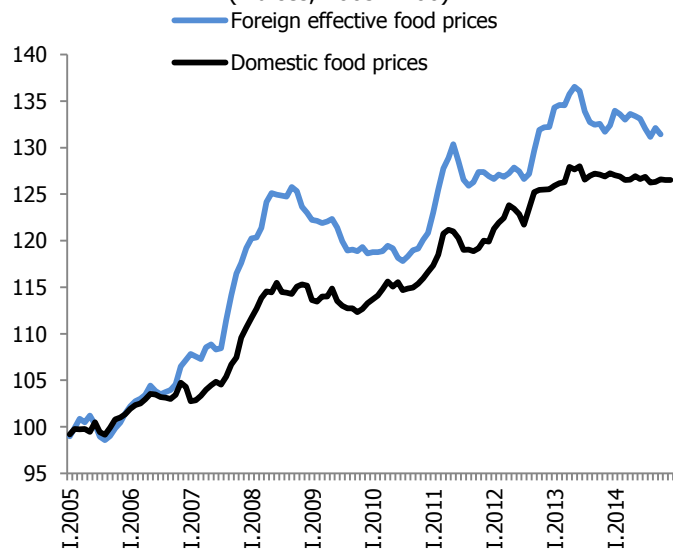
... while on annual basis core inflation continued to decline for the fourth consecutive month, with the fall in December equaling 0.3% (compared to the fall of 0.4% in November).

The annual decline in prices was due to the decline in the price of the IT equipment, means and services for house maintenance, as well as the communication prices.

On a cumulative basis, core inflation is higher by 0.6%, which is mainly explained by the higher prices of pharmaceutical products.

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.

External input assumptions for 2015, which are included in the inflation projection, are revised in divergent directions.

Thus, according to the latest assessments, lower foreign effective inflation is expected by the end of 2015.

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

... reflecting the OPEC decision not to reduce the volume of production in the forthcoming period, as well as the continuous increase in the supply and surplus on the markets, amid 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 food products indicate upward adjustments of the prices of cereals in 2015, compared with the signals obtained during the October cycle of projections.

Such changes have been made despite the high yields in 2014 and the appreciation of the dollar against the euro and reflect the risks of reduced yield and quality of grains from the Southern Hemisphere, and the impact on yields in 2015 by the unusually cold and dry weather in the United States and the Russian Federation.

In view of the projected movement of prices in 2015, revisions of input assumptions suggest downward risks mainly due to the significant downward revision of the expected movement of energy prices ...

... amid equal initial conditions and upward revisions of the prices of cereals.

However, one should bear in mind that there is great uncertainty about the future movements in world oil prices and the possibility of sudden changes in this category.

In October 2014, the average nominal **net wage** registered an annual growth of 2.2%, which is a significant acceleration compared to the increase of 1% in September ...

... with the accelerating growth being mainly explained by the increase in the wages paid to the employees in the public administration⁴. Also, annual growth was recorded in the salaries in most sectors in the economy, with more significant increase being registered in the wages in the mining and construction, as well as in most service sectors ...

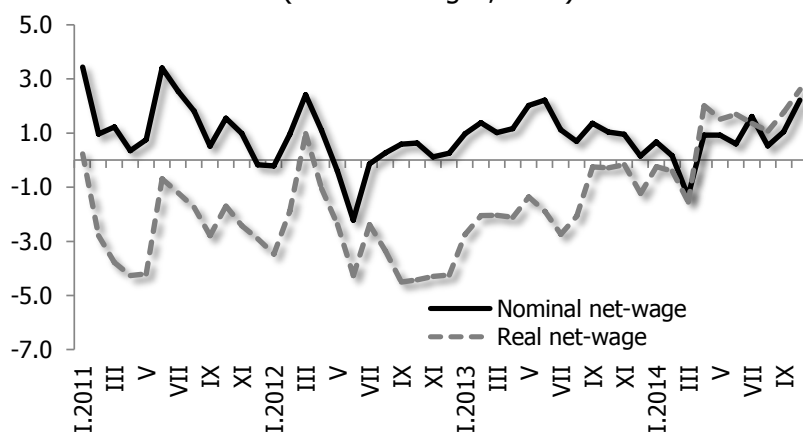
... while a decline was registered only in the wages in catering and agriculture.

The growth of the nominal wage in October was higher than anticipated in the October projection (expected growth of 1.4% in the fourth quarter of 2014).

In October, **real wages** registered an annual growth of 2.6%, in circumstances of lower consumer prices ...

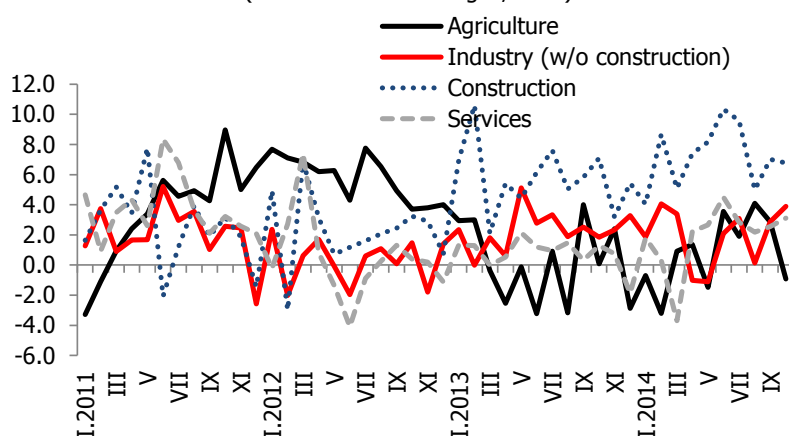
... which is higher than expected for the fourth quarter, within the October cycle of projections (expected growth of 1.9%).

Average net-wage
(annual changes, in %)



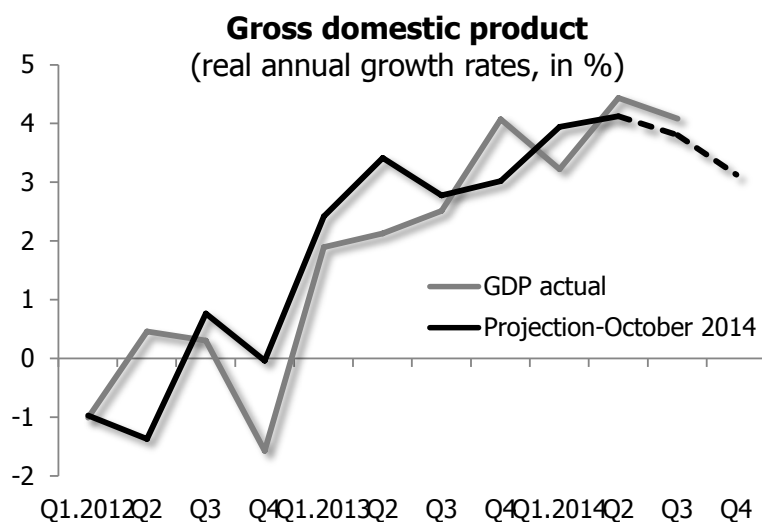
Source: SSO.

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



Source: SSO.

⁴ According to the Law amending the Law on payment of wages in RM ("Official Gazette of the Republic of Macedonia" No.139/2014), wages of employees in public administration increased by 4% starting with the payment of the wages for October 2014. Those are activities that mostly relate to the public sector: "Public administration and defense, compulsory social insurance", "Education" and "Activities of health and social care".



Source: SSO and NBRM projections.

In the third quarter of 2014, the real annual economic growth was 4.1%, and it was somewhat higher than expected according to the October projection (3.8%).

On the **production side**, favorable movements were registered in all economic sectors, with the manufacturing industry giving the highest annual contribution to the growth of the economy. From among the other sectors, more significant contribution to the growth was that of the group of activities "Wholesale and retail trade; Repair of motor vehicles and motorcycles; Transport and storage; Accommodation and food service activities", as well as the activities "Information and communications" and "Real estate activities"...

... while **in terms of demand**, the solid annual GDP growth is a result of the domestic demand, driven by the fast growth in investment and solid growth in the households' consumption ...

... as well as the export activity, partially offset by the increase in imports from abroad.

The 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.

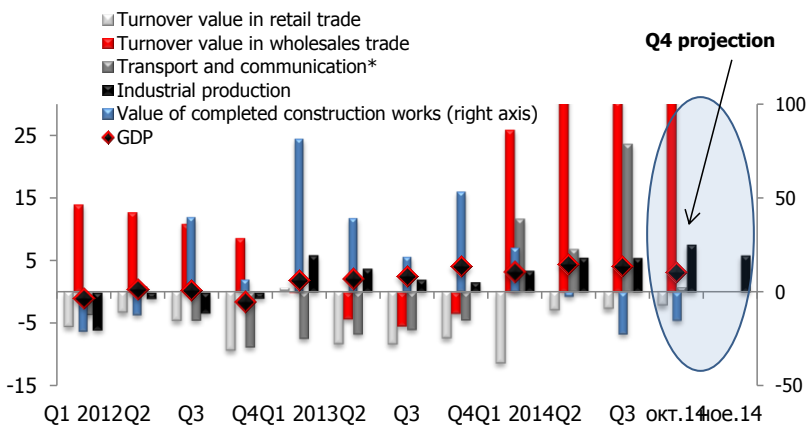
In the period October-November 2014, **industrial production** registered an average growth of 6.7% ...

... with the largest contribution to the growth being that of the production capacities in the technological industrial development zones (primarily the production of machines, devices and motor vehicles), as well as the production of the tobacco and energy sectors ...

... while a significant decline was recorded in the production of beverages.

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.

Such outcome and the accelerated annual growth dynamics of the industry compared to the third quarter (5.5%), are mostly associated with the growth of the industrial capacity utilization and export orders⁵...

... and furthermore, fast annual growth in October was recorded also in the inventories turnover⁶ in the industry.

In October, faster pace of annual growth was registered in the **"trade"** sector compared with the third quarter ...

... against the backdrop of further fast real growth in the wholesale and favorable developments in the trade in motor vehicles, while the retail trade registered a slower decline.

The conclusion about the positive economic growth is supported by the data on the turnover in **catering** whose growth in October was more intensive in comparison with the real growth registered in the third quarter.

Growth was registered also in the **transport** activity, although it was significantly slower compared to that registered in the third quarter.

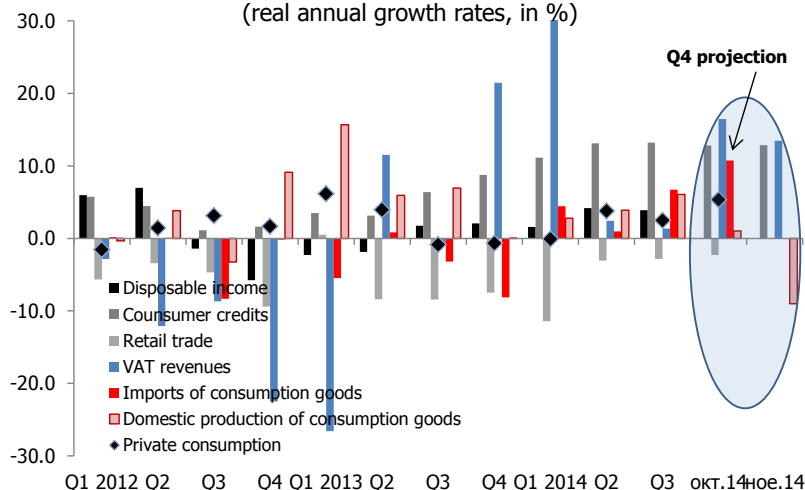
The reduced value of **completed construction works**, which commenced in the second quarter, continued in October. Namely, despite the fast growth on a monthly basis, data on completed construction works in October show an annual decline, although at a slower pace compared to the decline in the third quarter. Construction activity reduces after two years of fast growth, indicating a strong influence of base effects on its annual dynamics.

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

⁵ SSO's Business Tendency Survey in manufacturing industry.

⁶ Inventories turnover is a ratio between trade and inventories of finished products in the industry. Higher value of this indicator points to faster inventories 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.

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



Source: SSO and NBRM calculations.

with the expectations in the October projection.

Available indicators of **private consumption** point to growth in the fourth quarter and are somewhat more favorable compared to the previous quarter ...

... amid accelerated annual growth in real wages and private transfers, as well as growth in pensions paid ...

... and continuing steady pace with double-digit growth rates of lending to households.

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.

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 investment products and in the domestic production of capital goods ...

...while accelerated growth was registered also in the lending to the corporate sector and in the inventories of finished products.

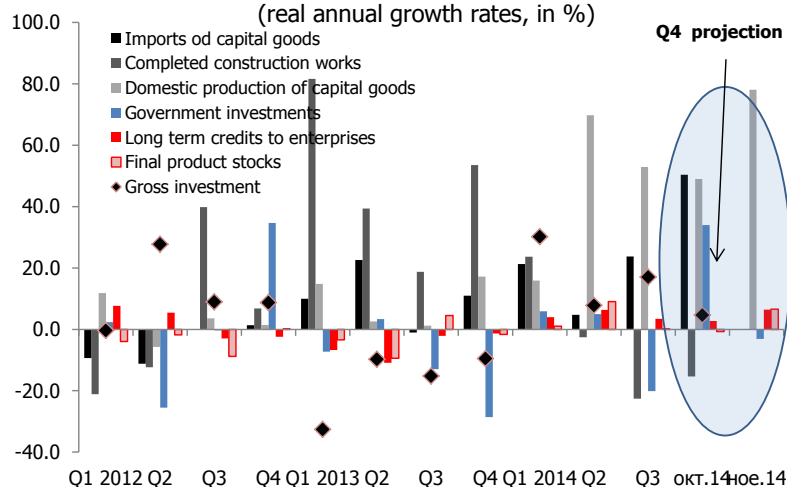
Favorable movements were registered also in the budget capital expenditures, which grew, as opposed to the decline in the previous quarter.

On the other hand, unfavorable movements were registered in the completed construction works and in foreign direct investment.

Available nominal data on **foreign trade** show narrowing of the trade deficit ...

... amid faster annual growth in the export than in the import of goods ...

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



Source: SSO and NBRM calculations.

... which is contrary to the expectations in the October projection for widening of the trade balance.

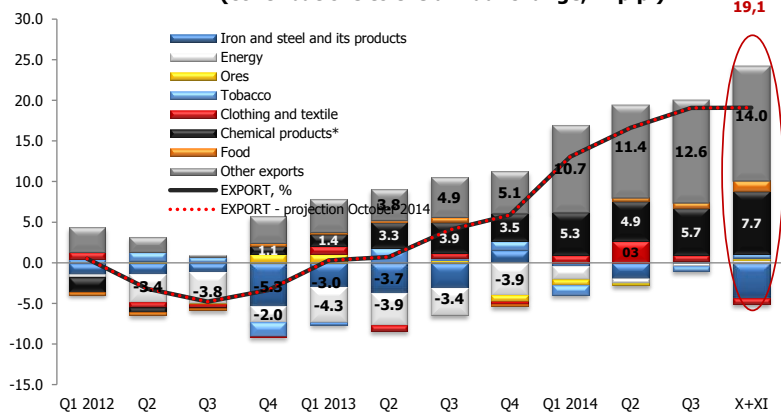
Budget performances in the first two months of the fourth quarter suggest upward deviation in **public consumption**, compared with the estimates, according to which a decline in public consumption is expected.

The estimates about 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 care⁷ and other transfers, versus their fall in the previous quarter.

⁷ Most of the transfers for health care relate to expenditures for goods and services.

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



Source: NBRM.

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

In the October - November period, **the deficit in the trade in goods with foreign countries decreased by 6% on an annual basis**, amid higher growth of exports compared with the imports of goods ...

... which is contrary to the expected widening of the trade deficit in the fourth quarter, according to the October projection.

Exports of goods registered an annual growth of 19.1% during October and November, amid further increased utilization 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, and textiles and clothing, which recorded an annual decline.

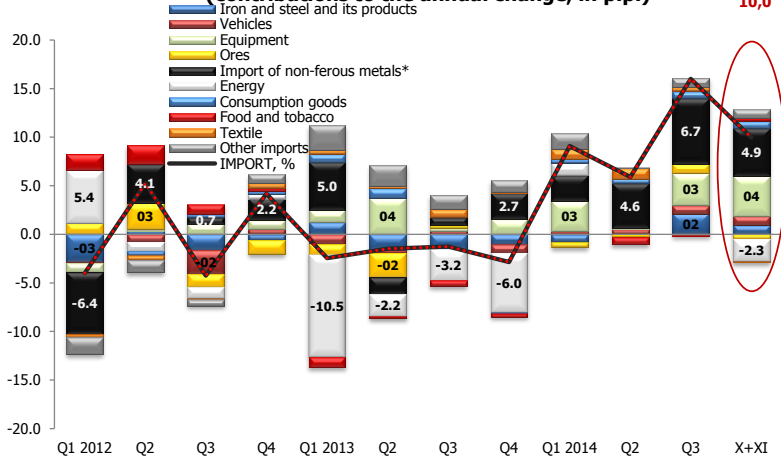
Compared with the projection, exports realized in October and November indicate an improved export performance relative to that expected for the fourth quarter. Positive deviation is registered in almost all export categories (with the exception of iron and steel and textiles and clothing), with the improved export performance of the new facilities giving the largest contribution.

Imports registered an annual growth of 10% in October and November, which is mostly due to the increased imports of raw materials for the new industrial facilities...

... 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 a result of the decline in the world oil prices, coupled with lower imported quantities.

Import performances in October and November, give a general indication of realized imports that are in line with those projected for the fourth quarter. However, within the individual import components, there are certain deviations from the projection. The largest upward deviation is

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



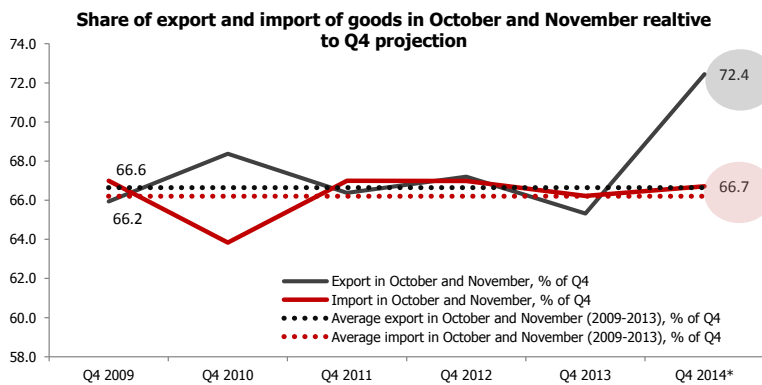
Source: NBRM.

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

achieved in the import of raw materials of the new export capacities, while other import categories are mainly just under or in line with the October expectations.

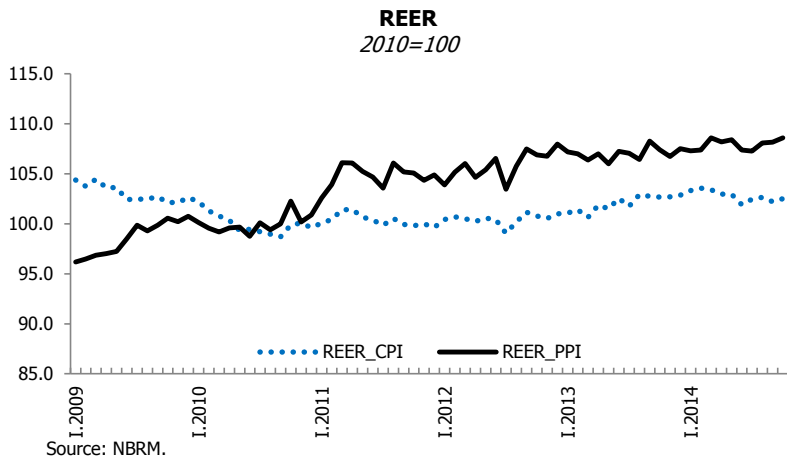
In October and November, the export and import performances are higher than the historical average, which suggests **possibly smaller trade deficit in the fourth quarter, compared with the October projection.**

Latest movements in world stock exchange prices indicate somewhat less favorable expectations for the prices of nickel and copper, on average, for the current 2015. On the other hand, the latest expectations about the prices of crude oil suggest significantly sharper annual decline in the price expressed in euros for 2015, which indicates more favorable terms of trade by the end of the year.

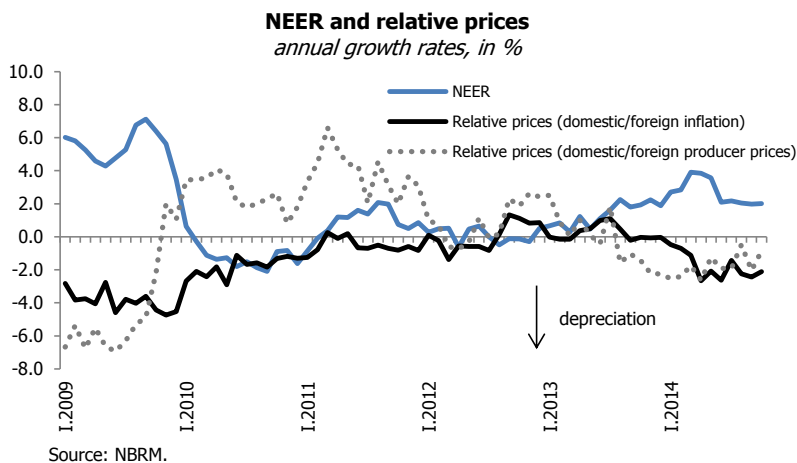
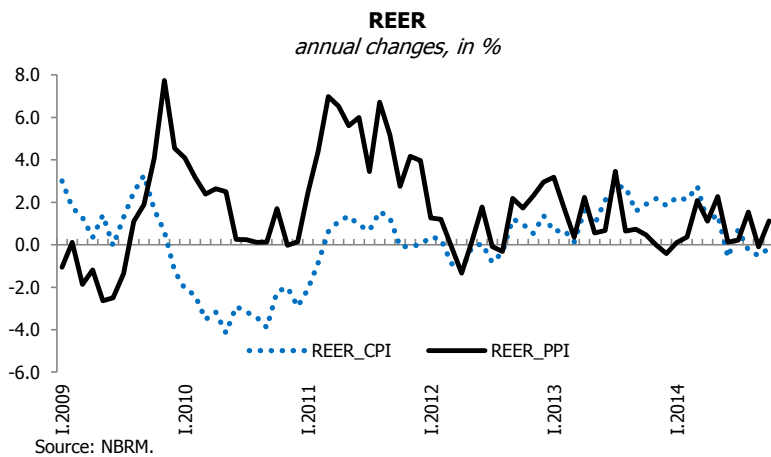


Source: NBRM.

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

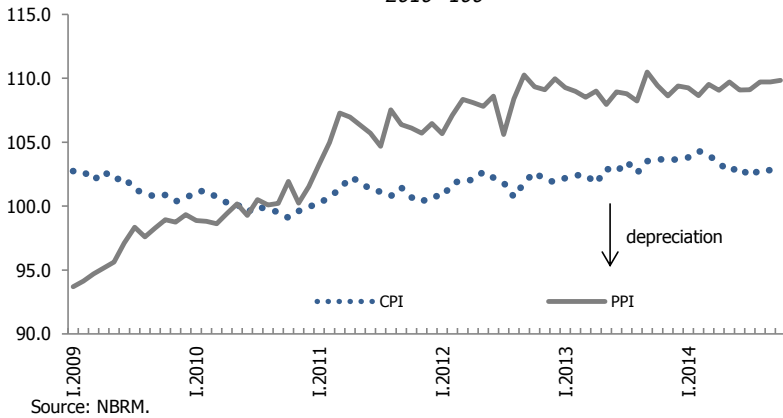


In November 2014, price competitiveness indicators of the domestic economy registered mild deterioration on an annual level. Compared with the same month of the previous year, the REER deflated by consumer prices appreciated slightly by 0.4%, after three months of decline, while the REER deflated by producer prices again appreciated by 2.5% on an annual basis.

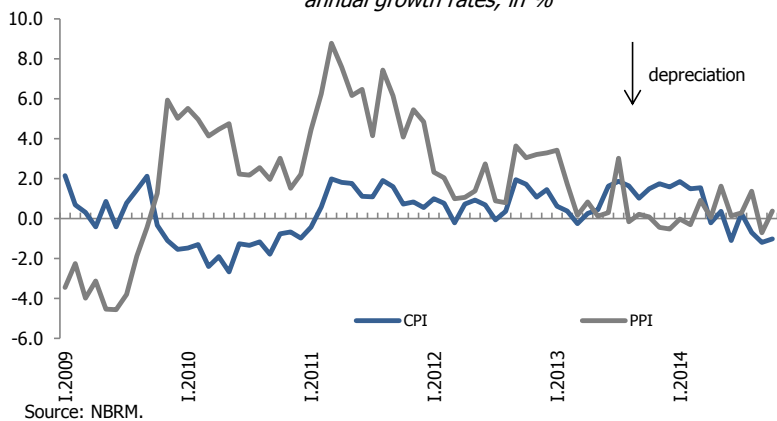


The further appreciation of the nominal effective exchange rate (by 2.7%) on an annual basis, primarily as a result of the prolonged depreciation of the Russian ruble and Ukrainian hryvnia against the denar, caused upward pressures on both REER indices. On the other hand, the growth of foreign consumer prices, as opposed to the slight annual decline in domestic prices, as well as faster growth in foreign versus domestic prices of industrial products, led to a decline in relative prices by 2.2% and 0.2% respectively.

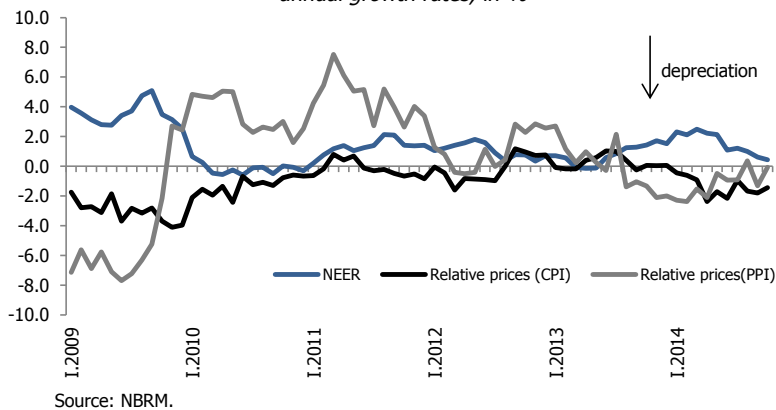
REER, excluding primary commodities
2010=100



REER, excluding primary commodities
annual growth rates, in %



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



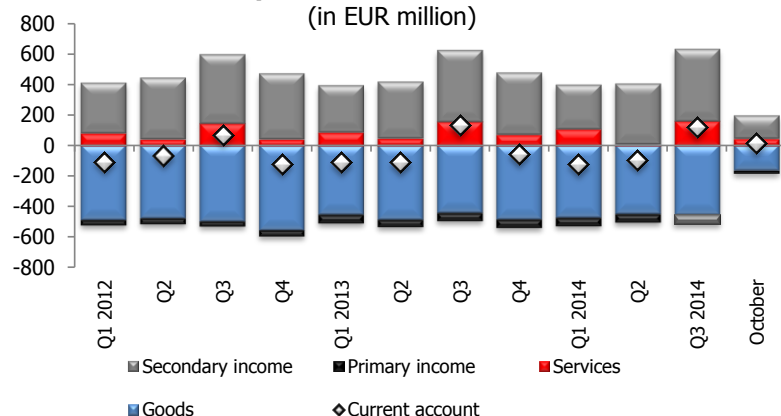
The analysis of the movement of the REER indices calculated with weights based on the foreign trade without primary products⁸, indicates divergent movements in the domestic price competitiveness. The REER deflated by consumer prices depreciated by 1.2% on an annual basis, while the REER deflated by producer prices appreciated by 1%.

Improvement in the REER deflated by consumer prices is entirely due to the continued annual decline in the relative consumer prices by 1.4%, driven by the reduction in domestic prices, compared to the annual growth in foreign prices. On the other hand, slight annual rise was registered also in the relative prices of industrial products (of 0.8%), driven by the decline in the foreign relative to the increase in domestic prices of industrial products. NEER appreciation continued in November, but at a slower pace (0.2%), with the annual change again being driven by the depreciation of the Turkish lira and the Serbian dinar against the denar.

⁸ 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.

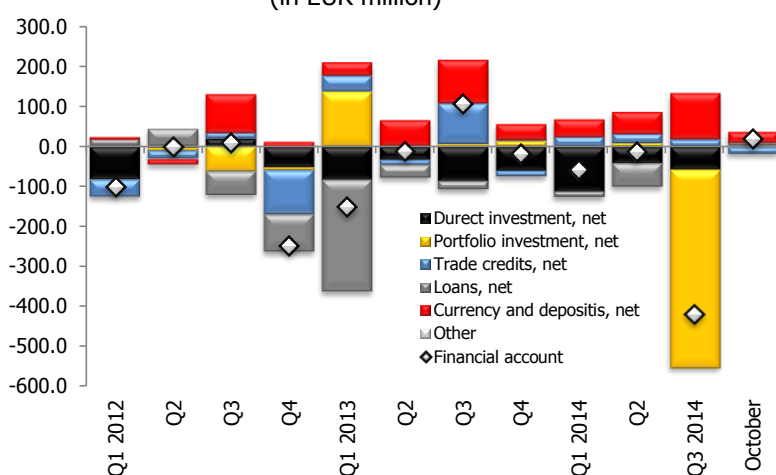
In October 2014, the balance of payments current account registered a surplus of Euro 13.2 million (or 0.2% of GDP), contrary to the expectations for a deficit in the fourth quarter, according to the October projection.

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

... while the primary income is generally in line with the October expectations.

Financial account components

(in EUR million)



Source: NBRM.

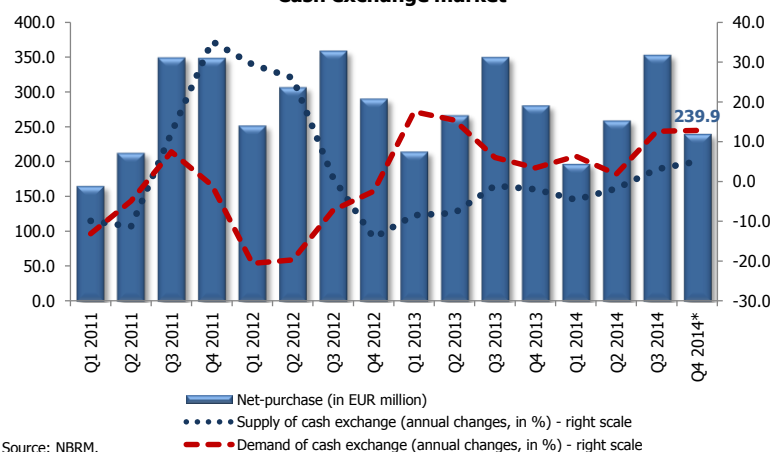
In October, net outflows in the amount of Euro 19.4 million (or 0.2% of GDP) were made through the financial account, while according to the October projection, for the last quarter of the year net inflows are expected⁹.

For the most part, the downward deviation relative to the October projection is due to weaker performances in direct investments (net acquisition of financial assets, rather than the expected net incurrence of liabilities in this category). Other components of the financial account did not register major deviations relative to the October expectations.

Recent data on currency exchange operations, as of December 2014 indicate further increase in the supply of and demand for foreign currency.

In the last quarter of 2014, the net purchase in the foreign exchange market totaled Euro 289.6 million, which is an annual increase of 3.2%.

Cash exchange market



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 somewhat higher than projected with the October projection.

⁹ 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.

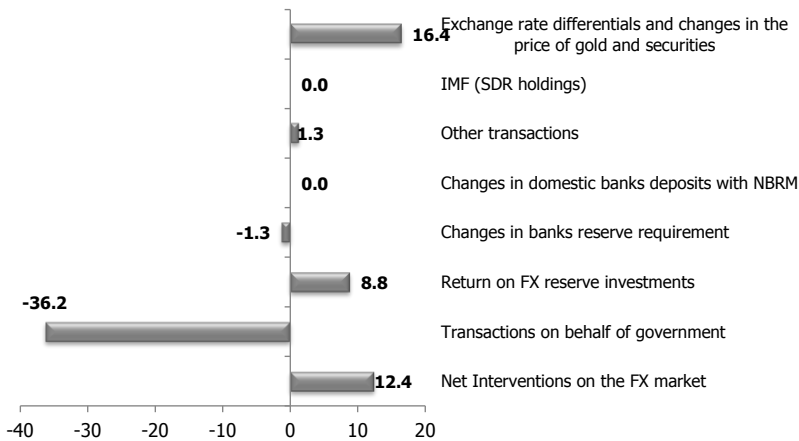
Foreign exchange reserves
(stock, in EUR million)



Source: NBRM.

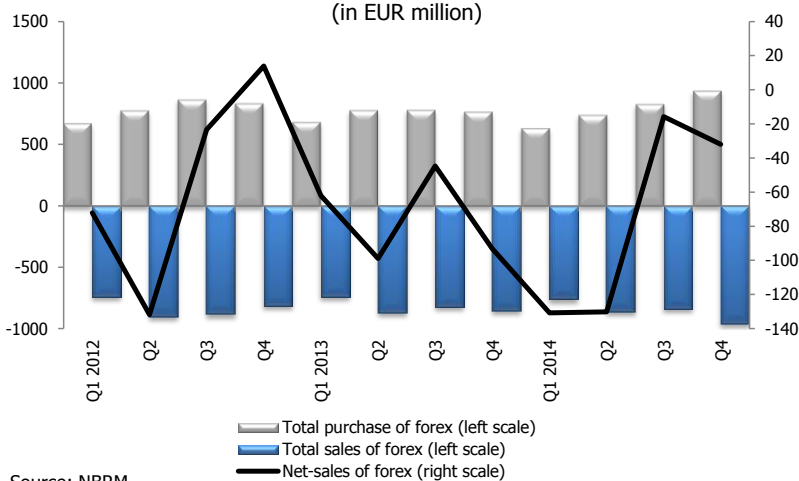
As of 31 December 2014, gross foreign reserves were in the amount of Euro 2,436.5 million, which is an increase of Euro 1.5 million compared to the end of September. The increase in foreign reserves was due to the currency changes and changes in the price of gold, the net purchase of foreign currency by the NBRM on the foreign exchange market and the revenues from the investment of foreign reserves, while transactions on behalf of the government acted in the opposite direction.

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



Source: NBRM.

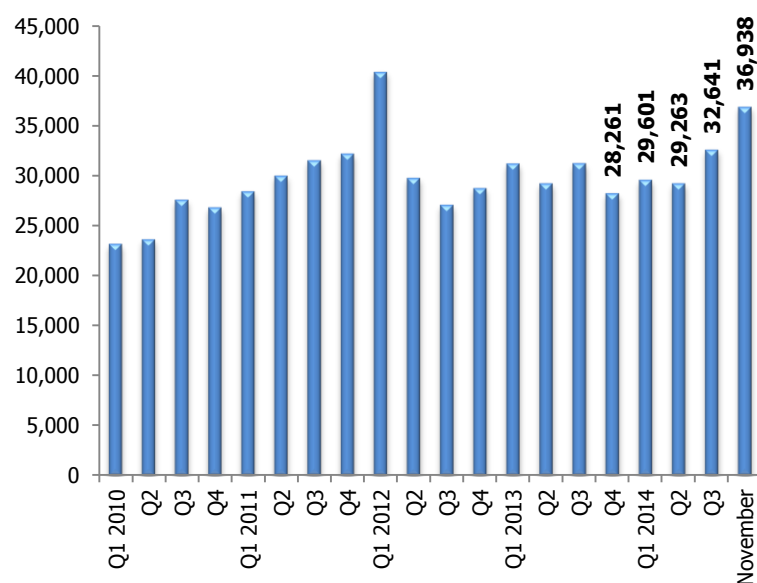
Foreign exchange market
(in EUR million)



Source: NBRM.

In the fourth quarter, the **foreign exchange market** of banks registered net sales of Euro 31.9 million, which is lower by Euro 65.7 million on an annual basis. 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 22.3% and 12.7%, respectively). The analysis by sector suggests that better annual performances are due to the non-residents sector, where a significantly higher net purchase was realized on an annual basis, but also to the increased net purchase by exchange offices.

Monetary policy instruments, in MKD million



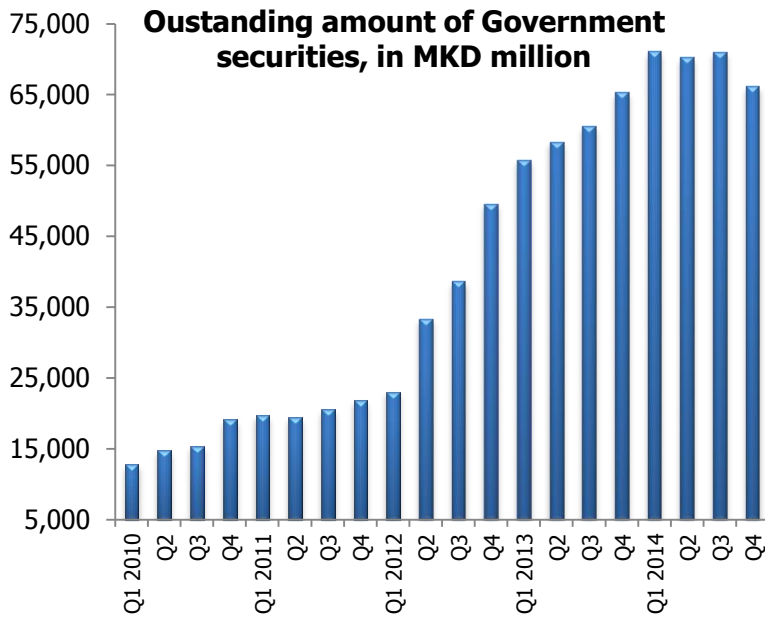
Source: NBRM.

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

... at a time when the net foreign assets of the NBRM registered a moderate 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.

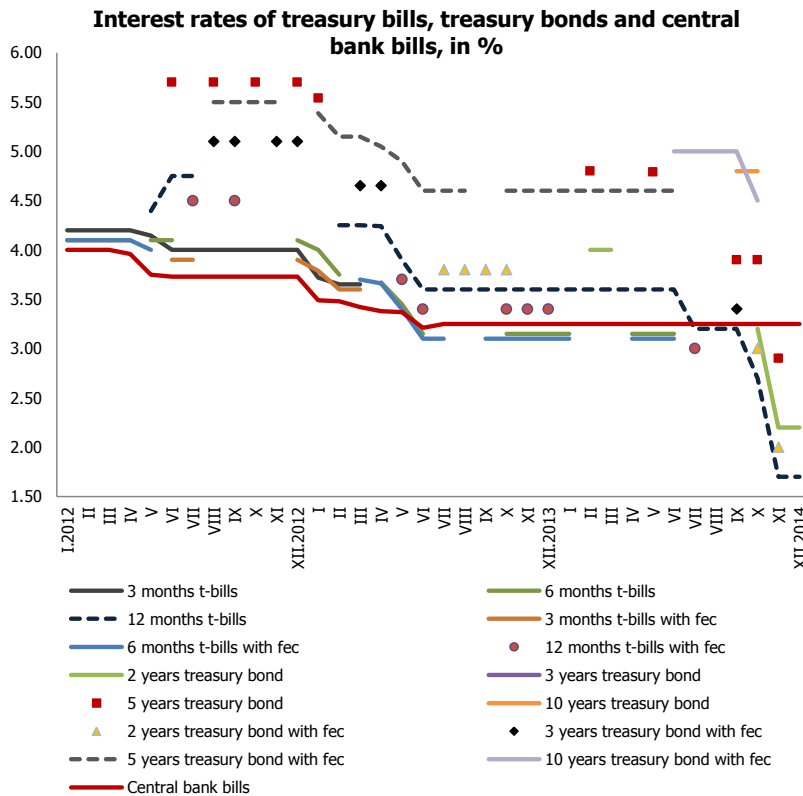
According to the latest available data, in November, in the Budget of the Republic of Macedonia a deficit of Denar 1,015 million was registered. On a cumulative basis, for the period January to November, the budget deficit amounted to Denar 19,125 million (or 3.7% of GDP¹⁰), representing 97.6% of the projected budget deficit for 2014 in accordance with the Supplementary Budget. In terms of its financing, in November 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.

¹⁰ 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 3.6% of GDP.



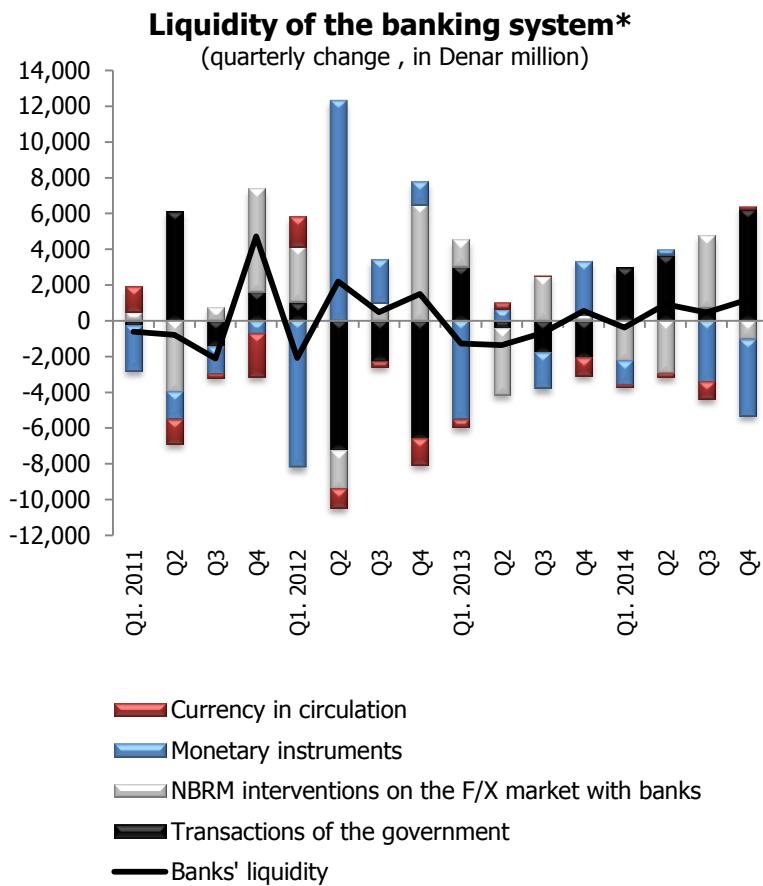
The stock of government securities in the domestic market amounted to Denar 66,162 million at the end of December and compared to September 2014, it is lower by Denar 4,753 million. On a cumulative basis, as of December, net issuance of government securities in the amount of Denar 843 million was registered.

Source: NBRM.



Interest rates on government securities on the auctions held in December ranged from 1.7% for the 12-month treasury bills, 2.2% for the 2-year government bonds without foreign currency clause and 2.7% for the 5-year government bonds with foreign currency clause, up to 3.8% for the 10-year government bonds. Part of the government securities issued in December were with lower interest rates compared to previous auctions, while part of the interest rates were unchanged.

Source: NBRM.



*Positive change- liquidity creation, negative change- liquidity withdrawal .
 ** Refers to July and August.

Source: NBRM.

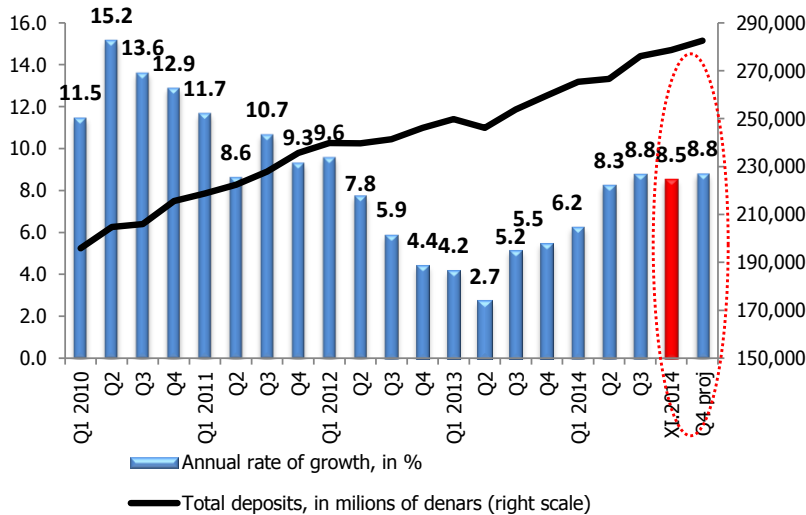
Regarding the flows of creating and withdrawing liquidity, in November liquidity was created through government transactions, which is solely due to the withdrawals from government Denar deposits with the NBRM. Currency in circulation also gave a small contribution in this regard. According to the realized net sale of foreign currency on the foreign exchange market, the NBRM interventions on the foreign exchange market with the market makers acted towards withdrawing liquidity. Liquidity was withdrawn also through monetary instruments. Against such background, in November the total liquidity increased on a monthly basis.

In late November, reserve money increased relative to the end of September, which is in line with the expectations for their growth in the fourth quarter ...

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

MONETARY SECTOR

Total deposits

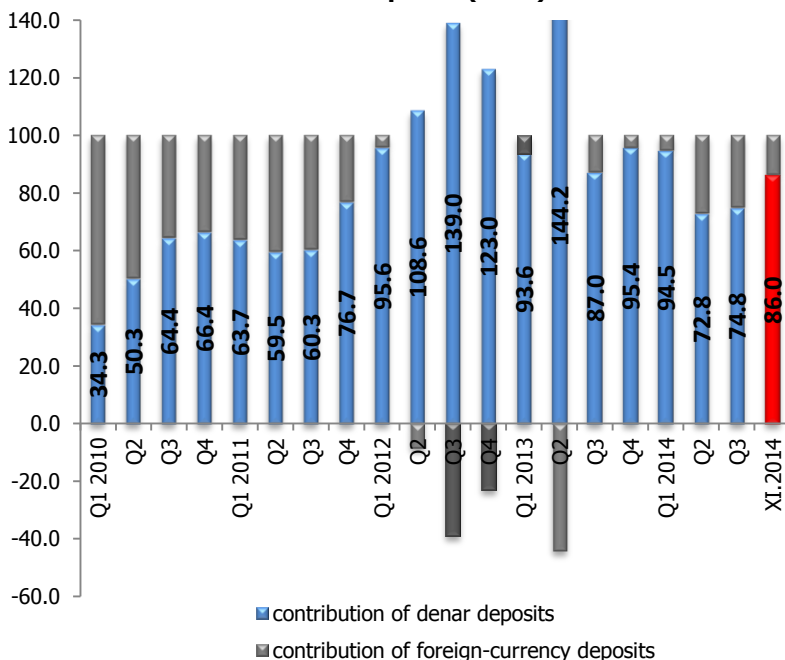


*Includes demand money
Source: NBRM.

The monthly growth of total deposits continued in November at a faster pace compared to the previous month. The expansion of the deposit base is mainly a result of the monthly increase in the deposits of other financial institutions and households (accounting for 46% and 42% of the total growth, respectively, with moderate growth also of corporate deposits (accounting for about 16% of the total growth).

The annual growth rate of total deposits equaled 8.5% at the end of November, which is below the projection for the last quarter of 2014 (of 8.8%). On a quarterly basis, total deposits increased by Denar 2,550 million representing 39% of the projected increase for the fourth quarter of 2014, according to the October projection.

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



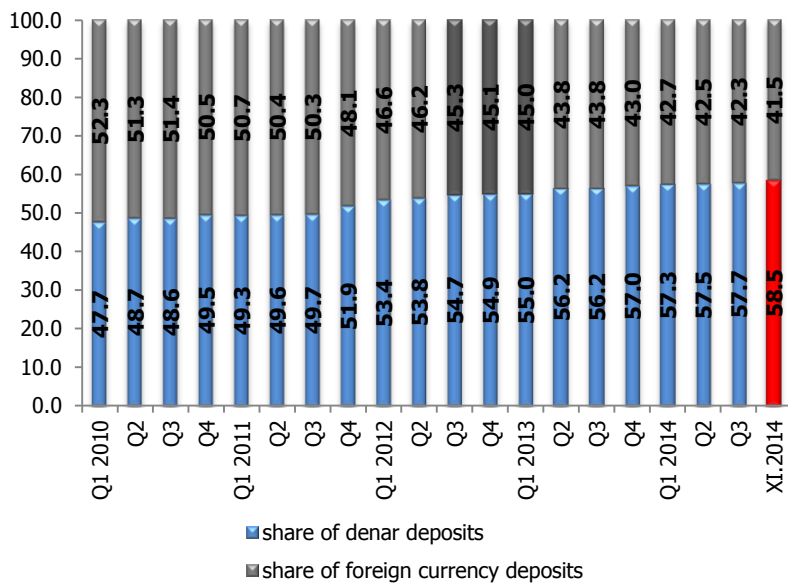
Source: NBRM.

*Includes demand deposits.

Registered annual increase in total deposits is mainly explained by the growth of Denar deposits, amid moderately reduced contribution of foreign currency deposits (contribution of 14% in the total deposit growth versus 21% in the previous month). November is the second month in a row in which further moderate monthly reduction of deposits in foreign currency is registered...

MONETARY SECTOR

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

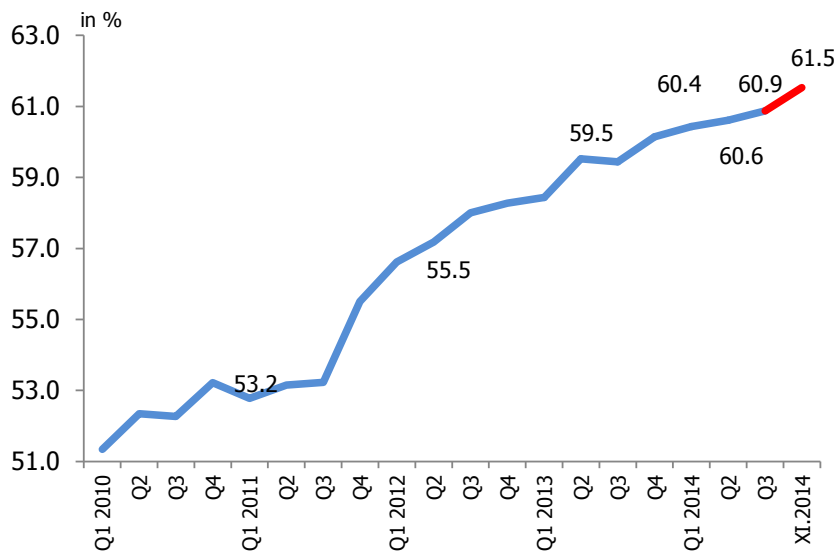


... contributing to a minimal change in the currency structure of total deposits. Namely, at the end of November, there was a slight increase in the share of Denar deposits, amid a reduced share of foreign currency deposits.

Source: NBRM.

*Includes demand deposits.

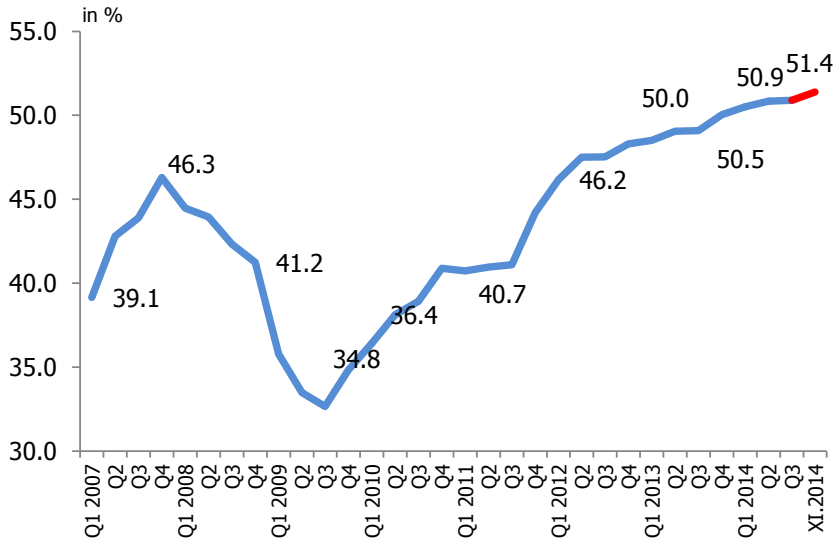
Share of M4 in denars in total M4 (in %)



Source: NBRM.

MONETARY SECTOR

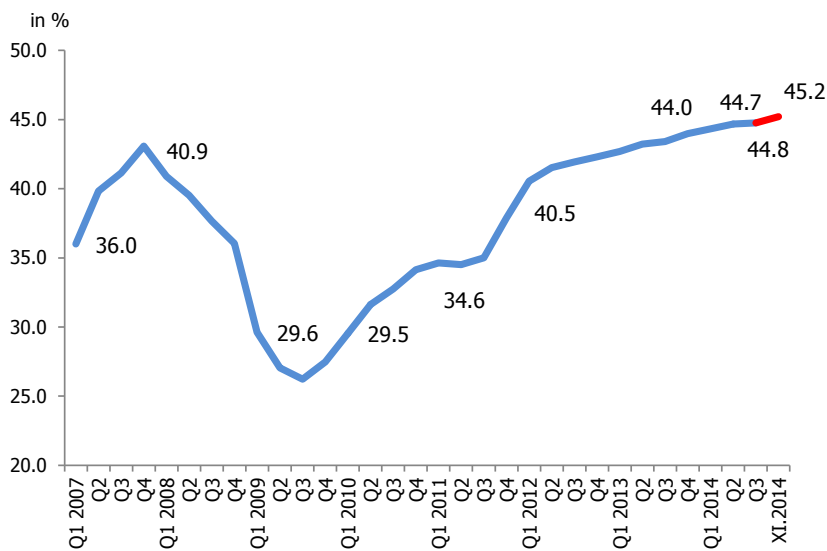
Share of denar deposits in the total household deposits, in %



Source: NBRM.

*Includes demand deposits.

The share of household denar deposits in the total household deposits (excluding demand deposits)



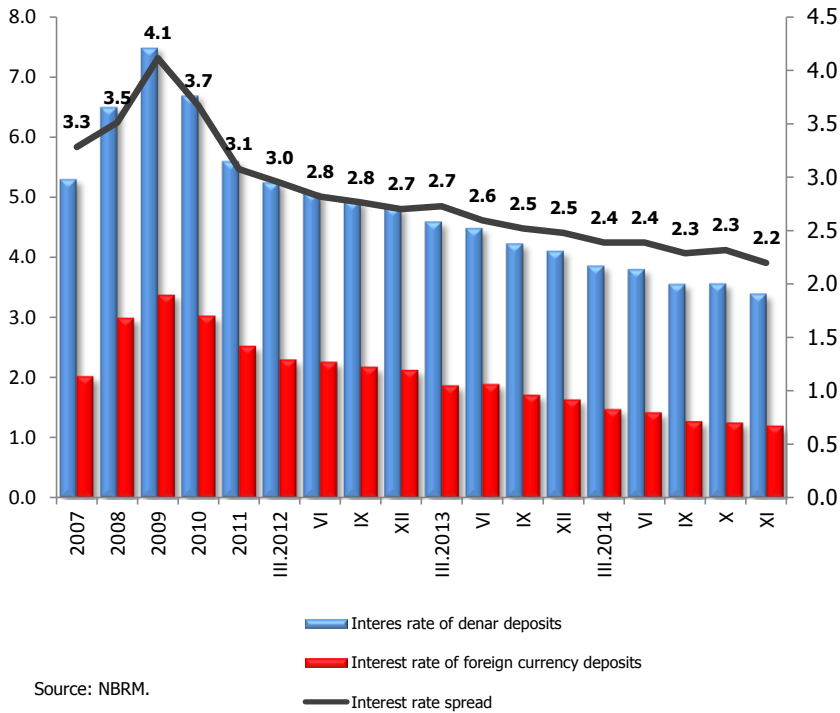
Source: NBRM.

Total household deposits continued to grow in November, with the growth still being largely driven by Denar deposits.

Thus, the share of denar deposits in the total household deposits registered a slight increase and equaled 51.4%.

MONETARY SECTOR

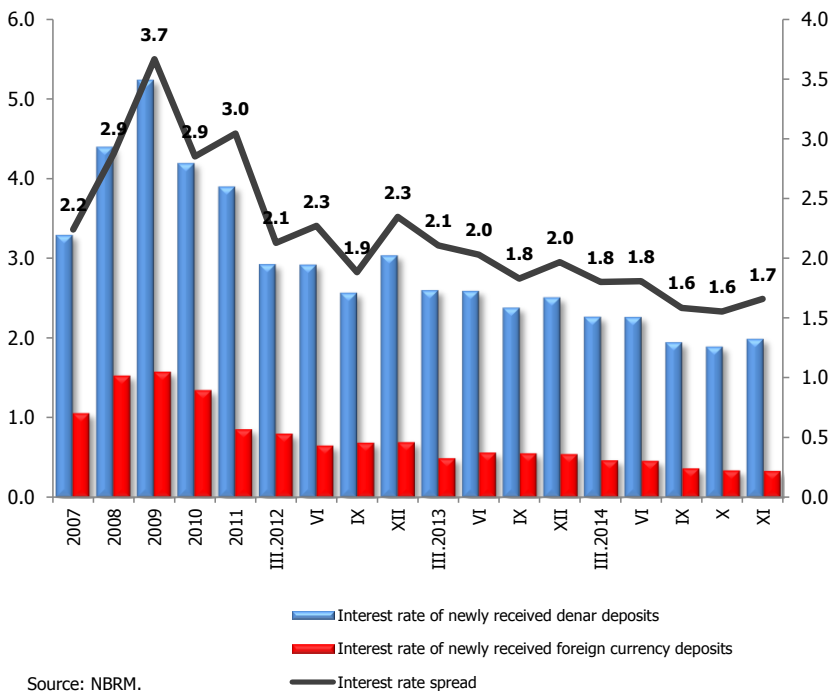
Interest rates on denar and foreign currency deposits, in%



Source: NBRM.

In November, yields from total Denar and foreign currency savings declined (by 0.2 percentage point and 0.1 percentage point, respectively) indicating further slight narrowing of the interest rate spread between them. More stable movements were registered in the newly received deposits, with the interest rate spread between the new Denar and foreign currency savings registering a minimal widening compared with the previous month.

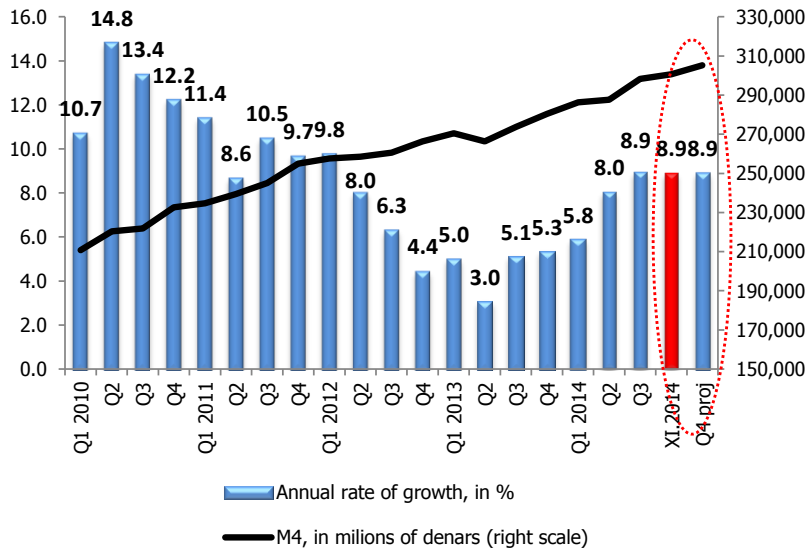
Interest rate on newly received denar and foreign currency deposits, in %



Source: NBRM.

MONETARY SECTOR

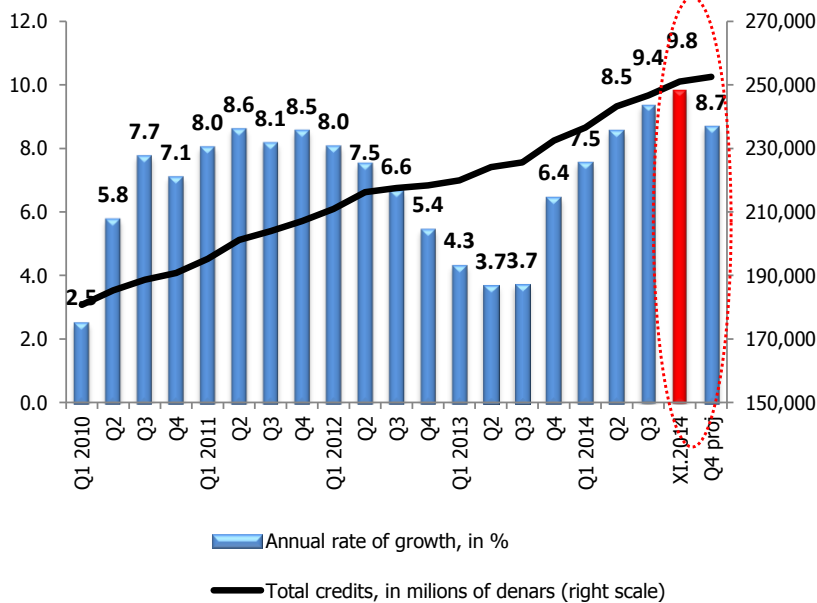
Broad money, M4



Broad money M4 continued to grow in November, at an accelerated pace compared to the previous month. At the end of November, the annual growth rate of the broad money supply equaled 8.9% which is consistent with the growth dynamics projected for the last quarter of 2014. On a quarterly basis, the realized monetary growth is about 35% of the expected increase in the last three months of 2014.

Source: NBRM.

Total loans

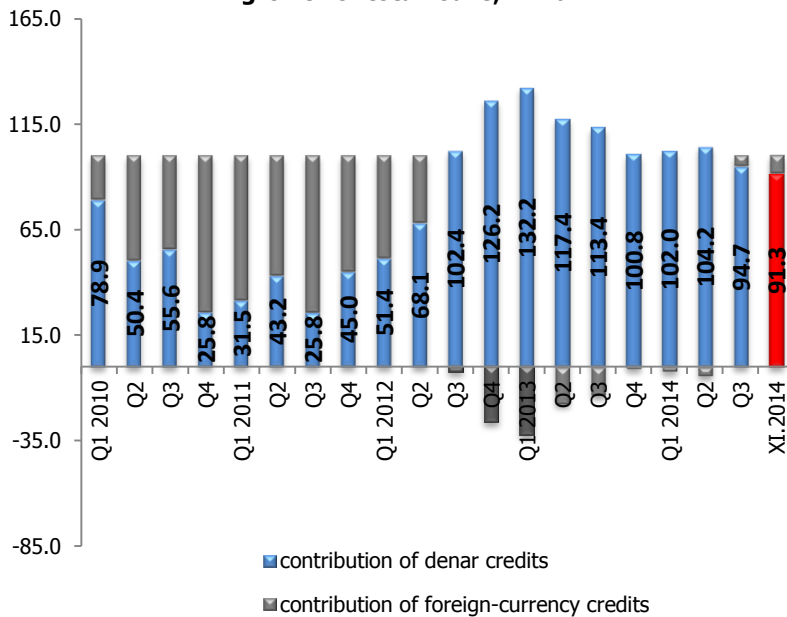


During November, the credit market registered certain acceleration of bank lending to the private sector compared to the previous month. Moreover, during this period there was a significantly intensified activity of the corporate segment (accounting for 72% of the total monthly growth), as opposed to the performances in October, when loans to households were the main driver of the monthly increase.

Source: NBRM.

At the end of November, the annual growth rate of total loans equaled 9.8%, which is above the annual growth of 8.7%¹¹ projected for the last quarter of 2014. On a quarterly basis, total loans increased by Denar 4,403 million, representing approximately 75% of the expected growth by the end of the year.

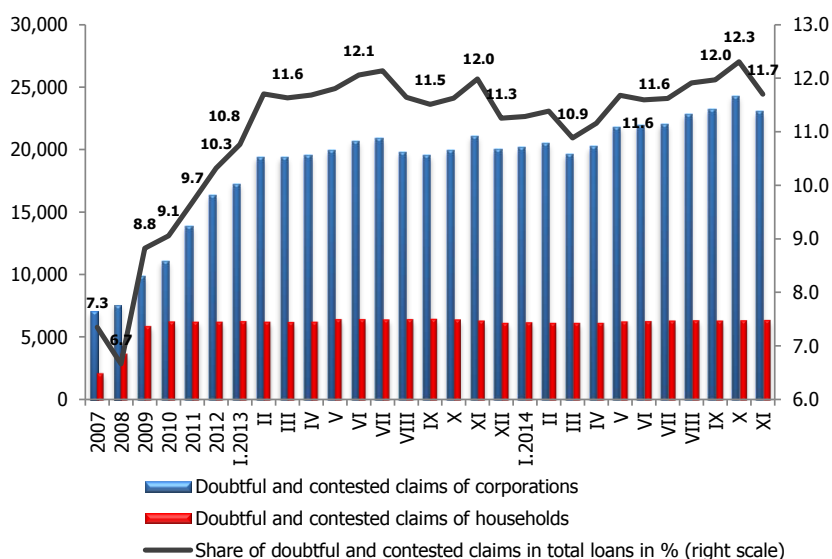
Contribution of denar and foreign currency loans to the annual growth of total loans, in %



Registered annual growth of total loans is mostly driven by the increased Denar loans, with the foreign currency loans also giving their moderate contribution in this direction. In November, foreign currency loans grew moderately (contribution of 28% to the total monthly growth), contrary to the decline in the previous month.

Source: NBRM.

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



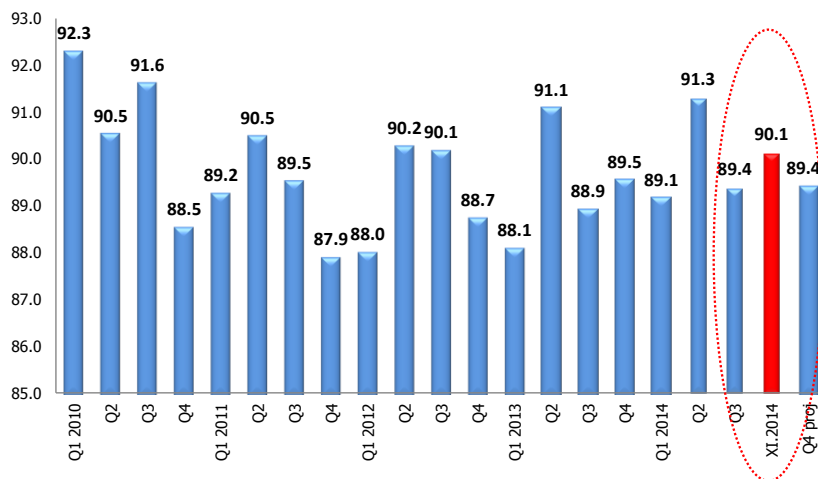
Source: NBRM.

After seven months of steady growth, in November there was a significant reduction of total doubtful and contested claims on a monthly basis, with the share of non-performing loans to total loans being reduced to 11.7%. On an annual basis, total doubtful and contested claims continued to grow, but at a significantly slower pace compared to the previous month. Such movements in total doubtful and contested claims on a monthly and annual basis are driven by the changes in the non-performing loans to the corporate sector (monthly decline and slower pace of the annual growth in November).

¹¹ The lower growth rate for the end of 2014 is largely due to the base effect, given that in December 2013, a significant acceleration of the credit activity of the private sector was registered (monthly growth of Denar 3,850 million).

MONETARY SECTOR

Ratio of total loans to deposits, in%

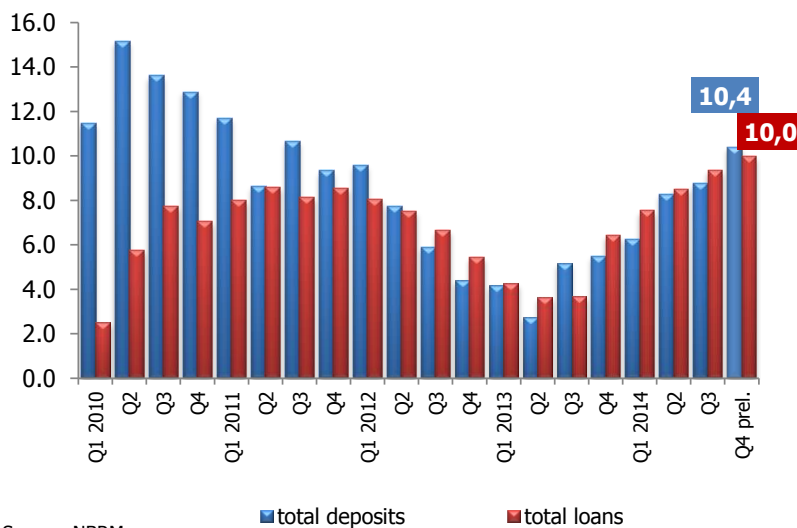


Source: NBRM.

In November, the utilization of the deposit potential for lending to the private sector was higher than that registered in the previous quarter and the level expected within the projection for the end of the year ...

... as a result of the more intensive quarterly increase of the loans to the private sector relative to the growth of the deposit base.

Total loans and deposits, annual changes, in %



Source: NBRM.

According to the preliminary data, the total deposits growth continued in December, with significantly higher intensity compared to the previous month. The growth of total deposits in December was equally driven by the growth of household deposits and the growth of corporate deposits, with the contribution of Denar deposits being dominant in both sectors. As for total loans, preliminary data show a significant acceleration of growth compared to the previous month, and compared to the average growth since the beginning of the year. In continuation of the November performances, also in December, most of the newly extended loans were placed with companies (about 87% of the total monthly growth), indicating a significant movement of the credit activity to the corporate sector compared with the performances from the beginning of the year. Against such a backdrop, total deposits and loans in December were higher by 10.4% and 10%, respectively, 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

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).

- 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.