National Bank of the Republic of Macedonia

MONETARY POLICY AND RESEARCH DEPARTMENT

Recent Macroeconomic Indicators
Review of the Current Situation

July 2016

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

In late June, the external economic environment faced yet another unexpected challenge – the Brexit. This event again made markets volatile and led to unfavorable expectations for the British and the European economies, enhancing the downward risks to growth, especially in the European Union countries. However, the effects of the Brexit are not yet quantifiable and time determinable, considering that the process of disintegration and further negotiations are expected to take longer. As for the performance, the latest high frequency data for the euro area mainly point to growth in the second quarter. Thus, data on industrial output for April have shown slightly higher growth compared to the first quarter, and more favorable trends in foreign trade. Additionally, the labor market continued registering downward trend in the unemployment rate, which in May 2016 was reduced to 10.1%. On the other hand, consumer and business confidence surveys still do not point to significant positive developments, especially for the segment of the economy that relates to household consumption. According to the preliminary estimates for June 2016, inflation is slightly positive for the first time after January 2016 at 0.1% annually (-0.1% in May), given the slower decline in energy prices, and the minor acceleration of core inflation from 0.8% in May to 0.9% in June.

Observed from a viewpoint of the individual quantitative external environment indicators for the Macedonian economy, the forecasts regarding the foreign effective demand have not undergone major changes relative to the April cycle. Thus, the assessment of growth of foreign demand in 2016 has been revised slightly upward, while for 2017, it remains unchanged. These assessments do not include the current downward revisions in almost all European economies due to the Brexit. The expectations for **foreign effective inflation** for 2016 and 2017 have been revised slightly downward. **In 2016, prices of most primary commodities are expected to further decline and to recover in 2017,** amid divergent revisions by individual product. Thus, **world oil prices** are expected to be lower in 2016 compared to the April forecasts, while for 2017, they are expected to increase slightly faster, reaching a higher price level than previously expected. In **metal prices**, the latest perceptions for 2016 are divergent, whereby the nickel price is expected to decline at somewhat slower pace, while the copper price is expected to decline faster than previously forecasted, while 2017 is expected to experience more favorable movements i.e. stronger price growth compared to the April forecast. With regard to world **prices of food,** there are no expectations for pressures on domestic inflation in 2016, amid faster decline in wheat and corn prices for 2016, given the improved perceptions for production and expectations for high stock. The expectations for 2017 are less favorable, i.e. slightly lower growth in food prices than previously forecasted. However, it should be kept in mind that expectations about the prices of these primary commodities are exceptionally volatile, especially since the cut-off date was a few days after the referendum in the UK that has created additional uncertainty about their pace.

The latest assessments indicate that during the current and the next year, **EURIBOR will follow similar path as in the April forecasts,** which corresponds to the unchanged ECB's monetary policy setup since March this year.

The comparison of the latest macroeconomic indicators with their projected dynamics within the baseline scenario from the April forecasting round provides a divergent picture

of the deviations in the individual segments of the economy. GDP data confirm the growth of the economy in the first quarter, which is still lower than the growth expected in the April forecast. The sector-by-sector analysis of the trends in the second quarter that relies upon the available high frequency indicators for April and May, suggests continued growth. However, compared to the first quarter, almost all sectors have reported shower pace of growth. **The lower performance in the first quarter, as well as the indications of slowing growth in the second quarter, points to potentially weaker GDP growth than forecasted for the first half of the year.** Also, domestic non-economic factors related to the political developments in the country further raise the uncertainty about the performance and assessment of the economic activity. In June, consumer prices kept on decreasing (on an annual basis), given the lower food and energy prices, while core inflation remained positive. Despite the slight decline, from the aspect of the forecasted path of movement of domestic prices, it is estimated that current developments do not suggest greater deviation from the April forecast by the end of 2016. As for input assumptions in the inflation projection, the latest revisions of the expected movement of external prices generally indicate maintenance of low global prices.

Recent foreign reserves data (adjusted for the effects of the price and exchange rate differentials and price changes of securities), in the second quarter of 2016, indicate a decline. Analyzed through the factors of change, the decline in the reserves in the second quarter mainly results from the net sales of foreign currency by the NBRM in the foreign exchange market, under the influence of developments on the domestic political scene, and less from transactions on behalf of the government, i.e. servicing of regular government liabilities. Analyzing available external sector data for the second quarter, foreign trade data as of May give an indication of a higher annual trade deficit, given the decline in exports and increase in import of goods. At the same time, the latest available data on the currency exchange market, as of June, show lower net purchase from currency exchange operations, as an effect of the uncertain domestic political environment. However, at the end of May, there were signs of gradual stabilization, and a 7.6% increase in June, on an annual basis. The analysis of foreign reserves adequacy indicators shows that they continue to hover in a safe zone.

In terms of monetary sector developments, in May 2016, data on total deposits with banks show a moderate monthly decline of 0.5%, which is lower compared to the previous month. The decrease remains associated with the uncertainty about the political situation in the country, whereby the decline was entirely due to the further decrease in household deposits (second consecutive month), amid growth of corporate deposits. On an annual basis, total deposits in May grew by 3.6% and were below expectations for the second quarter of the year (6.6%). Analyzing the credit market, in May, total loans to the private sector remained relatively stable compared to the previous month, amid growth in household loans and fall in loans to the corporate sector. On an annual basis, total loans grew by 6.4% and were below expectations from the April forecast (7.6%) for the second quarter of the year. These performances are partly a response to the uncertain environment, and the decline in the deposit base, but largely reflect the write-off of past due claims, as required by the decision of the National Bank adopted in December 2015[1].

In the first five months of 2016, the Budget of the Republic of Macedonia registered a deficit of Denar 6,317 million, financed through government deposits with the National Bank, and to a lesser extent, through net issuance of government securities on the domestic market. The deficit in the period January-May accounted for 33% of the planned deficit for the entire year, according to the Budget of the Republic of Macedonia for 2016.

The latest macroeconomic indicators and assessments indicate changes in some key monetary policy variables as well as risks, compared to the baseline scenario provided in the April forecasts. Foreign reserves (adjusted for price and exchange rate differentials and price

[1] If we ignore the effect of write-offs, the annual loan growth rate would be higher, at around 8%.

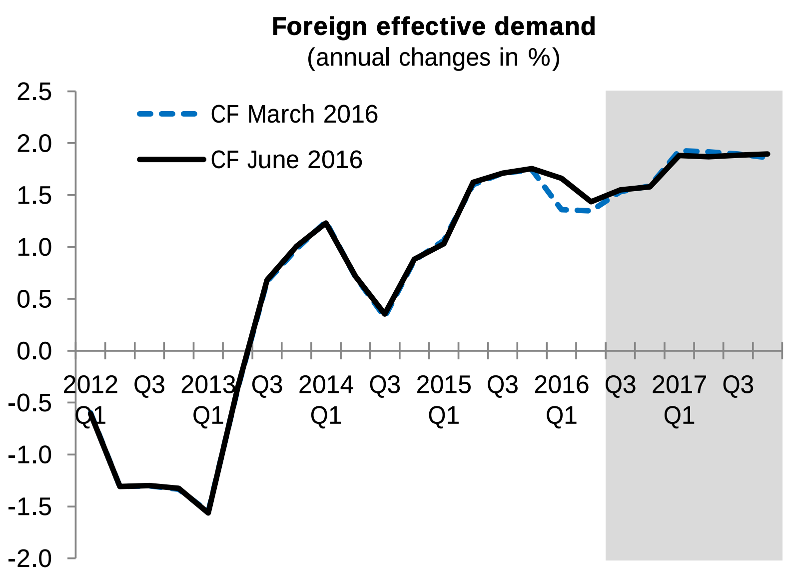
changes of securities) decreased in the second quarter, primarily under the influence of non-economic factors. However, foreign reserves adequacy indicators continue to move in the safe zone. Available high frequency indicators of economic activity suggest continued growth in the second quarter of 2016, but probably at a slower pace than expected. Inflation performances correspond to the expectations in the April forecasts and the assessments for environment of low global prices, indicating no major deviations from the inflation forecast. Within the monetary sector, data for May indicate a gradual stabilization, i.e. slower decline in deposits, while credit growth remains weak. Performance of deposits and loans at the end of May was weaker than expected for the second quarter of 2016, and indicate deviations from the levels forecasted in April. However, it should be borne in mind that the deviation of the loans is partly due to the change of regulations. The set of measures undertaken by the National Bank in early May is expected to further stabilize the situation. **Nevertheless, the uncertainty associated with the domestic political developments, and the global environment emphasized within the April forecasts is still present, coupled with the recent developments related to the UK referendum. The above requires continuous monitoring of the performance, and regular reassessment of risks and their relevance in the context of achieving monetary goals.**

Selected economic indicators[1]

Indicator	2012	2013	2014	2015 Jan.	Feb.	Mar.	Q1	Apr.	May	Jun.	Q2
I. Real sector indicators											
Gross domestic product (real growth rate, y-o-y) [2]	-0.5	2.7	3.5				3.8				3.4
Industrial production [3]											
y-o-y	-2.8	3.2	4.8	1.1	3.1	0.6	1.5	-0.9	-5.0	6.4	0.1
cumulative average	-2.8	3.2	4.8	1.1	2.1	1.5	1.5	0.8	-0.4	0.8	0.8
Inflation [4]											
CPI Inflation (y-o-y) [5]	4.7	1.4	-0.3	-1.5	-1.0	-0.3	-0.9	0.1	0.3	0.5	0.3
CPI Inflation (cumulative average)	3.3	2.8	-0.3	-1.5	-1.2	-0.9	-0.9	-0.6	-0.5	-0.3	-0.3
Core inflation (cumulative average)	2.1	3.0	0.6	-1.1	-0.6	-0.4	-0.4	-0.2	0.0	0.1	0.1
Core inflation (y-o-y)	2.1	3.0	0.6	-1.1	-0.2	0.0	-0.4	0.5	0.8	0.8	0.7
Labor force											
Unemployment rate	31.0	29.0	28.0				27.3				26.8
II. Fiscal Indicators□ (Central Budget and Budgets of Funds)											
Total budget revenues	138,115	140,248	145,929	10,527	12,089	15,163	37,779	14,383	13,750	12219.0	40352.0
Total budget expenditures	155,840	159,505	168,063	12,732	14,467	16,881	44,080	14,375	15,348	13849.0	43572.0
Overall balance (cash)	-17,725	-19,257	-22,134	-2,205	-2,378	-1,718	-6,301	8	-1,598	-1630.0	-3220.0
Overall balance (in % of GDP) [1]	-3.8	-3.8	-4.2	-0.4	-0.4	-0.3	-1.1	0.0	-0.3	-0.3	-0.6
III. Financial indicators [6]											
Broad money (M4), y-o-y growth rate	4.4	5.3	10.5	11.1	9.7	8.8	8.8	9.7	8.9	9.2	9.2
Total credits, y-o-y growth rate	5.4	6.4	10.0	9.2	9.2	9.2	9.2	10.2	9.5	9.0	9.0
Total credits - households	6.5	10.2	11.8	11.5	11.8	12.1	12.1	12.3	12.4	12.4	12.4
Total credits - enterprises	4.5	3.8	8.6	7.5	7.3	7.1	7.1	8.7	7.4	6.7	6.7
Total deposits (incl. demand deposits), y-o-y growth rate	4.9	6.1	10.4	10.6	9.5	8.4	8.4	9.5	8.4	8.9	8.9
Total deposits - households	7.2	6.7	8.9	8.4	7.6	8.1	8.1	7.5	6.9	6.2	6.2
Total deposits - enterprises	-1.6	3.1	15.7	17.4	14.4	9.0	9.0	17.1	14.5	17.8	17.8
Interest rates [7]											
Interst rates of CBBills	3.73	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25
Lending rates											
denar rates (aggregated, incl. denar and denar with f/x clause)	8.5	8.0	7.5	7.4	7.3	7.2	7.3	7.2	7.1	7.1	7.1
f/x rates	7.0	6.5	6.3	6.1	6.0	6.0	6.0	5.9	5.9	5.9	5.9
Deposit rates											
denar rates (aggregated, incl. denar and denar with f/x clause)	5.1	4.4	3.7	3.3	3.2	3.1	3.2	3.0	3.0	2.9	3.0
f/x rates	2.2	1.8	1.4	1.5	1.5	1.4	1.5	1.4	1.3	1.3	1.3
IV. External sector indicators											
Current account balance (millions of EUR)	-240.0	-134.1	-68.7	37.6	2.9	-86.9	-46.5	-57.1	-28.5	3.4	-82.1
Current account balance (% of GDP)	*-1.6*	*-1.6*	-0.8	*0.4*	0.0	-1.0	-0.5	-0.6	-0.3	0.0	-0.9
Trade balance (millions of EUR) [8]	-1,946.7	-1,748.1	-1757.9	-73.7	-109.9	-194.5	-378.1	-202.8	-110.6	-133.1	-446.5
Trade balance (% og GDP)	*-25.7*	*-21.6*	-20.7	*-0.8*	*-1.2*	-2.1	-4.2	-2.2	-1.2	-1.5	-4.9
import (millions of EUR)	-5,070.6	-4,983.3	-5504.5	-365.5	-408.9	-533.6	-1308.1	-498.0	-469.6	-514.0	-1481.7
export (millions of EUR)	3,124.0	3,235.2	3746.6	291.8	299.1	339.1	929.9	295.2	359.0	380.9	1035.2
rate of growth of import (y-o-y)	0.3	-1.7	10.5	-3.0	-2.3	19.6	5.4	9.1	-2.1	18.8	8.2
rate of growth of export (y-o-y)	-2.8	3.6	15.8	23.8	6.1	13.4	13.9	-0.2	13.1	15.8	9.9
Foreign Direct Investment (millions of EUR)	131.1	229.4	197.4	35.4	12.0	20.6	68.0	36.5	-8.3	18.3	46.5
External debt											
Gross external debt (in milllions of EUR)	5171.7	5219.7	5992.3				6251.5				6359.8
public sector	2162.1	2172.4	2846.8				3024.7				3059.8
public sector/GDP (in %)	28.5	26.7	33.4				33.3				33.7
private sector	3009.5	3047.4	3145.5				3226.9				3300.0
Gross external debt/GDP (in %)	68.2	64.0	70.3				68.8				70.0
Gross official reserves (millions of EUR) [9]	2,193.3	1,993.0	2,436.5	2,483.7	2,330.7	2,354.8		2,344.3	2,328.5	2,254.8	

Indicator	2015 Jul.	Aug.	Sep	Q3	Oct.	Nov	Dec	Q4	2015	2016 Jan.	Feb.	Mar.	Q1	Apr.	May	Jun.	Q2
I. Real sector indicators																	
Gross domestic product (real growth rate, y-o-y) [2]				3.6				3.9					2.0				
Industrial production [3]																	
y-o-y	-2.7	12.7	8.6	5.7	13.1	11.5	10.5	11.7	4.9	8.0	15.2	8.9	10.7	3.6	5.3		
cumulative average	0.2	1.7	2.5	2.5	3.6	4.4	4.9	4.9	4.9	8.0	11.7	10.7	10.7	8.7	8.0		
Inflation [4]																	
CPI Inflation (y-o-y) [5]	-0.4	0.1	-0.2	-0.2	-0.5	-0.3	-0.3	-0.4	-0.3	0.1	0.0	-0.4	-0.1	-0.7	-0.7	-0.7	-0.7
CPI Inflation (cumulative average)	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	0.1	0.1	-0.1	-0.1	-0.2	-0.3	-0.4	-0.4
Core inflation (cumulative average)	0.2	0.3	0.3	0.3	0.4	0.4	0.5	0.5	0.5	1.6	1.6	1.7	1.7	1.6	1.6	1.6	1.6
Core inflation (y-o-y)	1.0	0.4	0.8	0.7	0.6	1.1	1.3	1.0	0.5	1.6	1.6	1.8	1.7	1.6	1.2	1.5	1.5
Labor force																	
Unemployment rate				25.5				24.6	26.1				24.5				
II. Fiscal Indicators□ (Central Budget and Budgets of Funds)																	
Total budget revenues	14,458	11,537	13,319	39,314	14,046	13,889	15,827	43,762	161,207	12,923	12,925	14,742	40,590	14,820	13,344		
Total budget expenditures	16,038	13,240	14,389	43,667	14,911	15,303	19,099	49,313	180,632	14,611	15,696	15,918	46,225	14,318	14,528		
Overall balance (cash)	-1,580	-1,703	-1,070	-4,353	-865	-1,414	-3,272	-5,551	-19,425	-1,688	-2,771	-1,176	-5,635	502	-1,184		
Overall balance (in % of GDP) [1]	-0.3	-0.3	-0.2	-0.8	-0.2	-0.3	-0.6	-1.0	-3.5	-0.3	-0.5	-0.2	-1.0	0.1	-0.2		
III. Financial indicators [6]																	
Broad money (M4), y-o-y growth rate	7.8	7.0	6.2	6.2	7.0	6.8	6.8	6.8	6.8	4.5	5.4	6.2	6.2	3.8	3.7		
Total credits, y-o-y growth rate	8.9	8.8	8.8	8.8	8.4	7.9	9.5	9.5	9.5	8.6	8.7	8.4	8.4	7.5	6.4		
Total credits - households	12.7	12.7	12.8	12.8	12.5	12.6	12.9	12.9	12.9	12.6	12.8	13.0	13.0	12.8	12.2		
Total credits - enterprises	6.3	6.0	6.0	6.0	5.4	4.5	7.1	7.1	7.1	5.5	5.8	5.1	5.1	3.7	2.0		
Total deposits (incl. demand deposits), y-o-y growth rate	7.4	6.7	5.7	5.7	6.5	6.6	6.5	6.5	6.5	4.3	5.3	6.2	6.2	3.1	3.7		
Total deposits - households	6.2	4.8	5.0	5.0	4.4	4.5	4.1	4.1	4.1	3.6	3.5	3.1	3.1	0.9	-0.4		
Total deposits - enterprises	11.4	13.1	7.1	7.1	11.0	11.7	13.0	13.0	13.0	6.4	11.8	16.0	16.0	9.2	14.5		
Interest rates [7]																	
Interst rates of CBBills	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	4.00		
Lending rates																	
denar rates (aggregated, incl. denar and denar with f/x clause)	7.0	7.0	7.0	7.0	6.9	6.9	6.8	6.9	7.1	6.8	6.7	6.7	6.7	6.7	6.6		
f/x rates	5.9	5.8	5.8	5.8	5.8	5.8	5.7	5.8	5.9	5.7	5.7	5.6	5.6	5.5	5.5		
Deposit rates																	
denar rates (aggregated, incl. denar and denar with f/x clause)	2.9	2.7	2.7	2.7	2.7	2.6	2.6	2.6	2.9	2.5	2.5	2.5	2.5	2.5	2.5		
f/x rates	1.3	1.2	1.1	1.2	1.1	1.1	1.1	1.1	1.3	1.1	1.1	1.1	1.1	1.1	1.1		
IV. External sector indicators																	
Current account balance (millions of EUR)	26.7	39.1	65.1	130.9	-36.7	-22.2	-70.7	-129.6	-127.3	27.7	-4.5	-33.9	-10.7	-91.8			
Current account balance (% of GDP)	0.3	0.4	0.7	1.4	-0.4	-0.2	-0.8	-1.4	-1.4	0.3	0.0	-0.4	-0.1	-1.0			
Trade balance (millions of EUR) [8]	-158.8	-110.9	-92.7	-362.3	-166.3	-161.6	-210.8	-538.7	-1725.7	-65.8	-131.6	-175.8	-373.2	-160.8	-183.7		
Trade balance (% og GDP)	-1.7	-1.2	-1.0	-4.0	-1.8	-1.8	-2.3	-5.9	-19.0	-0.7	-1.4	-1.9	-3.9	-1.7	-1.9		
import (millions of EUR)	-505.8	-428.1	-460.1	-1394.0	-535.0	-521.6	-536.5	-1593.2	-5776.9	-354.1	-477.5	-525.0	-1356.5	-529.3	-529.4		
export (millions of EUR)	347.0	317.3	367.4	1031.7	368.7	360.0	325.8	1054.4	4051.2	288.3	345.9	349.2	983.3	368.5	345.6		
rate of growth of import (y-o-y)	0.7	2.4	-4.8	-0.7	2.7	13.1	5.5	6.9	4.9	-3.1	16.8	-1.6	3.7	6.3	12.7		
rate of growth of export (y-o-y)	7.1	4.1	2.3	4.5	4.3	5.0	7.2	5.4	8.1	-1.2	15.6	3.0	5.7	24.8	-3.7		
Foreign Direct Investment (millions of EUR)	16.4	7.6	-18.6	5.5	56.2	-23.7	18.1	50.7	170.7	-0.1	36.5	29.8	66.3	34.6			
External debt																	
Gross external debt (in milllions of EUR)				6240.1				6353.7	6353.7				6707.4				
public sector				3036.6				2935.4	2935.4				3282.3				
public sector/GDP (in %)				33.4				32.3	32.3				34.7				
private sector				3203.5				3418.3	3418.3				3425.2				
Gross external debt/GDP (in %)				68.6				69.9	69.9				70.9				
Gross official reserves (millions of EUR) [9]	2,198.3	2,177.7	2,187.4	2,187.4	2,188.0	2,203.4	2,261.7	2,261.7	2,261.7	2,246.9	2,253.4	2,266.3		2,193.8	2,164.3		

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

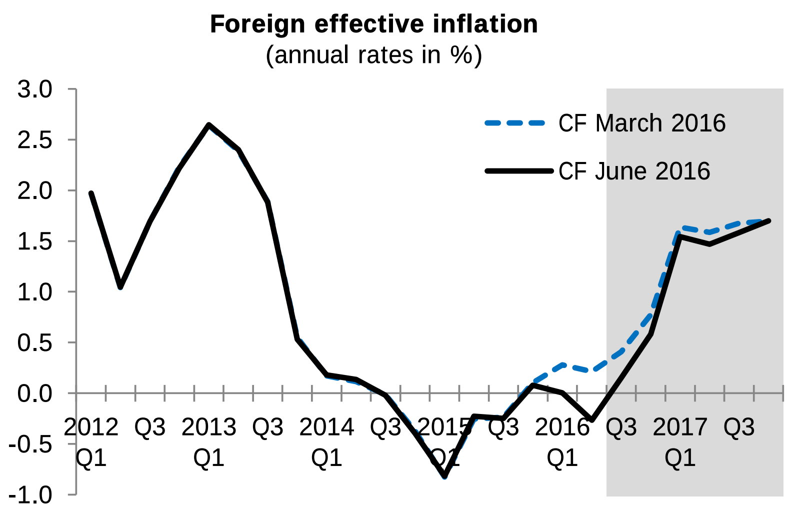


Source: "Consensus Forecast" and NBRM calculations.

The comparison with the April forecast indicates slightly higher growth rate of the foreign effective demand in 2016...

...and now it is expected to increase by 1.6% on annual basis (1.5% in April), primarily due to the favorable expectations for growth in Serbia.

No changes have been made for 2017, and the growth in foreign demand is expected to be 1.9%.



Source: "Consensus Forecast" and NBRM calculations.

According to the latest estimates, the foreign effective inflation was revised downward for 2016 and 2017.

Recent estimates for 2016 indicate a minor foreign inflation of 0.1%, compared to 0.4% as forecasted in April...

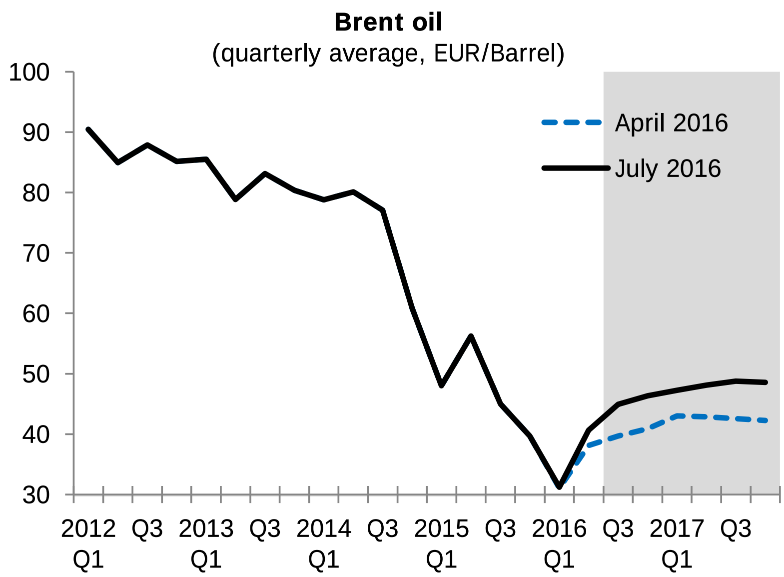
...amid downward revisions in almost all countries, and given the strongest effect of the new forecasts for decline rather than rise in prices in Serbia[2], Bulgaria and Slovenia.

Estimates for **2017** have been adjusted slightly downward from the April forecast (1.6% versus 1.7% in April), amid minimal downward revisions in most countries.

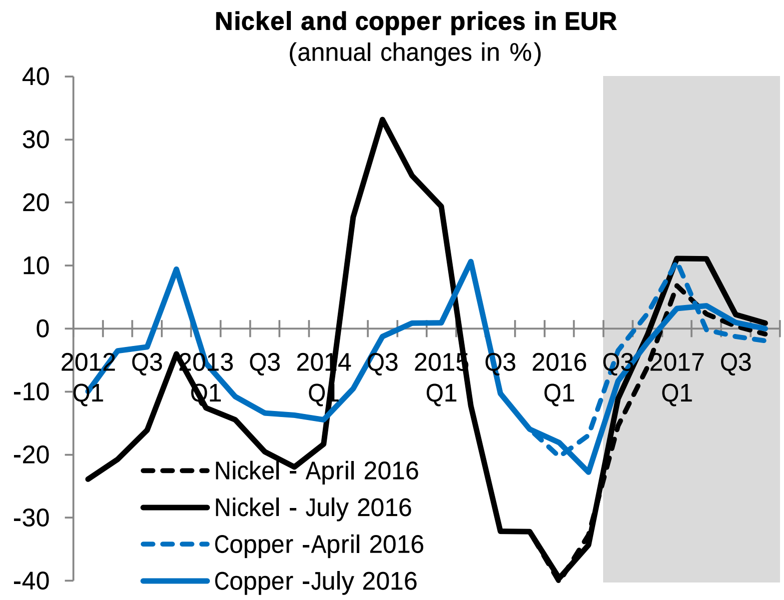
According to the latest estimates, upward changes were made in the expectations for the future movement of Brent oil prices...

...amid expectations for further production cuts in some countries (the United States and Venezuela), as well as some unexpected events that resulted in

[2] Inflation in Serbia has been adjusted for the changes in the exchange rate.



Source: IMF and NBRM calculations.



Source: IMF and NBRM calculations.

lower production[3]...

...but given the still high stocks of this energy source, as well as perceptions for adverse effects from the Brexit[4], no greater upward movement has been expected[5].

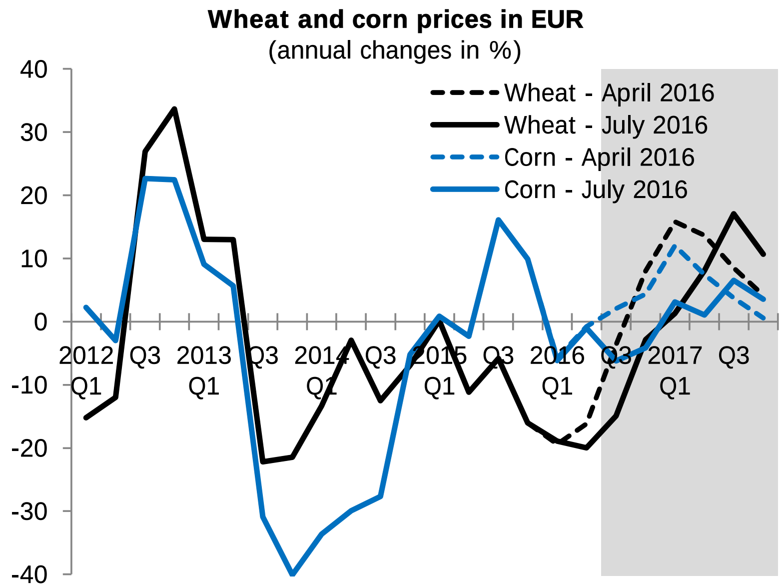
Hence, a smaller decline in oil prices is expected for 2016 than forecasted in April, while for 2017, its growth rate is expected to be slightly higher.

Prices of primary metals in the global market for 2016 have been revised in different directions, but for 2017, they are more favorable.

In 2016, the price of nickel is expected to register a smaller decline that forecasted in April due to expectations for production cuts, globally. Recent estimates for the price of copper for 2016 indicate a faster decline compared to the April forecast, in line with the estimates of deterioration of the outlook of the manufacturing industry in China.

In 2017, prices of both metals are expected to increase at a faster pace compared to the April forecasts.

[3] Reduced production in Canada due to the forest fires, and reduced production in Nigeria and Libya because of the geopolitical tensions.
[4] It is expected that Brexit will slow down the economic growth of the EU and reduce demand for oil, while the appreciation of the US dollar caused by the Brexit will further reduce demand because of the more expensive oil imports.
[5] Source: http://www.wsj.com/, http://www.reuters.com/, http://oilprice.com/.

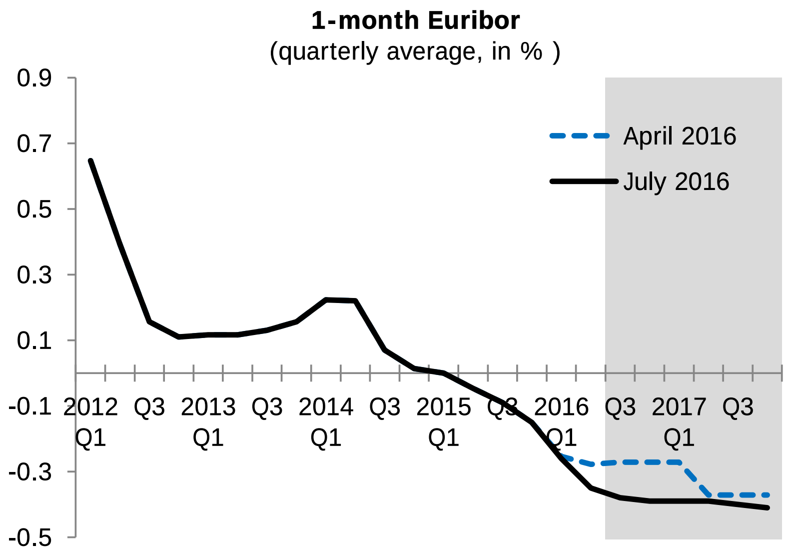


Source: IMF and NBRM calculations.

Recent forecasts for wheat and corn prices suggest moderate downward revision for 2016 and 2017, relative to the April forecast...

...whereas, for 2016, prices are expected to decline at a stronger pace, while for 2017, price of these products is expected to decrease at a slower pace relative to the April forecasts...

...amid improved perceptions for the future global production and expectations for high level of global inventories[6].



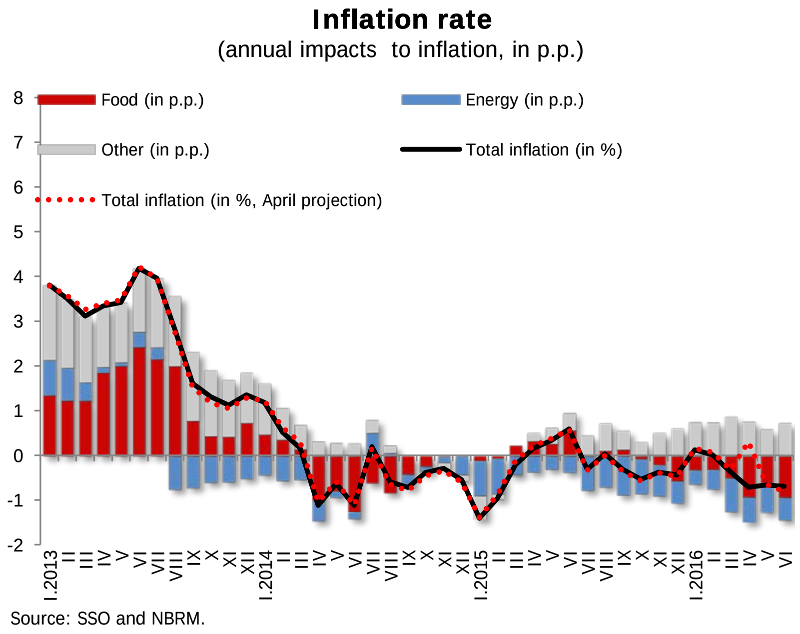
Source: "Consensus Forecast" and NBRM calculations.

Compared to April, there have not been any significant changes in the forecasts for the foreign interest rate, considering the unchanged monetary policy stance of the ECB since March this year.

It is again forecasted that the one-month EURIBOR will be in the negative zone throughout the entire forecast horizon...

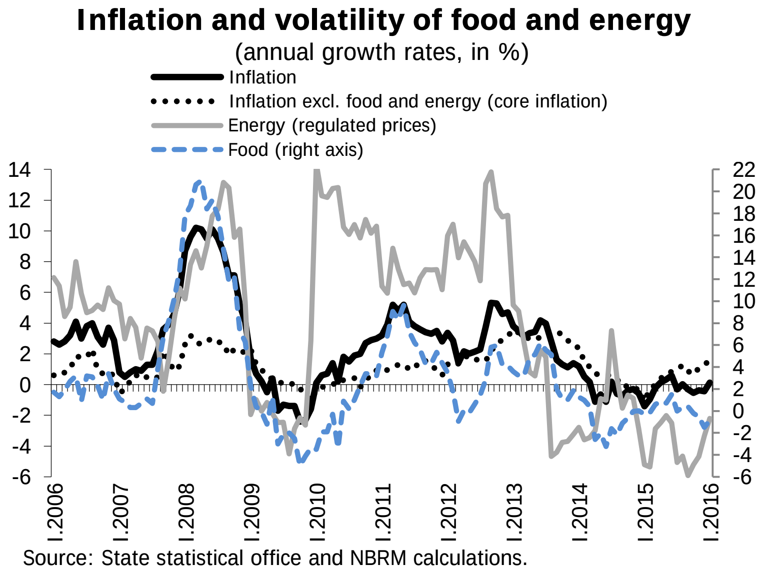
...whereby this interest rate is expected to average -0.35% and -0.4% in 2016 and 2017, respectively, compared to -0.27% and -0.35% in the April forecast.

[6] Source: Food and Agriculture Organization of the United Nations.



In June, consumer prices remained at the level of the previous month (monthly inflation rate of 0%)...

...amid rising energy prices and prices included in the core inflation, while prices of food have slightly decreased[7].

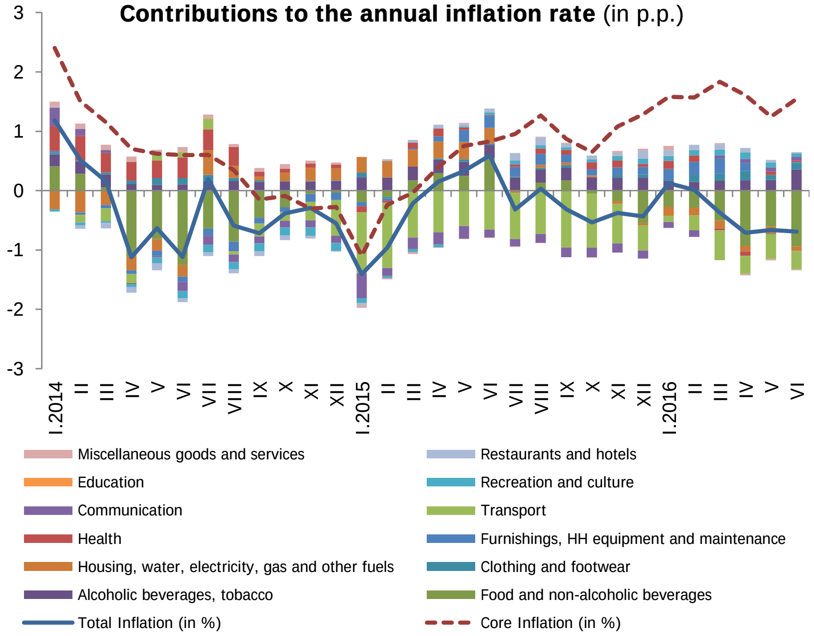


The annual inflation was negative in June and equaled 0.7% (same as in the previous two months) which is in line with the expected inflation rate in the April forecast cycle.

However, the structural analysis of inflation shows small variations in different price categories. Thus, the fall in food prices is slightly stronger than expected, while the deviation in energy prices and core inflation is upward (smaller decline than expected in energy prices and higher core inflation than forecasted).

[7] Observed by group of products, vegetables are the category with the highest negative contribution in June (monthly decline of 9%), while fruits (monthly growth of 8.2%), tobacco (monthly growth of 5.8%) and liquid fuels and lubricants (monthly growth of 3.2%) are the categories with the greatest positive contribution.

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



Source: SSO and NBRM.

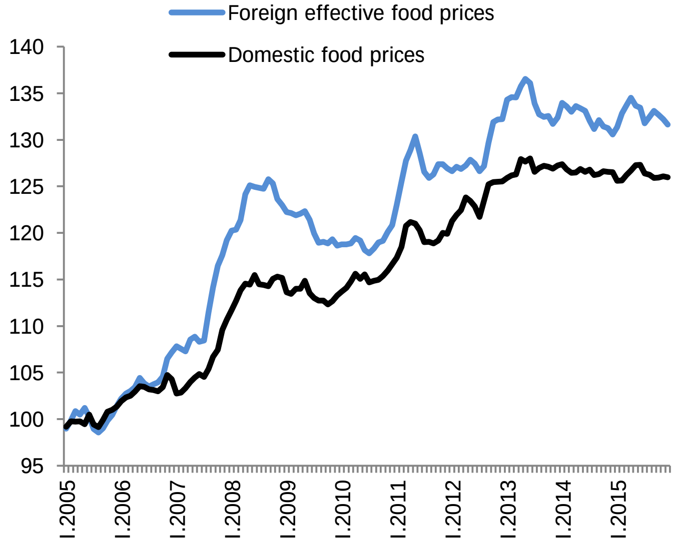
In June, the core inflation rate was 0.3%...

...with an annual growth of 1.5% (versus 1.2% in the previous month).

Observing the structure of core inflation, the (annual) growth in June is due to the small rise in prices of most categories within the core inflation, with the highest contribution of tobacco prices[8].

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.

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

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

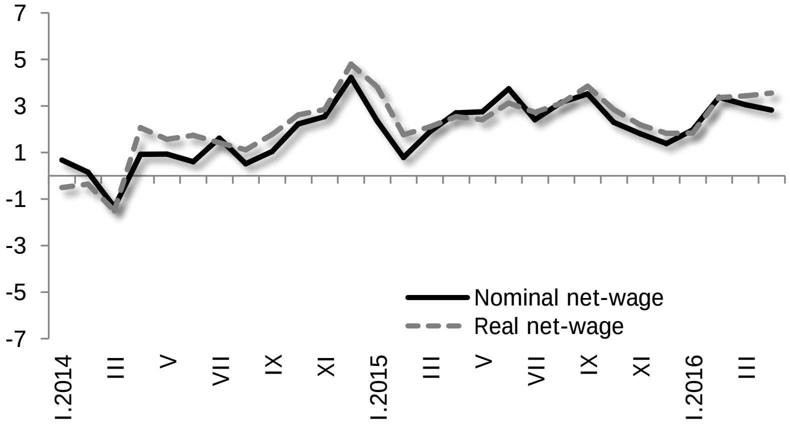
However, the assumption for maintenance of environment of low global prices remains valid (further drop in prices or minor growth), so that the upward correction of oil price is not expected to generate pressures for increase in domestic prices.

When inflation follows the forecasted trajectory, **the risks surrounding the forecast for 2016** are mainly associated with the uncertainty about the expected movement in prices of primary commodities.

In April 2016, the average net wage registered a nominal annual growth of 2.8%, which is a moderate deceleration of the growth (of 0.2

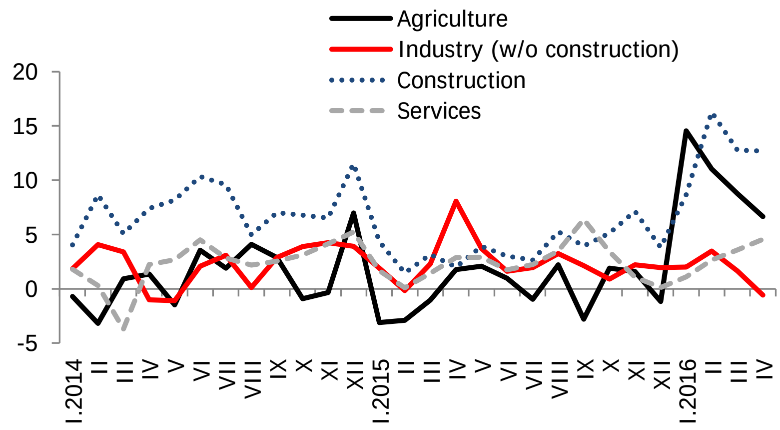
[8] The annual growth in tobacco prices in June is a combination of several factors: the increase in excise duty in July 2015 (from 1 July 2016 to 1 July 2023 the excise duty will be increasing by 0.20 denars each year), which is a flat increase in cigarette prices by 5 denars per box in March 2016 and an increase in the price of a certain type of cigarettes in June 2016.

Average net-wage
(annual changes, in %)



Source: SSO.

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



Source: SSO.

percentage points), compared to the previous month.

Upward movement in wages has been observed in most of the activities, with the highest growth recorded in arts, entertainment and recreation, construction, administrative and auxiliary services, and in professional, scientific, and technical activities.

On the other hand, lower wages in April were paid in mining, energy and in several service activities[9], but the cut was relatively small.

Given the decrease in consumer prices, in April, the **real wages** increased by 3.5%.

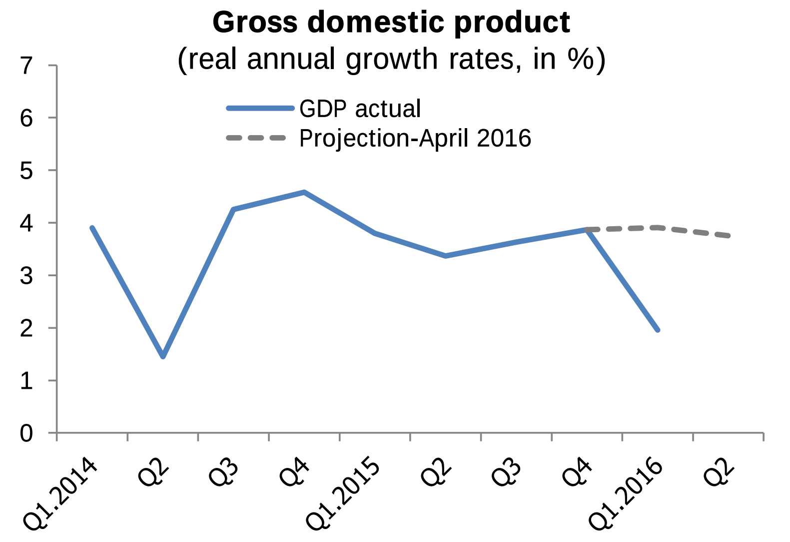
April wages moderately deviate from the April forecast for the second quarter of the year (expected nominal and real annual growth of 2.7%).

In the first quarter of 2016, the real annual GDP growth was 2%, which is slower compared to previous pace, and lower than forecasted in April (3.9%).

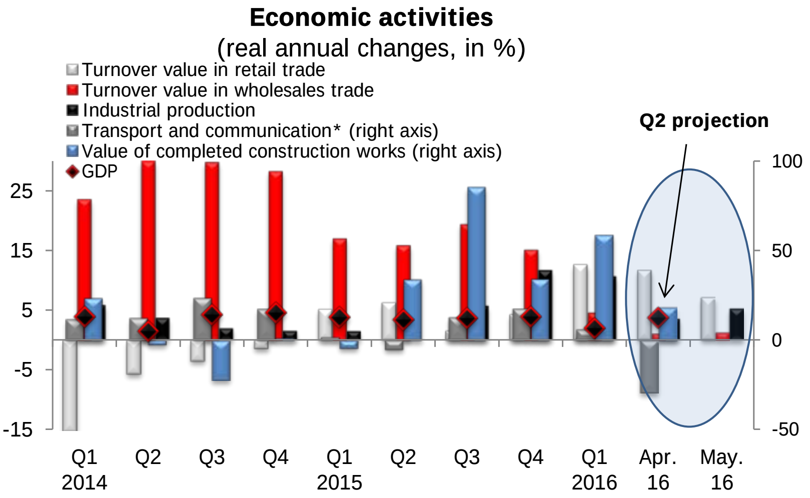
Analyzing the demand, in the first quarter, domestic demand remained unchanged, while net exports increased. Observing by component, exports, and private consumption made the greatest contribution to the growth, while public spending made a small positive contribution. Contrary to the expectations for growth of investment activity in the April forecast, in the first quarter, the gross capital formation dropped. This shift is the main driver of the slower growth in GDP.

Observing the production side, growth of the added value was registered in most economic sectors[10], with the construction, trade, transport, catering, and financial

[9] Within the services sector, lower wages were paid in April in trade, education, real estate activities, and in the health and social care.
[10] The added value has decreased in industry, in the category of public administration and defense, compulsory social security, education, health and social care, as well as in arts, entertainment and recreation, other services, activities of households as employers, activities of households that produce commodities and provide services for own purposes.



Source: SSO and NBRM projections.



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

activities making the greatest contribution to the growth.

High-frequency data for the second quarter of 2016 indicate growth in the domestic economy, with positive performance in most economic sectors. Yet, compared to the first quarter, the growth rate in almost all sectors has been decelerating. Also, domestic non-economic factors related to the political developments in the country continue raising uncertainty about the performance and assessments of the economic activity in the second quarter.

In the period April-May 2016, the industrial output registered an average growth of 4.4%, which is slightly slower compared to the annual dynamics in the first quarter. The growth entirely reflects the higher production in manufacturing, despite the slower production in both mining and energy sectors.

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

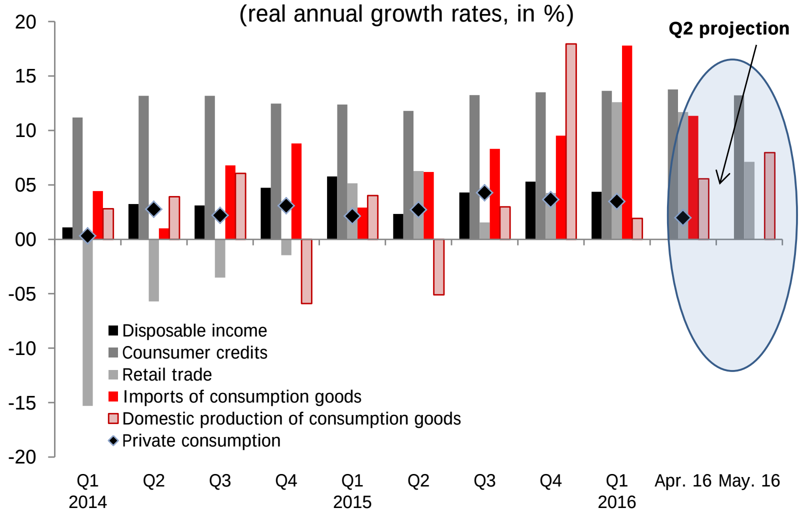
In the period April-May, the turnover in total **trade** increased, but at a slower pace. The turnover in wholesale and retail trade increased, while the trade in motor vehicles decreased. Amid solid growth of retail, the slowdown was due to the slower growth of the wholesale and the decrease in the trade in motor vehicles.

Favorable developments in **construction** (double-digit growth in the value of completed construction works, although at a slower pace), and positive indicators in the field of **hotels and restaurants** (higher number of tourists, overnight stays, and value of turnover) also support the economic growth in the second quarter.

On the other hand, the available data for the **transport sector** (unfavorable trends in indicators related to the railway transport in April) point to potential deterioration in this sector during the second quarter.

The available aggregate demand indicators mainly confirm the estimates for growth of economic activity in the second quarter of 2016.

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



Source: SSO and NBRM calculations.

High-frequency data on **private consumption** point to further increase in the period April-May 2016...

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

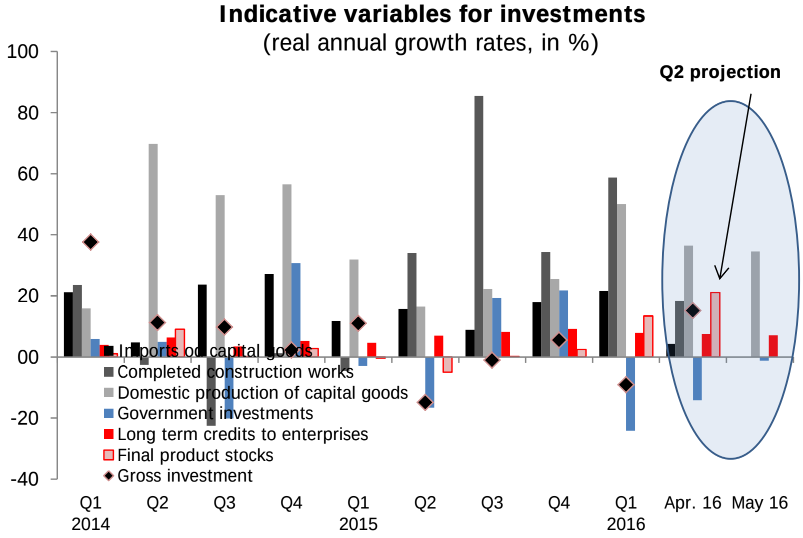
In addition, the solid growth in the domestic production and the import of consumer goods, as well as the turnover in retail trade are in line with the assessment of the growth of private consumption in the second quarter.

Analyzing the indicative private consumption categories, decline was registered only in private transfers, as a reflection of the uncertain domestic political environment.

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

...given the expected growth of investment in fixed assets amid continuing double-digit growth in the value of completed construction works (although somewhat more moderate compared to the previous quarter) and moderate growth in import of machinery and equipment...

...as well as solid growth in long-term lending to the corporate sector, although at



Source: SSO and NBRM calculations.

a slightly slower pace compared to the previous quarter.

At the same time, high annual growth is still present in the domestic production of capital goods.

Analyzing the stocks, in April, the stock index of finished products in industry registered an annual growth indicating a potential growth of this component of gross capital formation during the second quarter of the year.

Among the indicative categories for the investment trends, government capital cost have been decreasing (at a slower pace though).

Nominal data on the **balance of trade in goods** in April-May 2016, point to annual widening of the deficit, which does not correspond to the April forecast for slight narrowing...

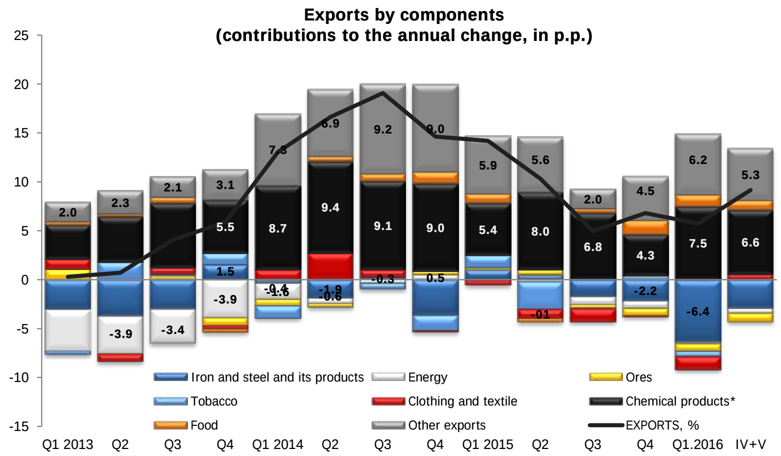
...given the similar pace of growth of both exports and imports.

Budget performances in the first two months of the second quarter, indicate a small decline in **public consumption**, thus far, contrary to the expectations for growth as forecasted in April...

...amid strong drop in expenditures for goods and services due to the high base effect.

On the other hand, wage expenditures of employees in the public sector and health care transfers[11] have increased, but at a slower pace compared to the previous quarter.

[11] Most of these assets refer to expenditures for goods and services.



Source: NBRM.

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

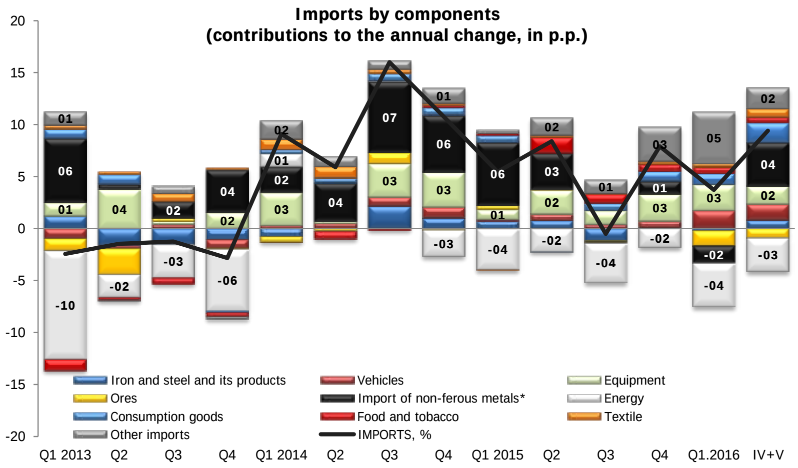
In April and May, **the deficit in the trade in goods with foreign countries increased by 9.9% on an annual basis**, given the faster growth of imports compared to exports of goods...

...contrary to expectations for a slight narrowing of the trade deficit for the second quarter of 2016, as forecasted in April.

In the period April-May, **export** of goods registered an annual growth of 9.2%, reflecting primarily the improved performance of the new production facilities, coupled with the slightly higher export of food, and clothing and textile...

...contrary to the reduced export activity of the metal manufacturing sector.

Compared with the April projection, exports in April and May is in line with the expected export performance for the second quarter. Positive deviations have been registered in some of the new industrial facilities, as well as in the export of iron and steel, while export of tobacco and ores is weaker than expected.



Source: NBRM.

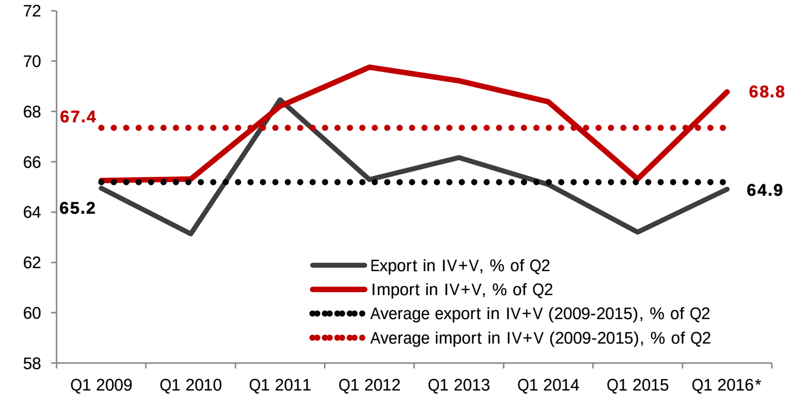
** The following data depict the overall imports of one major export capacity in the free industrial zone.*

Imports rose by 9.4% on an annual basis in April and May, as a result of the increase in imports of raw materials for the new facilities, followed by the imports of vehicles, consumer goods, and other commodities...

...while the import of energy continued decreasing.

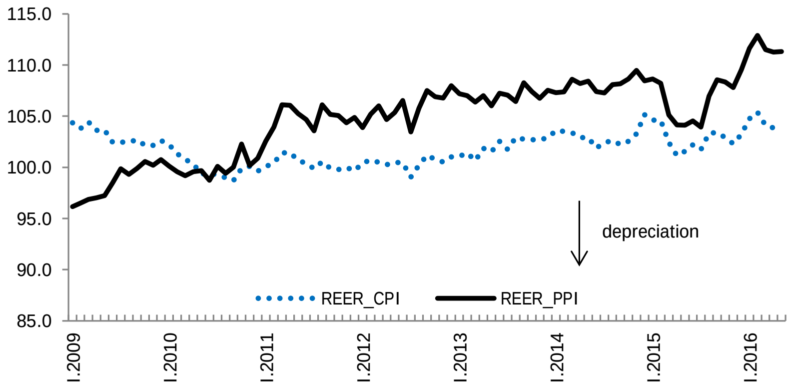
Import of goods in the period April-May suggests higher than forecasted performance for the second quarter of the year. Analyzing by category, upward deviation is observed in imports of iron and steel and their products, vehicles and consumer goods, while the import of raw materials for the new facilities is slightly lower than expected.

Share of exports and imports of goods in April relative to Q2 projection



The performance of exports and imports in April and May point to higher trade deficit for the second quarter than forecasted in April.

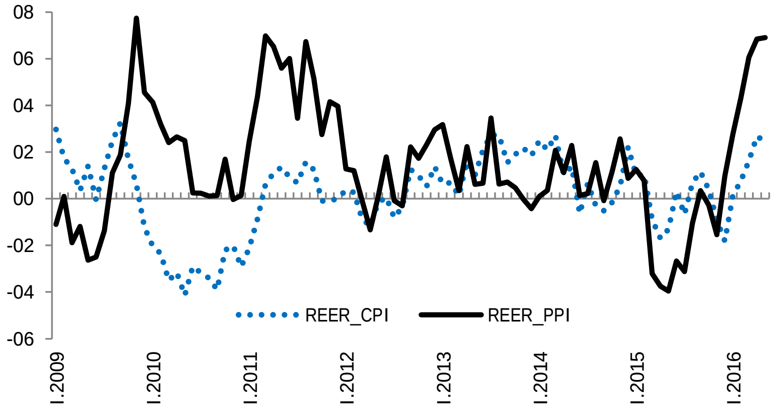
REER
(2010=100)



Source: NBRM.

In May 2016, price competitiveness indicators of the domestic economy pointed to annual deterioration. The REER index deflated by consumer prices appreciated by 2.5% and the REER index deflated by producer prices registered a more pronounced appreciation of 6.9%[12].

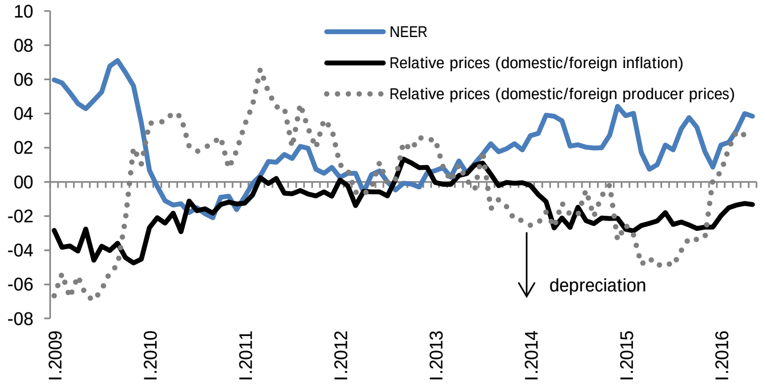
REER
annual changes, in %



Source: NBRM.

[12] The appreciation through relative producer prices could be overestimated. Namely, unlike the foreign prices that have dropped, domestic prices have stagnated during 2016. However, it should be borne in mind that the weight structure of domestic index still does not include the latest changes in the structure of domestic production, and accordingly, the price changes via this index might not properly depict the actual changes.

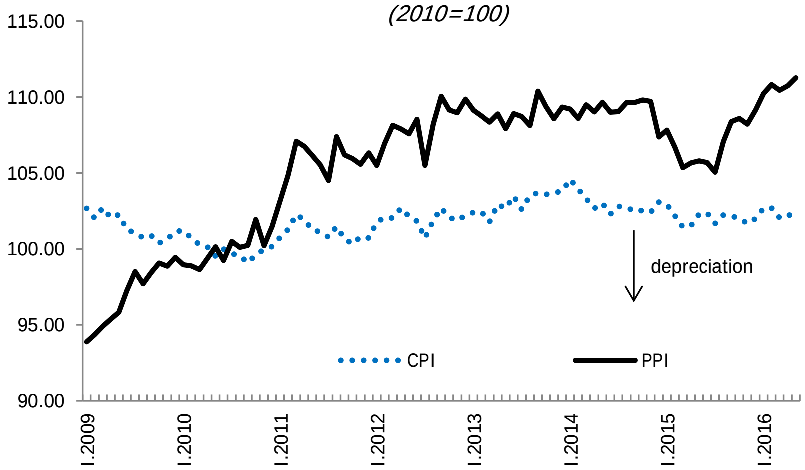
NEER and relative prices
annual growth rates, in %



Source: NBRM.

These developments are mainly due to the NEER dynamics, which appreciated by 3.8% on an annual basis, as a result of the depreciation of the Russian ruble, the British pound and the Turkish lira against the denar. Annually, the relative prices of industrial products have increased by 2.9%, while the relative consumer prices have decreased by 1.3%.

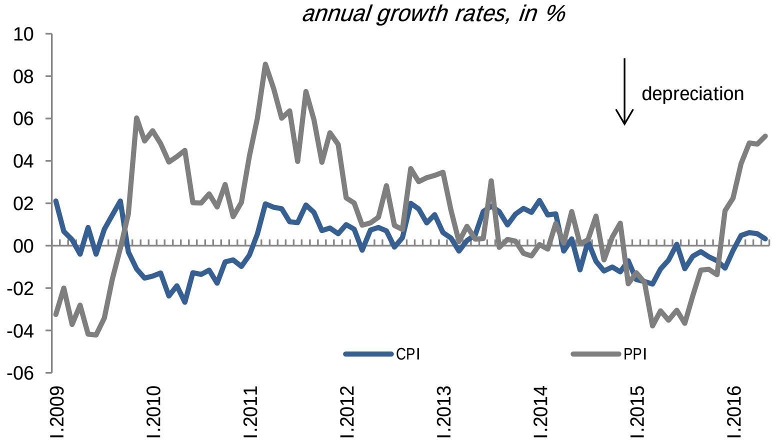
REER, excluding primary commodities
(2010=100)



Source: NBRM.

The analysis of REER indices, as measured using weights based on the foreign trade without primary commodities[13], indicates that they have appreciated. In May, the REER index deflated by consumer prices appreciated by 0.3%, while the REER deflated by producer prices appreciated by 5.2%.

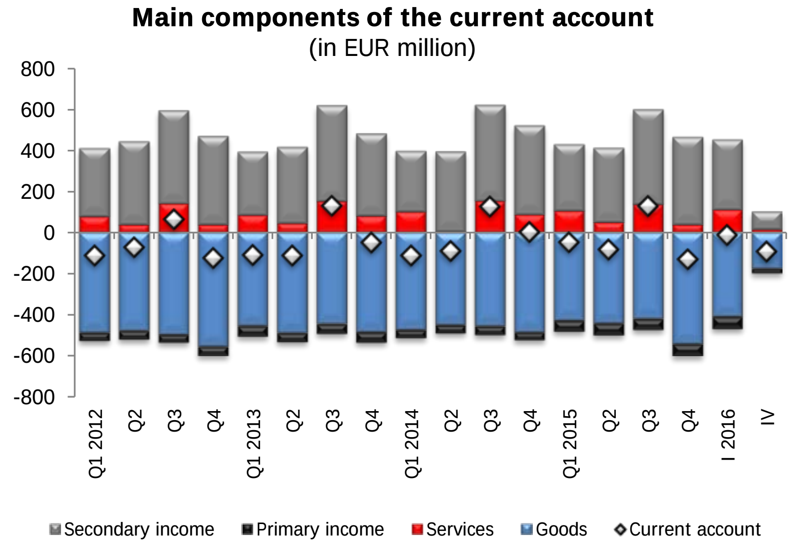
REER, excluding primary commodities
annual growth rates, in %



Source: NBRM.

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

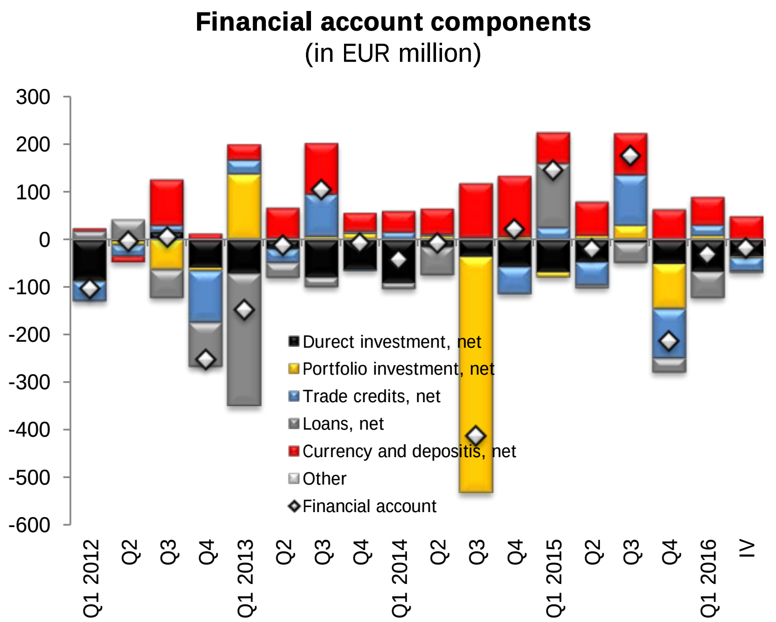
On an annual basis, relative consumer prices fell by 0.9%, while the relative prices of producer prices increased by 3.9%. The NEER has appreciated by 1.2% on an annual basis.



Source: NBRM.

In April 2016, the balance of payments' current account registered a deficit of Euro 91.8 million (or 1% of GDP), which is higher than forecasted in April for the second quarter.

Observing individual components, this decline is largely due to the significantly lower surplus of secondary income, and somewhat higher deficit in primary income, compared with the April forecast. On the other hand, the balance of trade in services recorded a favorable movements, i.e. higher surplus than expected, when the trade deficit is as forecasted in April.



Source: NBRM.

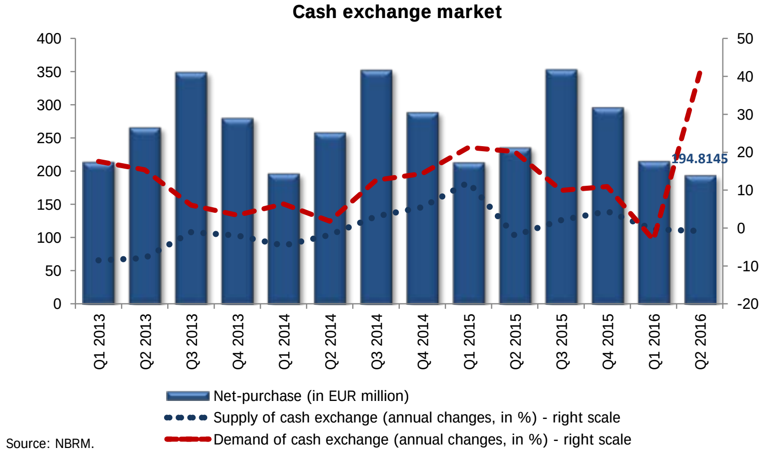
In April 2016, the financial account registered net inflows of Euro 18.3 million (or 0.2% of GDP), which is lower than forecasted in October for the second quarter[14].

The deviation from the April forecast is mostly recorded for the loans, where unlike the expectations of high net inflows, April registered almost neutral flows (mainly due to lower withdrawals in the government and public companies) and the currency and deposits (significantly higher outflows in other sectors of the economy). The developments in direct investment are solid and higher than planned, with positive results also being recorded in trade credits which registered net inflows, contrary to the small net outflows as forecasted in April.

[14] 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.

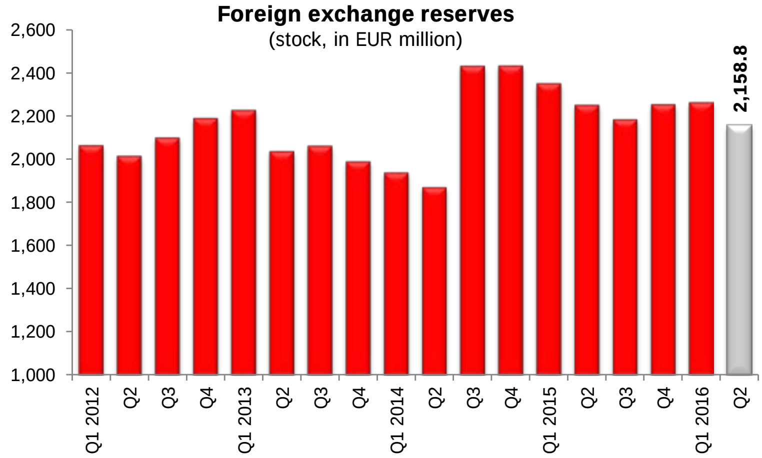
Currency exchange operations data as of June 2016, point to alleviated pressures on the currency exchange market that emerged in late April and early May, as a result of the lower supply of, and higher demand, for foreign currency.

The net purchase in the foreign exchange market in the second quarter totaled Euro 194.8 million, which is an annual decline of 17.6%.
The data on the net purchase from the currency exchange market point to lower private transfers than expected with the April forecast. However, from the end of May through June, there were signals for gradual stabilization.

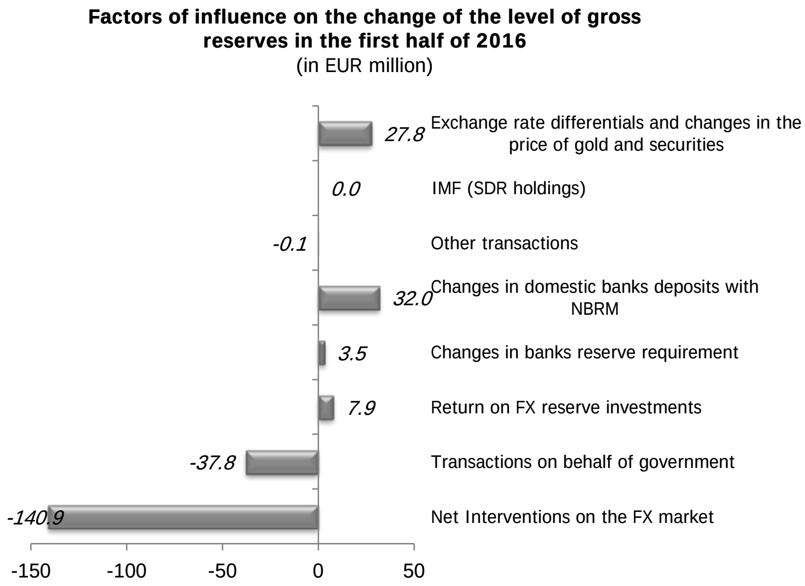


Source: NBRM.

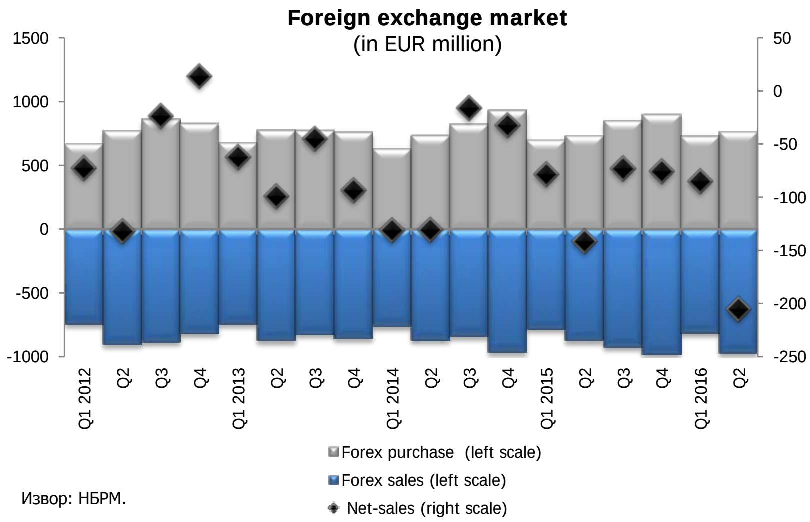
As of 30 June 2016, the gross foreign reserves stood at Euro 2,158.8 million, down by Euro 107.6 million compared to the first quarter of 2016. The reduction of foreign reserves is mostly due to the NBRM interventions in the foreign exchange market, as well as the NBRM transactions on behalf of the government. The foreign currency deposits of domestic banks with the NBRM, the positive currency changes, and changes in the price of gold, as well as the NBRM transactions, acted in the opposite direction.



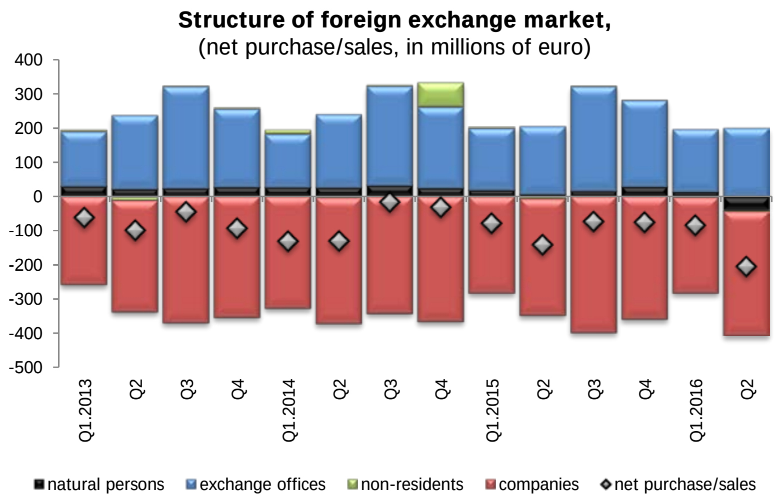
Source: NBRM.



Source: NBRM.



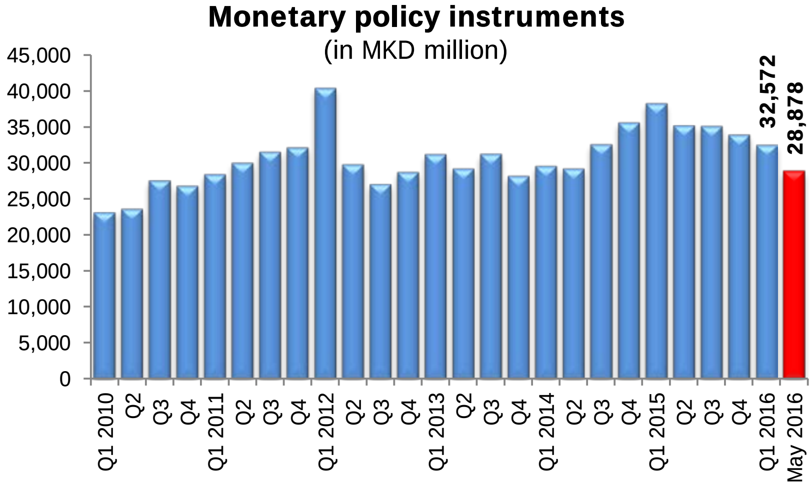
Извор: НБРМ.



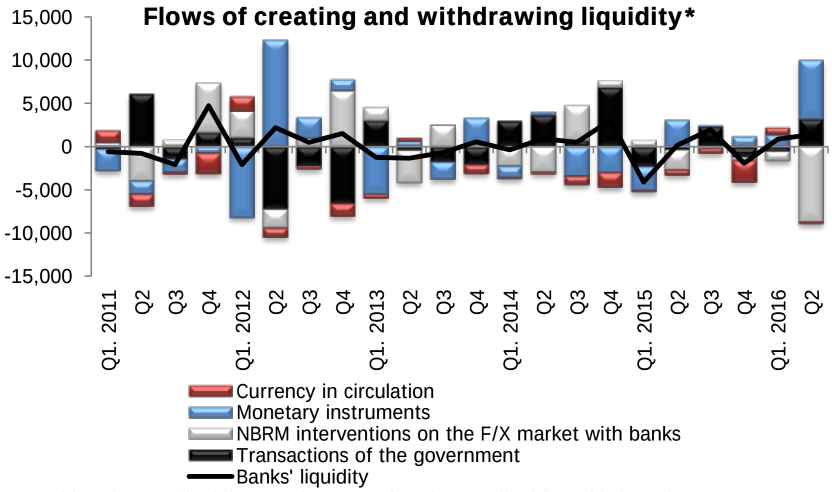
Source: NBRM.

In the second quarter of 2016, the foreign exchange market of the banks registered a net sale of Euro 204.9 million, which is an annual growth of Euro 63.5 million. This annual change is a result of the faster growth in the demand for, relative to the supply of, foreign currency (of 10.9% and 4.3%, respectively).

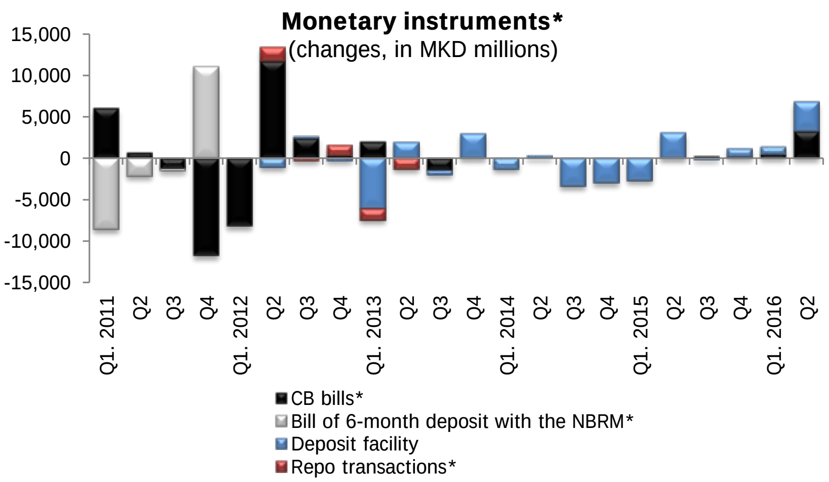
The sector-by-sector analysis shows that these performances mainly reflect the increased net sales by natural persons (net purchase in the same period of 2015) and the increased net sales by the companies.



Source: NBRM.



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



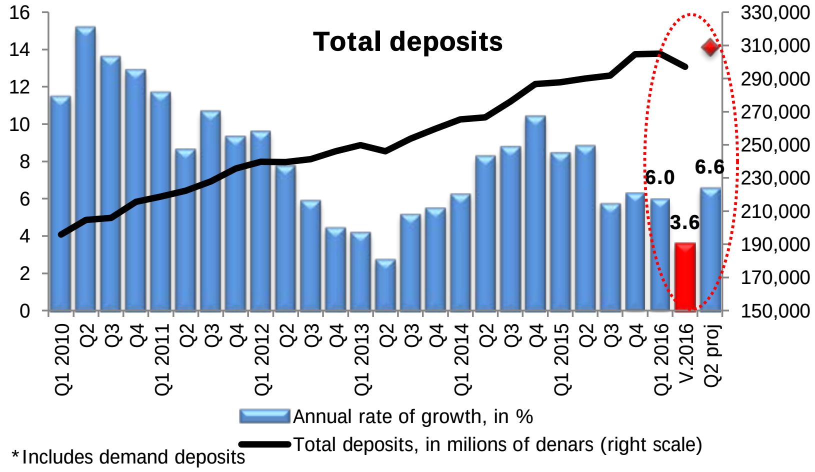
*Positive change- liquidity creation, negative change- liquidity withdrawal
Source: NBRM.

Data as of May point to creating liquidity through monetary instruments relative to the end of the first quarter, versus the small withdrawal for the second quarter, as forecasted in April.

The analysis of the flows of liquidity creation and withdrawal from the balance sheet perspective in May suggests significant withdrawal of liquid assets through the NBRM net foreign assets, which declined contrary to the expectations for a small increase in the second quarter. This performance reflects the NBRM intervention aimed to stabilize the currency exchange market, as an effect of the domestic political developments. On the other hand, total government deposits with the NBRM declined as of May, which is higher than forecasted for the second quarter.

In May, the reserve money has increased compared to the end of the first quarter, in line with the expectations for the second quarter of the year. Taking into account the changes in some balance sheet components and their deviations from the forecast, the lower than expected level of monetary instruments, from the balance sheet aspect, is explained by the divergence in net foreign currency assets.

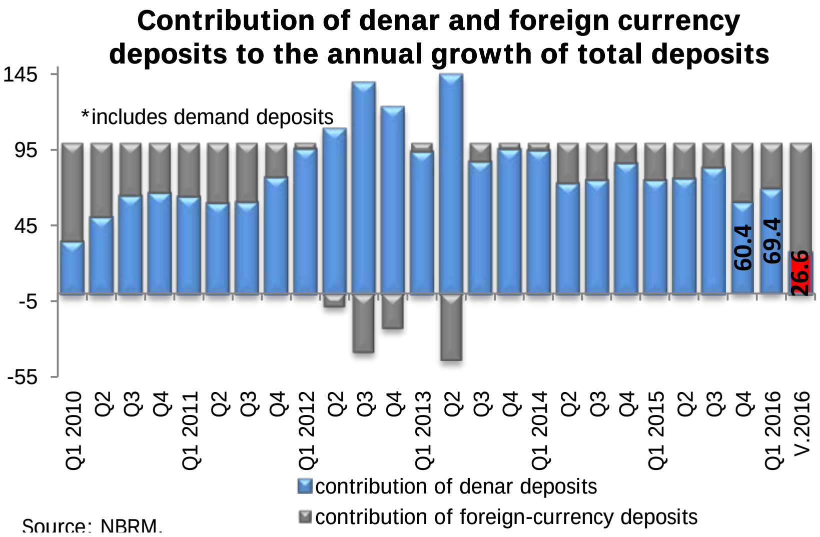
According to the operational data on the liquidity flow, in the second quarter, the liquidity of the banking system increased. Analyzing the individual factors, government transactions and monetary instruments have created liquidity, while foreign exchange transactions of the National Bank with market makers and currency in circulation have withdrawn liquid assets from the banking system.



*Includes demand deposits
Source: NBRM.

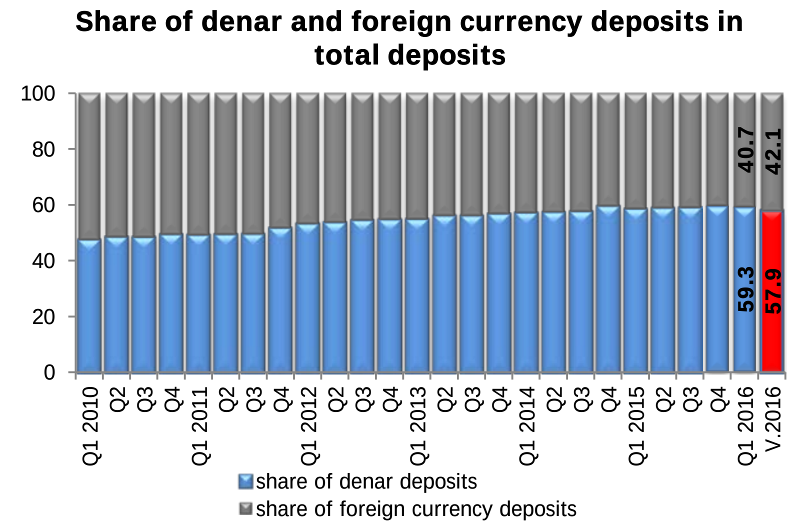
In May, total deposits dropped on a monthly basis, but at a slower pace compared to the previous month. Namely, after a significant decline in April due to the deteriorating political situation in the country, in May, the deposit base stabilized. Analyzed by sector, the decline is completely due to the lower household savings, amid increasing corporate deposits.

In May, the annual growth rate of total deposits equaled 3.6%, which is below the growth of 6.6% for the second quarter of 2016, as forecasted in April. In nominal terms, in the period from April to May, broad money dropped versus the projected growth of Denar 4.088 million which indicates the probability of deviation from the forecast for the second quarter of the year.



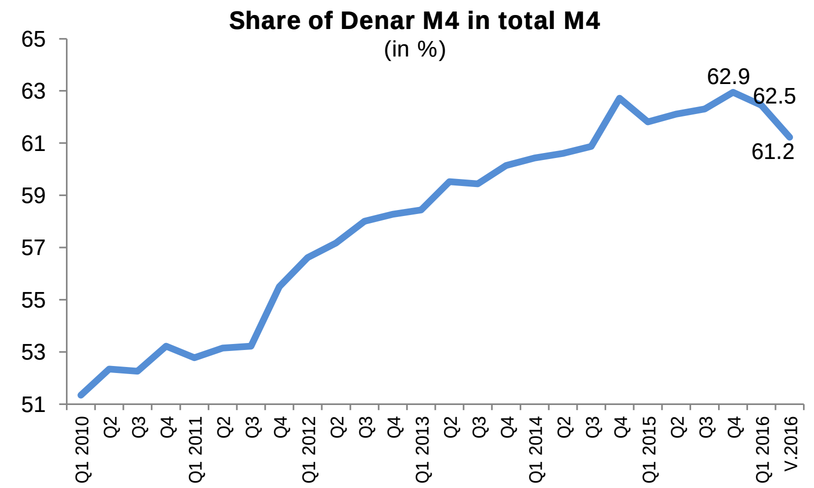
Source: NBRM.
*Includes demand deposits.

Analyzing the currency structure of deposits, the contribution of denar deposits to the annual growth of total deposits in May further declined. The moderate decline was due to the more intensive annual growth in foreign currency deposits compared to the growth of denar deposits.

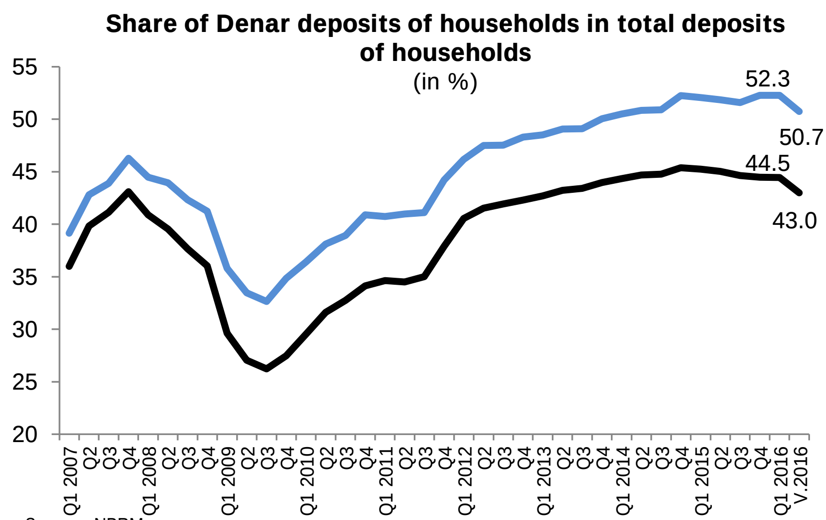


*includes denar deposits with FX clause. Source: NBRM.

*Includes demand deposits.



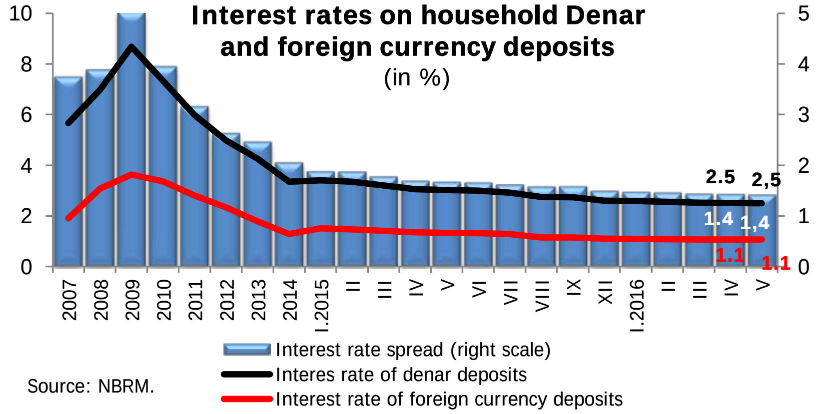
Source: NBRM.



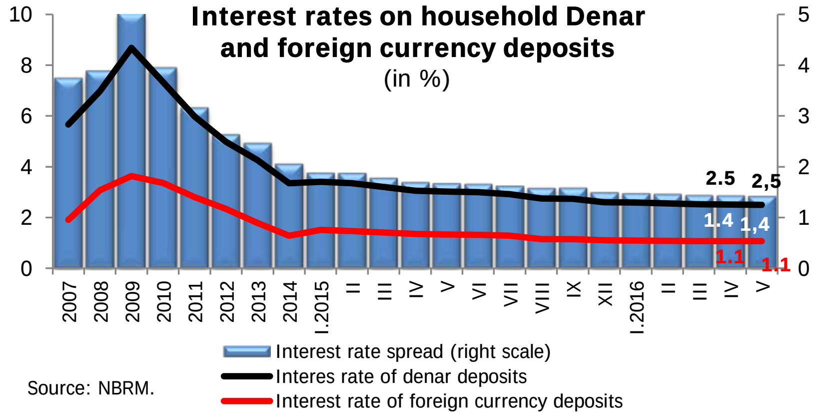
Source: NBRM.

Notwithstanding the shifts, the share of denar deposits in total deposits in May remained relatively stable compared to the previous month. Denar deposits continued explaining most of the banks' deposit base.

Uncertainty about the political developments in the country in May had an effect on the household deposits. Namely, they continued to decline with moderately higher intensity relative to April. Observing by currency, the reduction of household deposits predominantly stems from the fall in denar deposits. This further reduces the share of denar household deposits in total household deposits.

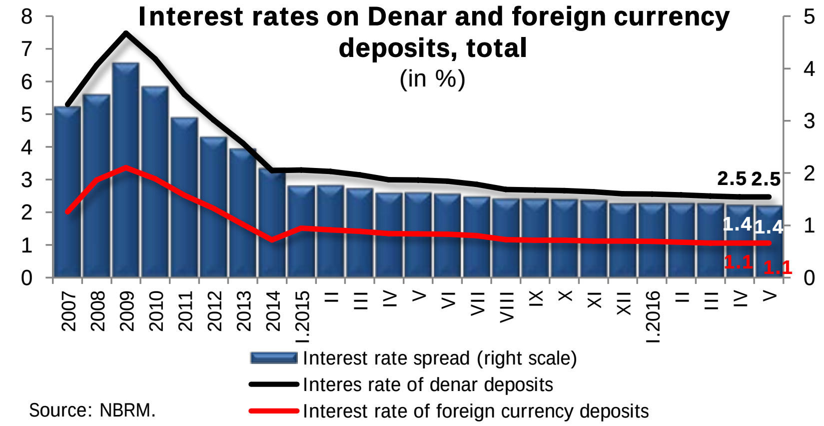


Source: NBRM.

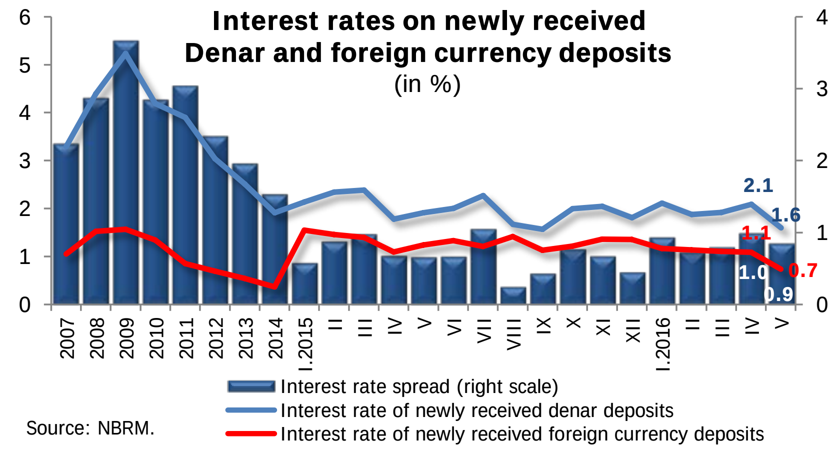


Source: NBRM.

In May, the interest rate spread between the household denar and foreign currency interest rates remained at the same level as in the previous month. Interest spread of new deposits has narrowed as a result of the faster decrease in interest rate on denar deposits, amid negligible decrease in the interest rate on foreign currency deposits.



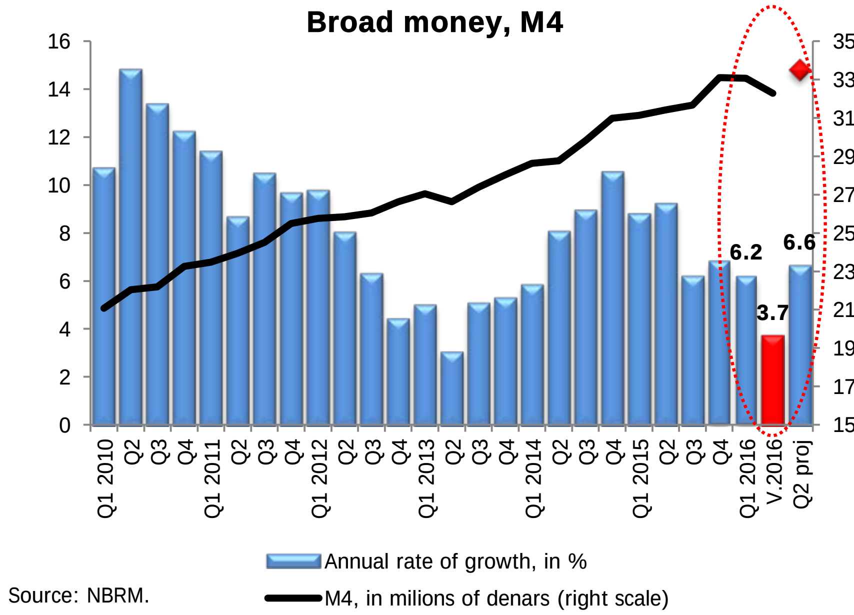
Source: NBRM.



Source: NBRM.

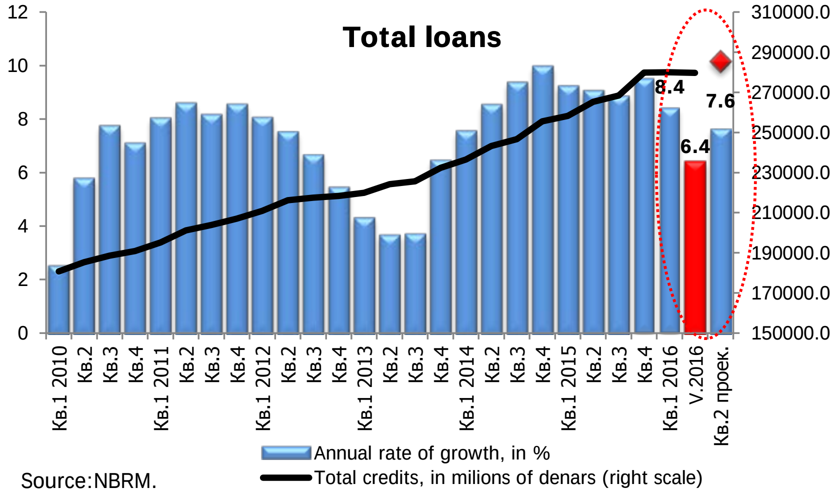
Interest rates on total denar and foreign currency deposits have remained unchanged compared to the previous month. Regarding the newly accepted deposits, the interest rates on denar and foreign currency deposits have decreased, whereby the interest rate spread have slightly widened. However, note that the interest rates on newly accepted deposits are volatile[15], possibly resulting in frequent and temporary adjustments of the interest spread.

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



Source: NBRM.

In May, broad money M4 have decreased on a monthly basis, but more moderately compared to April. The drop of money supply is almost equally due to the reduction of cash in circulation (as opposed to the growth in April) and total deposits. **On annual basis, the broad money has increased by 3.7%, which is below the forecasted growth of 6.6% for the second quarter of 2016.** In nominal terms, in the period from April to May, the broad money dropped versus the forecasted growth of Denar 4.299 million, indicating the probability of deviation from the forecasts for the second quarter of the year.

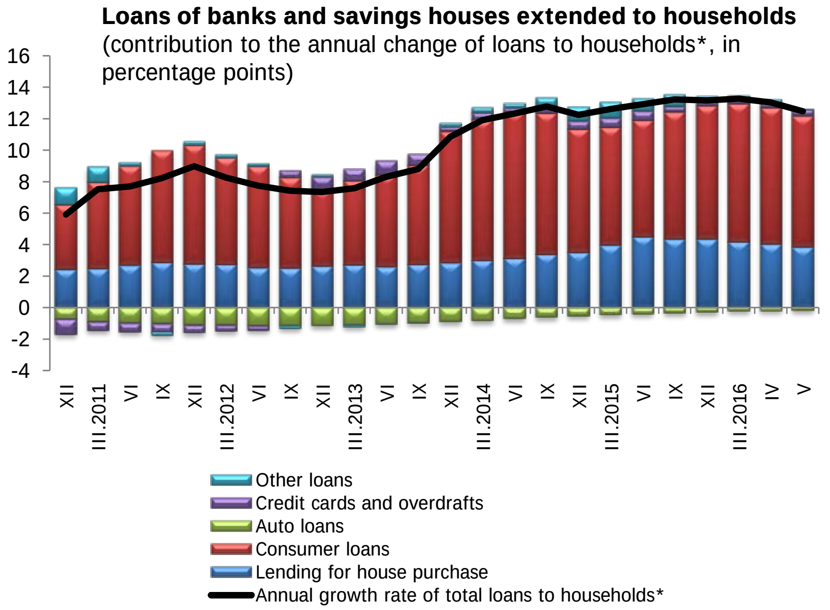


Source:NBRM.

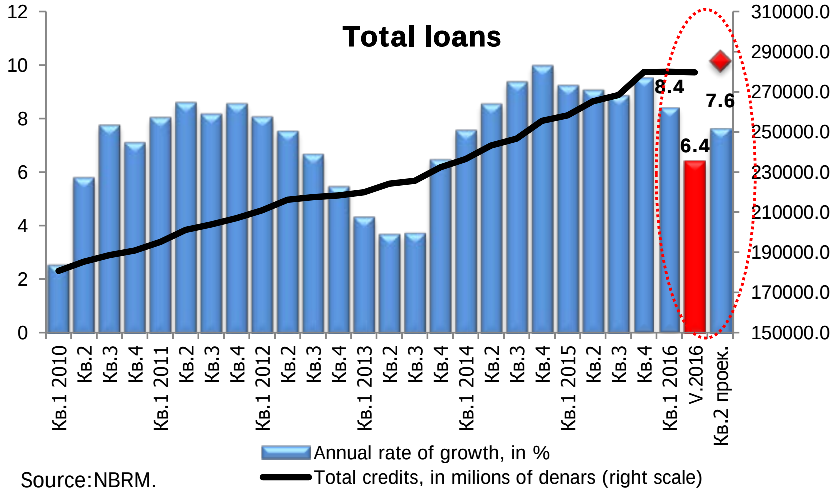
Total loans in May slightly decrease, despite the insignificant growth in the previous month. Analyzed by sector, similar to April, household loans registered a monthly increase, while corporate loans declined. These performances in part probably reflect the uncertain environment and the decline in the deposit base, but largely reflect the write-off of past due claims, according to the decision of the National Bank adopted in December 2015[16].

At the end of May, the annual growth rate of total loans equaled 6.4%, which is below the annual growth of 7.6% for the second quarter of 2016, as forecasted in April. In the period from April to May, total loans decreased, while the April forecast expected a growth of Denar 5.405 million for the second quarter of the year. Weaker performance as of May indicate a likelihood of deviation from the forecast for the second quarter of the year.

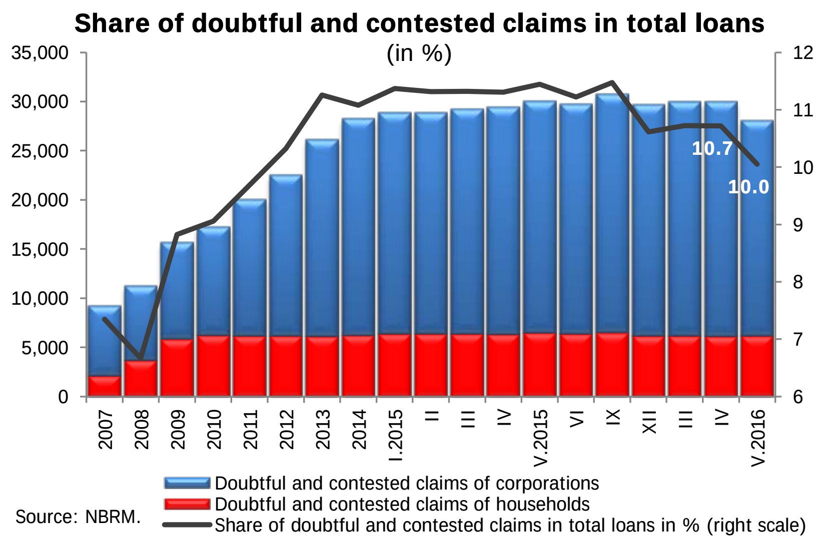
[16] On 17 December 2015, the National Bank Council adopted the Decision amending the Decision on credit risk management, which requires from banks, for the period from 1 January 2016 through 30 June 2016, to write-off any claim that has been fully provisioned for more than two years, and where the bank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



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



Source:NBRM.



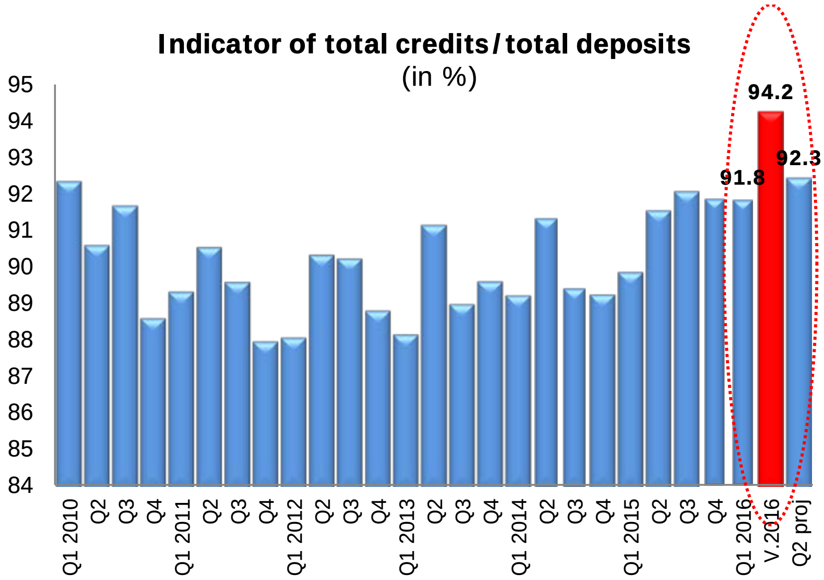
Source: NBRM.

Observing by currency, the annual growth of total loans is solely due to the higher denar loans[17] and denar loans with FX clause, amid decline in foreign currency loans. In May, the contribution of denar loans, and denar loans with FX clause, in total credit growth increased annually, compared to the previous month. Analyzing by sectors, the contribution of household loans to the annual growth has increased from 72.2% to 82%, while the contribution of corporate loans has decreased from 27.9% to 18.2%.

In May, the share of doubtful and contested claims in total loans significantly decreased compared to the previous month (0.7 percentage points) to 10%. The decline is primarily a result of the write-off of claims by banks which have been fully provisioned for more than two years[18]. Analyzed by sector, the decline is entirely due to the reduction in doubtful and contested claims on companies, while doubtful and contested claims on households registered a small monthly growth.

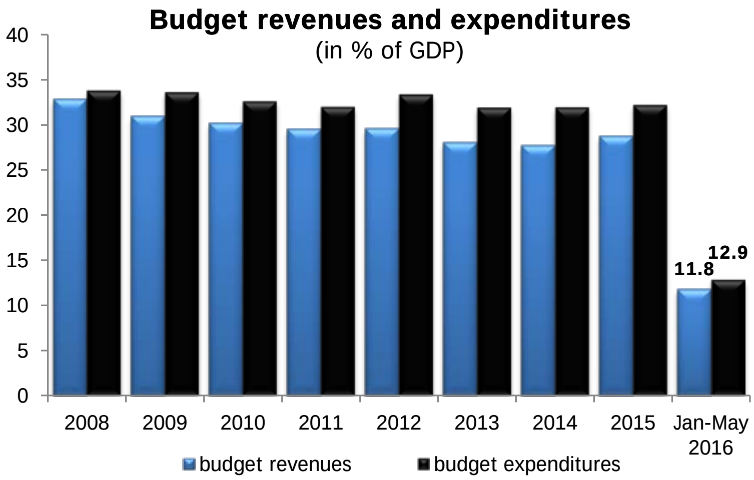
On an annual basis, total non-performing loans dropped in May, as a result of the annual decrease in doubtful and contested claims of the household and corporate sectors.

[17] Includes denar loans without FX clause, accrued interest, and doubtful and contested claims.
[18] For more information see page 42.



Source: NBRM.

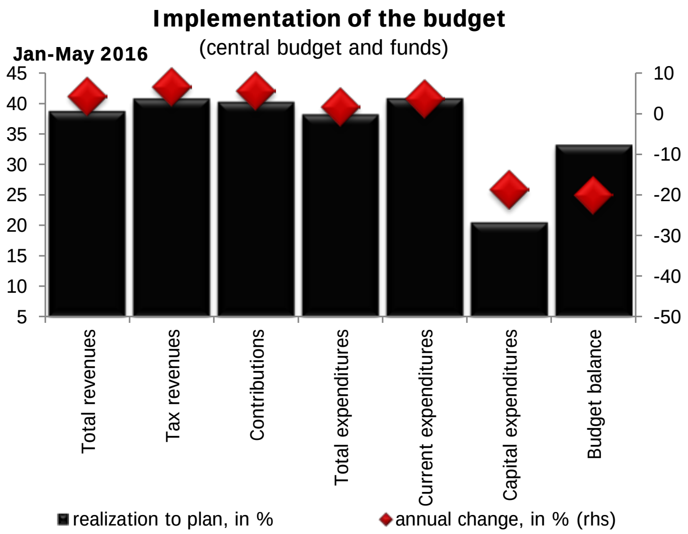
In May, there was a higher utilization of the deposit potential for lending to the private sector compared to the previous month and to the April forecast for the second quarter. These developments are the result of the increasingly pronounced fall in total deposits compared to the slight drop in total loans in this period.



Source: Ministry of Finance and NBRM's calculations.

In the period January-May 2016, the Budget of the Republic of Macedonia (central budget and budgets of funds) generated total revenues of 11.8% of GDP[19] (same as in the period January-May 2015). Budget revenues have increased by 4.3% on an annual basis. The annual budget revenues have increased due to the tax performances. Analyzed by individual tax category, the increase is predominantly driven by the annual growth of inflows from VAT and import duties.

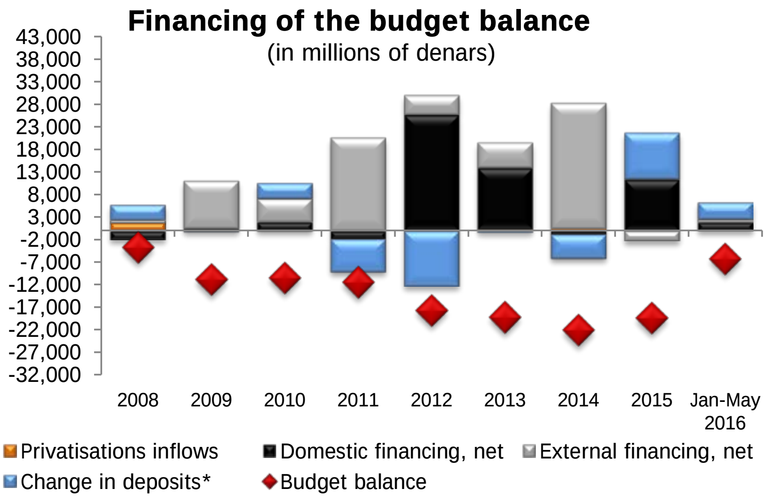
In January-May 2016, total budget expenditures accounted for 12.9% of GDP, down by 0.3 percentage points compared to the same period of 2015. On an annual basis, budget expenditures have increased by 1.7%, fully reflecting the higher current expenditures, while capital costs remain lower.



Source: Ministry of Finance and NBRM's calculations.

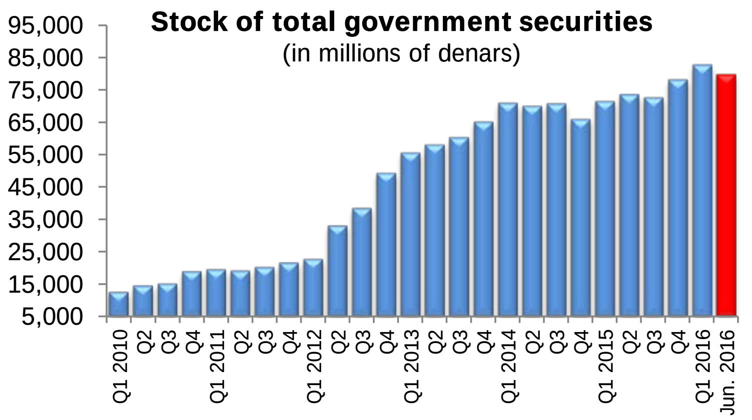
In January-May 2016, the budget revenues and expenditures constituted 38.5% of the forecasted revenues and expenditures, respectively, in accordance with the Budget for 2016. Analyzed by category, on the revenue side of the budget, the highest realization was recorded by inflows of profit tax, VAT, and excise duties of 45.6%, 41.5%, and 41.2% respectively. On the side of budget expenditures, the realization of current expenditures has made up 40.9% of the plan for 2016, while the realization of capital expenditures was 20.6% of the annual plan for 2016.

19 The analysis uses the NBRM April forecasts for the nominal GDP for 2016.



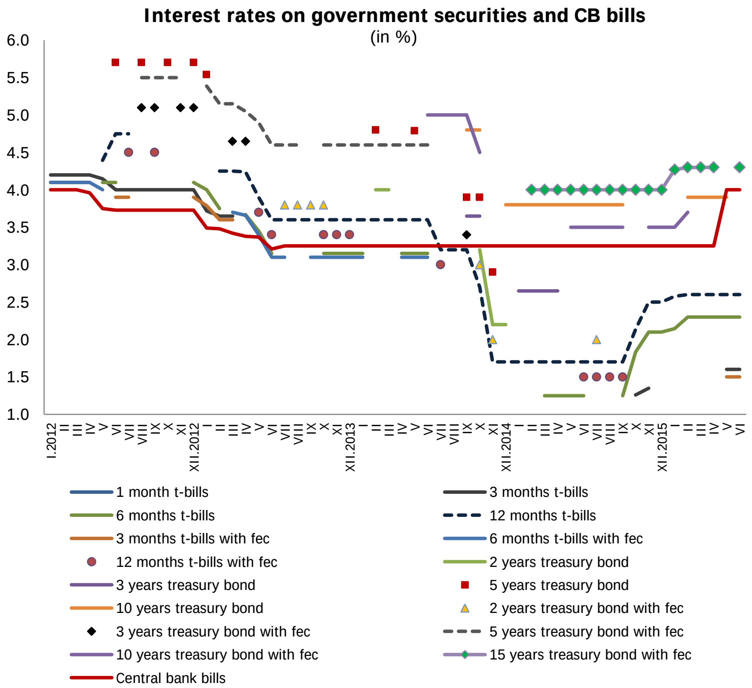
* Positive change- deposits withdrawal; negative change-deposits accumulation.
Source: MoF.

The latest available data show that in January-May 2016, the Budget of the Republic of Macedonia registered a deficit of Denar 6.317 million, which is 1.1% of the nominal GDP[20]. The deficit was mainly financed through withdrawals of government deposits with the NBRM and domestic financing, via the net issuance of government securities.



Source: NBRM.

The stock of government securities amounted to Denar 79.794 million at the end of June, which is by Denar 3.108 million less compared to the end of the previous quarter. Net amount of Denar 1,460 million of government securities were issued from the beginning of 2016 through June.



Source: NBRM.

Interest rates on government securities offered at the auctions held in June were 1.6%, 2.3% and 2.6% for 3-month, 6-month and 12-month treasury bills without FX clause, respectively, while the interest rates on 3-month treasury bills with FX clause was 1.5%. The interest rate on 15-year government bonds with FX clause was 4.3%. Interest rates on all government securities issued in June have remain unchanged compared with the previous auctions.

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

Annex 1 Timeline of the changes in the setup of the NBRM monetary instruments and selected supervisory decisions adopted in the period 2013 - 2015

January 2013

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

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

March 2013

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

July 2013

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

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

October 2013

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

November 2013

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

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

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

February 2014

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

April 2014

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

September 2014

- In order to further channel banks' excess liquidity to the non-financial sector, in September the NBRM revised the mechanism for transfer of the demand for CB bills, which is above the banks' potential into another instrument, i.e. seven-day standing deposit facility. According to these changes, for the seven-day standing deposit facility that banks are obliged to allocate if on the CB bills auctions they demand an amount higher than the potential[21], 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.

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

September 2014

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

October 2014

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

March 2015

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

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

April 2015

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

June 2015

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

August 2015

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

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

December 2015

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

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

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

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

May 2016

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

- The National Bank Council adopted the Decision on reserve requirement, which required an increase of the reserve requirement rate for banks' liabilities in domestic currency with FX clause. The measure has been aimed to encourage the process of denarization of deposits in the domestic banking system. Given the negligible market share of these liabilities in the banks' balance sheets, the changes have been made for the sole purposes of further maintenance of low propensity of the economic agents to place this type of deposits in domestic commercial banks.

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