

# **National Bank of the Republic of Macedonia**

MONETARY POLICY AND RESEARCH DEPARTMENT



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

June 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 (March - June 2015) and to make a comparison with the latest macroeconomic projections (April 2015). This will determine the extent to which the current situation in the economy corresponds to the expected movements of the variables in the latest forecasting round. 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.*

Generally, the global economic environment has not undergone major changes compared to the period of the last assessments. Uncertainties remain, yet the latest indicators suggest that some risks regarding the external environment are moderately lower compared to the April projections. This especially concerns the Euro area, where the latest data show further recovery, amid acceleration of the GDP growth rate of 0.4% in the first quarter, on a quarterly basis. Also, most high frequency indicators of growth in the second quarter of 2015 indicate relatively favorable developments. The labor market shows continuous decrease in the unemployment rate, which reached 11.1% in April, representing the lowest rate in the last three years. The latest ECB projections suggest almost unchanged expectations about GDP growth in the Euro area in the coming period, while still indicating a further reduction in downward risks<sup>1</sup>. It is expected that growth in the Euro area will continue to be driven by domestic demand, supported by the stimulating monetary policy measures and the neutral character of fiscal policy, while an additional impetus is expected from the lower oil prices, improved price competitiveness and growth in global demand. In terms of inflation, in May, price increase of 0.3% on annual basis was registered, which is the first positive inflation rate since November 2014. Also, a significant acceleration in the rate of core inflation to 0.9% was registered. These performances have contributed to the upward revision of expected inflation in 2015, with unchanged expectations for the next two years<sup>2</sup>. By the end of this year inflation will gradually accelerate as a result of the base effect of oil prices, while additional impetus on price movements in this and in the next two years is expected from the acceleration of the economic growth, the depreciation of the euro and the expected higher oil prices. The main challenge for the monetary policy in the Euro area remains the return of inflation rate to the targeted path, which is conditional on the transmission of the ECB's measures, as well as the geopolitical events and movements in the prices of energy and in the exchange rates. In this context, at the meeting held at the beginning of June, the ECB maintained the same key interest rate, amid unchanged framework of the set of non-standard monetary policy measures. **Observed from a viewpoint of the individual quantitative external environment indicators for the Macedonian economy, the assessments regarding the foreign effective demand did not register changes relative to the April projection.** There are still expectations for gradual recovery in foreign demand in 2015 and acceleration of growth in 2016. Also, there were no significant changes in the **foreign effective inflation**, i.e. there are expectations for an unchanged level of prices in 2015 and a minimally lower inflation in 2016. **Changes in the expectations for the prices of primary products are divergent.** Latest developments and assessments for the **world oil prices** point to a smaller drop compared to the April expectations. Yet another rise in oil prices is expected in 2016, similar to the April projections. Changes are registered also in the expected movement of the **prices of metals**, where the average changes for this and next year are moderately revised upwards. The assessment for the **food prices** suggests slower growth in the

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<sup>1</sup> According to the latest ECB's projections from June 2015, the growth rate of real GDP for 2015, 2016 and 2017 is estimated at 1.5%, 1.9% and 2%, respectively. The previous (March) projections estimated that the growth will be 1.5%, 1.9% and 2.1% for 2015, 2016 and 2017, respectively.

<sup>2</sup> In the June forecast, the ECB projected the HICP inflation rates at 0.3%, 1.5% and 1.8%, for 2015, 2016 and 2017 respectively, compared to the March projections of 0%, 1.5% and 1.8% for 2015, 2016 and 2017, respectively.

price of corn and a moderate decline in the price of wheat during 2015 and moderately faster growth in the price of cereals in 2016, indicating similar import pressures through this channel on domestic inflation and terms of trade as in the April projections.

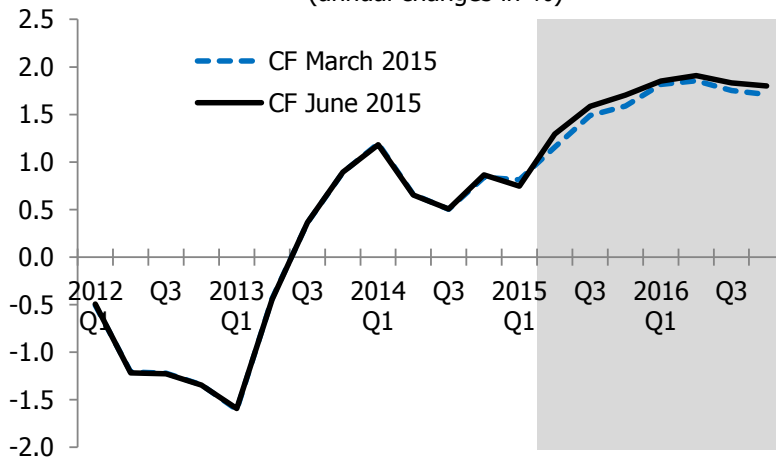
**The comparison of the latest macroeconomic indicators with their projected dynamics within the April forecasting round does not indicate major deviations in the individual segments of the economy.** Regarding the indicators relevant for the monetary policy, in April, for the first time after eight consecutive months of continuous decline, there was a small annual growth of domestic prices amid moderate increase in food prices and core inflation. Such movements in prices were expected within the April projection, but the increase is somewhat lower compared to the projections, mainly reflecting the slower growth in food prices. On the other hand, given the still low oil prices on the world market, the energy component remained in the negative zone also in April. Considering the moderately lower inflation, as well as the changes in the key assumptions for the prices of primary food products, **the risks in terms of the projected movement of domestic prices in 2015 are mainly downward.** However, changes in the expectations about the prices of primary products indicate that the uncertainty about the future movement of these products is significant, and the possibility of sudden changes in these categories is large.

**According to the latest available data, in the period April-June 2015, foreign reserves (adjusted for the price and exchange rate differences and price changes of securities) decreased, as projected in April.** Risks regarding the future dynamics of the foreign reserves are still present and are mainly related to the unfavorable external environment, which may cause downward deviations compared to the projected path. However, with the recent measures of the ECB which should support growth in the Euro area, they are mitigated. The available external sector indicators for the second quarter are still insufficient making it difficult to obtain an accurate picture of the possible deviations in the position of the balance of payments compared with the projections. The latest data on foreign trade as of April give an indication of somewhat higher trade deficit, due to weaker export performances. However, the evaluation period of one month is very short and therefore reliable conclusions in this domain cannot be drawn. At the same time, net purchases from currency exchange operations as of May provide a signal for somewhat lower private transfers than expected for the second quarter according to the April projection. The analysis of foreign reserves adequacy indicators shows that they continue to move within a safe zone.

**The latest high frequency data for the economic activity for the first quarter of 2015 point to further growth of the domestic economy.** The continued economic growth in the first quarter is evident through most of the indicators by sector. With regard to monetary developments, the data on the credit market as of April show further solid growth in total loans to the private sector, which in April was largely distributed among households. Banks have continued to support also the corporate sector, with corporate loans contributing with 44% to the monthly growth of total loans. On annual basis, total loans in April increased by 10.2% (expected annual growth of 8.8% for the second quarter according to the April projection), while the realized growth of total loans in April represents about 33% of the projected quarterly growth of total loans for the second quarter of 2015. In terms of deposit potential, data as of April show growth in total deposits (after the decline registered in the previous month), which for the most part has been driven by the growth of deposits of the corporate sector, amid further growth of household deposits, but at a slower pace compared to the previous month. Relative to the projection, performances in April represent 36% of the quarterly flow projected for the second quarter. On annual basis, total deposits grew by 9.5%, while the projection for the end of the second quarter was 10%. The performances as of April, in both the deposits and the loans can now be estimated to be within the projection. However, the period of assessment is very short to be able to provide reliable conclusions about the dynamics of the deposit and credit growth compared with the projection. The latest assessments of the level of the interest rate EURIBOR indicate its lower level in the 2015-2016 period, compared with the April projection, where now negative interest rate is expected also for 2016 (expectations for a positive interest rate in the April projection).

**The latest macroeconomic indicators and assessments do not point to major changes in the conclusions about the environment for conducting monetary policy and about the risks, compared to the assessments provided in the April projections. Also in this period, risks are a combination of external risks and risks caused by the domestic political developments.** Observing external risks, concerns about Greece's debt crisis are again brought to the fore in this period, which stresses the present uncertainty in the environment. At the beginning of June, foreign reserves decreased compared to the end of the first quarter, but foreign reserves adequacy indicators remain in the safe zone. Risks arising from external environment remain unfavorable, even though they are mitigated by the recent changes in the ECB's monetary policy. In terms of inflation, performances as of April show a small annual growth, which is within the expectations with the April projection. However, the price increase is slightly lower than projected, referring to the conclusion that the risks in terms of the projected movement of domestic prices in 2015 are mainly downward. The latest high frequency data on the economic activity for the first quarter of 2015 point to further growth of the domestic economy. In terms of the credit market, the data as of April showed further solid growth in total loans, for which it can now be concluded that it is in line with the April projection.

**Foreign effective demand**  
(annual changes in %)



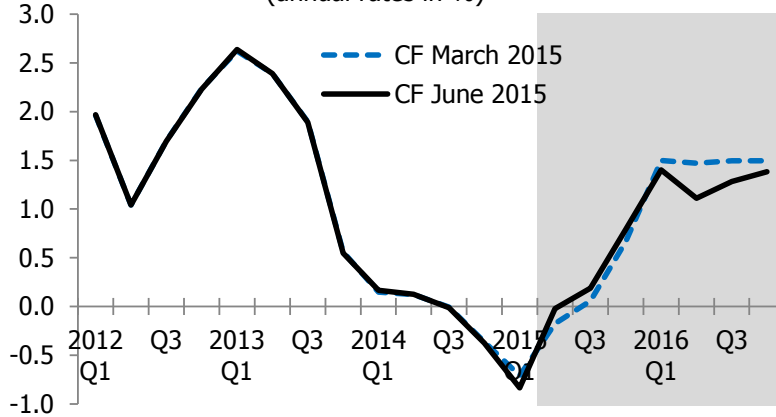
Source: "Consensus Forecast" and NBRM calculations.

**Compared to April assessments, there is no change in the expectations about the movement of foreign effective demand during the forecasting period...**

... i.e. it is still expected to grow by 1.3% and 1.8% in 2015 and 2016, respectively ...

... with the German economy still expected to be the main engine.

**Foreign effective inflation**  
(annual rates in %)



Source: "Consensus Forecast" and NBRM calculations.

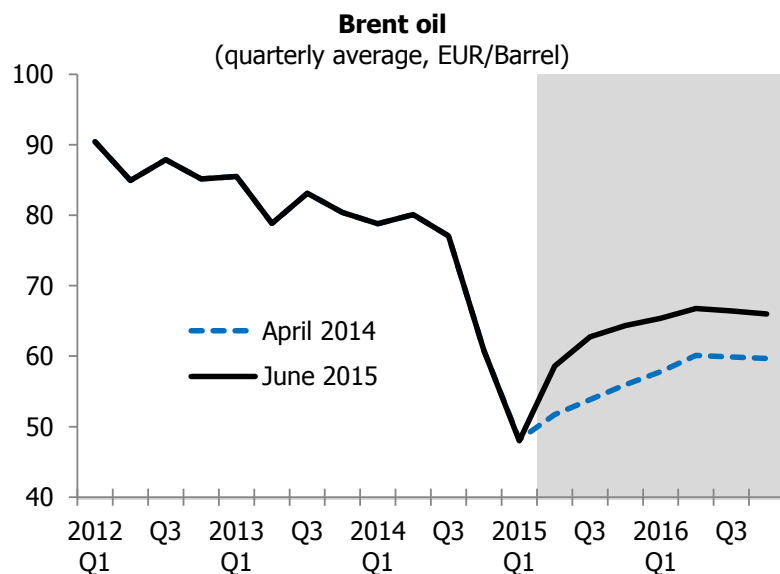
**In 2015, foreign effective inflation is expected to amount to 0%, which is the same as in the April projection.**

**On the other hand, downward revision of foreign inflation was made in 2016 ...**

... when it is expected to amount to 1.3%, compared to the April projection of 1.5% ...

... which is mostly due to the lower contribution of the inflation in Serbia<sup>3</sup>.

<sup>3</sup> Inflation in Serbia has been adjusted for the changes in the exchange rate.



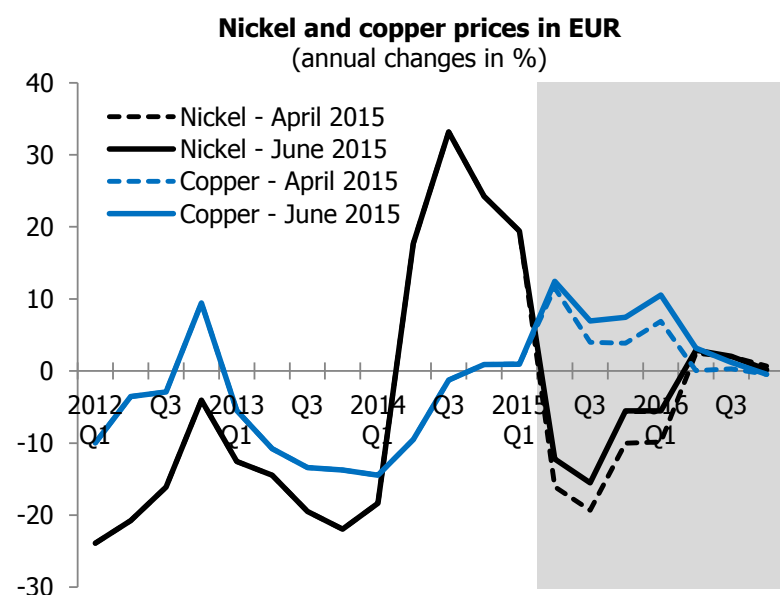
Source: IMF and NBRM calculations.

**In 2015, it is still expected that the price of "Brent" oil will register a significant decline.**

Although current conditions on the oil market still suggest that oil production is greater than consumption, it is now expected the projected decrease in oil prices to be lower compared with the April projection ...

... which is mainly influenced by the expectations for reduction of the excess supply, increased risk of future disturbances in the supply of oil related to the geopolitical tensions in the Middle East and North Africa and the possible stronger reaction of the demand in the USA and Europe to the lower oil prices especially during the summer.

**On the other hand, assessments of the growth in oil prices in 2016 were retained, with the same intensity as in the April projection.**



Source: IMF and NBRM calculations.

**In the period since the last projections, moderate upward revisions in metal prices were made.**

**Thus, now it is expected that in 2015 the price of nickel will register smaller decline compared to the April assessment ...**

...due to the possible reduction in the inventories of this metal, which are now high...

...amid assessments for faster growth in the price of copper ...

...related to the anticipated effects on the industrial activity resulting from the new stimulating measures undertaken by the Central Bank of China, which can affect demand, but also to the uncertainty due to the problems faced by production facilities in Chile.

**It is estimated that in 2016, the**

**price of nickel will register a smaller decline compared with April, while the price of copper will grow faster than previously envisioned.**

**According to the latest estimates, the prices of primary food products in 2015 have been revised downwards ...**

... i.e. now fall rather than rise in the price of wheat and slower growth in the price of corn is envisaged...

... as a result of the expectations for good harvest thanks to the favorable weather conditions so far and the solid levels of global inventories.

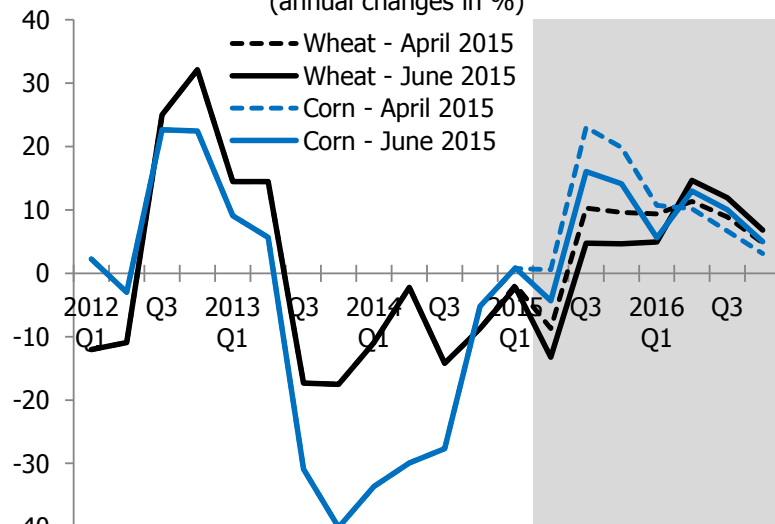
**Current estimates point to growth in the prices of food products in 2016, which would have a similar intensity as in the projections from April.**

**In a situation where the ECB remains committed to the implementation of the unconventional monetary policy measures, this policy acts toward moving the short-term interest rates on the money market in the negative zone.**

Consequently, the latest estimates are that the one-month EURIBOR in 2015 and 2016 will be negative and will average -0.03% and -0.04%, respectively, unlike April projections of -0.01% and 0.06 % respectively ...

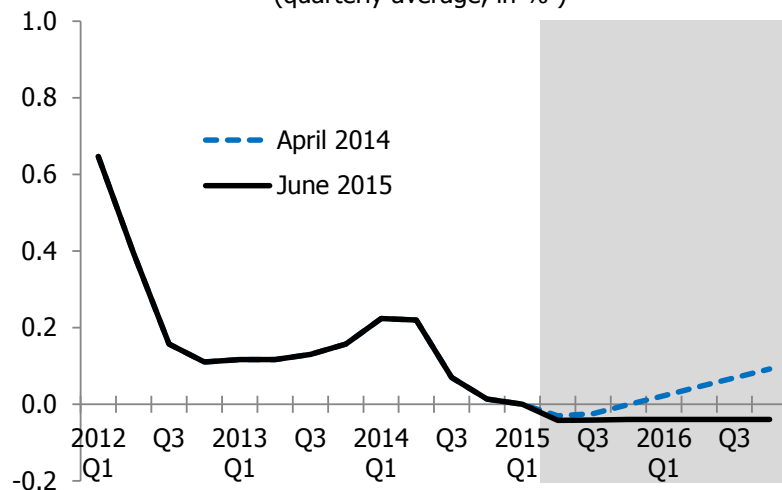
...which is further influenced by the expectations of higher future excess liquidity in the Euro System.

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



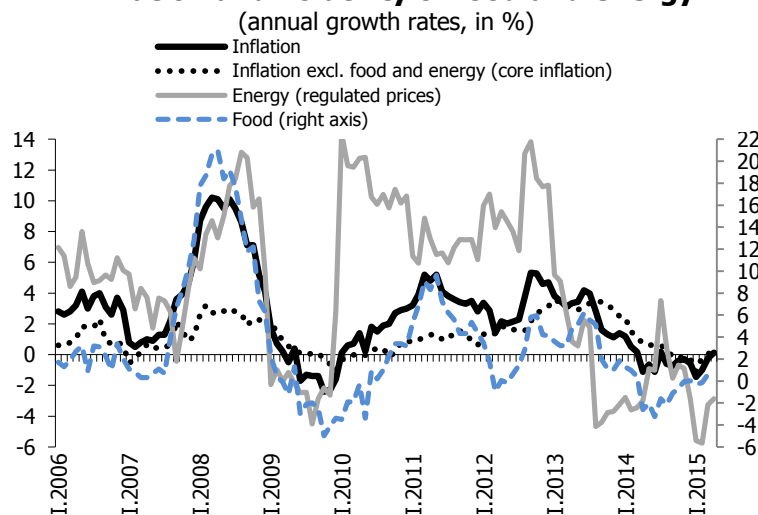
Source: IMF and NBRM calculations.

**1-month Euribor**  
(quarterly average, in % )



Source: "Consensus Forecast" and NBRM calculations.

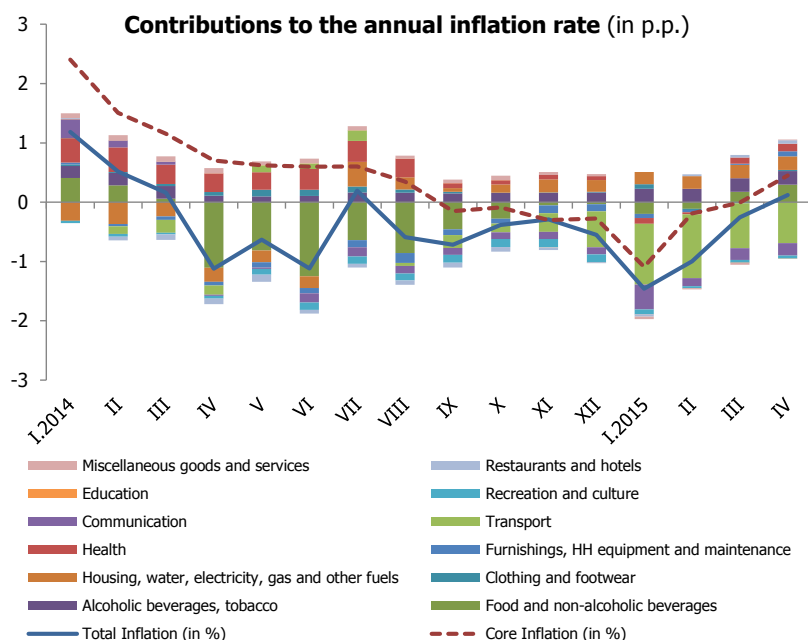
## Inflation and volatility of food and energy



Source: State statistical office and NBRM calculations.

**After the monthly decline in consumer prices in January and stagnation in February, consumer prices in April 2015, as it was the case also in March, recorded a positive monthly growth rate (of 0.4%) ...**

... amid growth in food prices and core inflation<sup>4</sup>.



Source: SSO and NBRM.

**According to the monthly pace, in April the general price level recorded a minimum annual growth (of 0.1%), after eight consecutive months of continuous decline ...**

...which is a lower rate than expected in the April forecasting round...

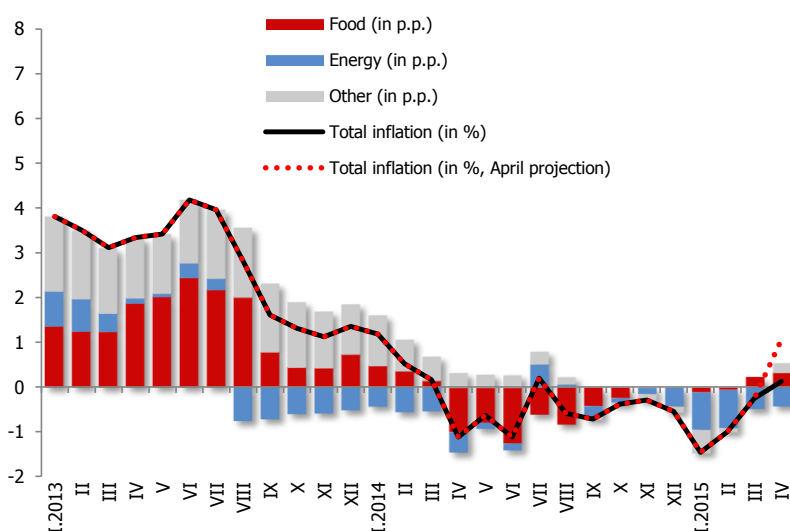
... amid downward deviation in the actual relative to the projected inflation in the food component and core inflation, while the reduction in the energy component is somewhat lower than expected.

<sup>4</sup> Categories with the largest individual contribution to the increase of the October CPI are the following: fresh vegetables (monthly price growth of 3.3%), clothing and footwear (monthly growth of 0.9%), and the category furniture, household equipment and maintenance of the household equipment (monthly price growth of 1.2%).



## Inflation rate

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



Source: SSO and NBRM.

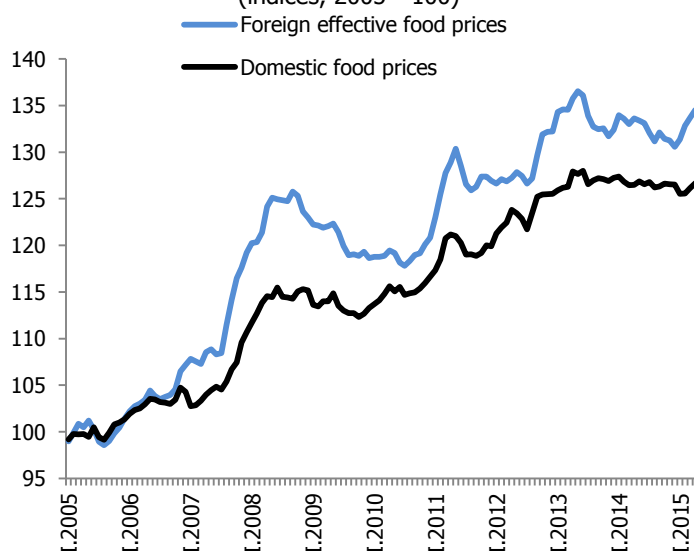
Core inflation in April was higher by 0.5% on a monthly basis (compared to the small decrease in March) ...

... and growth with the same intensity was registered also on an annual basis, which has been the first positive annual change of core inflation since August 2014.

In terms of the structure of core inflation, the April growth is largely driven by the prices of tobacco and pharmaceutical products, with significant downward impact of the fall in consumer prices for communications.

## 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, there was no change in the expected **foreign effective inflation** by the end of 2015.

On the other hand, the latest assessments for the **prices of internationally traded primary food products**, expressed in euros, point to downward adjustment for 2015, compared with the April projection ...

... which is explained by the setup of the fundamental factors, i.e. the relatively favorable situation on the supply side in circumstances of high inventories from production in the previous two years.

On the other hand, an upward adjustment was made in the assessment of the movement in the **price of oil** in 2015 ...

... as a result of the expectations for growth in global demand, but also due to the expected decrease in supply associated with the geopolitical tensions in the Middle East and North Africa.

**Risks surrounding the projected movement of domestic prices in 2015 are mainly downward**, amid downward deviation of the actual compared to the projected movement of prices in April and downward revision of the expected movement of the prices of cereals...

However, it should be emphasized that there is great uncertainty about the projected movement of world oil prices, given that the movement of these prices is sometimes determined by factors of temporary character.

In March 2015, the average **net wage** registered a nominal annual growth of 1.9%, which is an acceleration of the positive dynamics registered in the previous month.

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

... however, somewhat faster growth dynamic was registered in the wages in the energy sector and in part of the services sector (health, the activity "arts, entertainment and recreation" and other services) ...

...while downward movement on an annual basis was registered in the wages in agriculture, mining and some services.

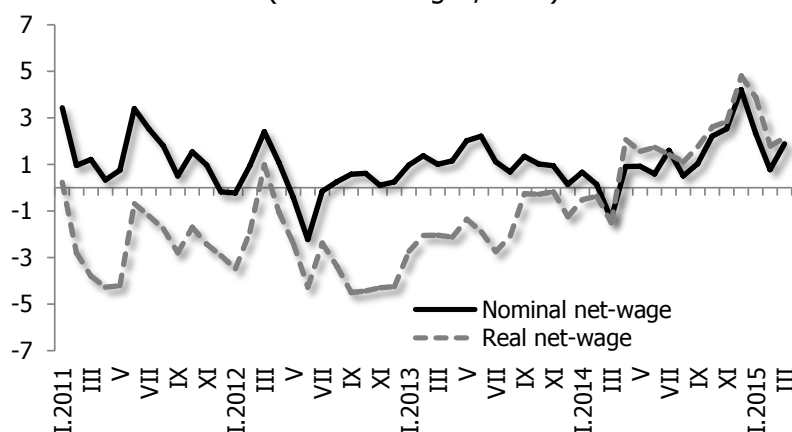
**On average, in the first quarter, net wages registered nominal annual growth of 1.7%, which is slightly less than expected in the April projection (of 2.6%).**

In March, real wages increased by 2.1%, amid reduced domestic prices.

Thus, **the real annual growth of wages in the first quarter was 2.6%**, which is still lower than expected in the April forecasting round (3.6%).

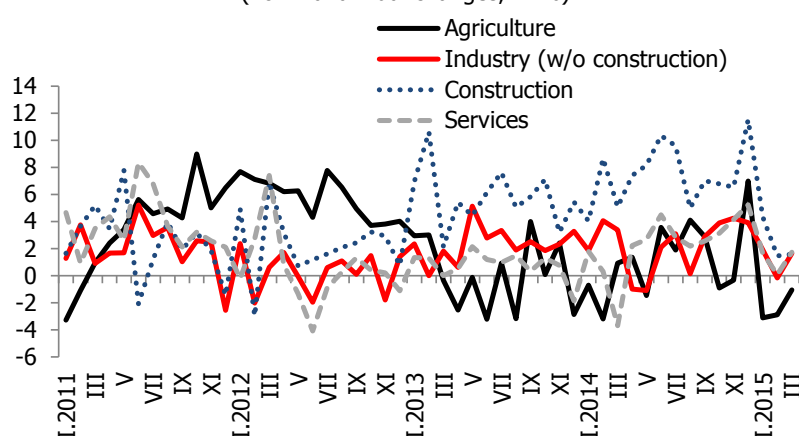
**The high frequency data for the first quarter of 2015 indicate growth of the domestic economy, given the**

**Average net-wage**  
(annual changes, in %)



Source: SSO.

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



Source: SSO.

**constant positive performance in most economic sectors.**

In the first quarter, **industrial production** grew by 1.5% on annual basis, which is a slower rate of growth compared to the previous quarter ...

... while production of motor vehicles, trailers and semi-trailers (the result of the operations of the facilities in the technological-industrial development zones), the energy sector and manufacturing of clothing are among the sectors with the largest contribution to the modest growth...

...growth in the first quarter was typical also for the production in the sector of metals ...

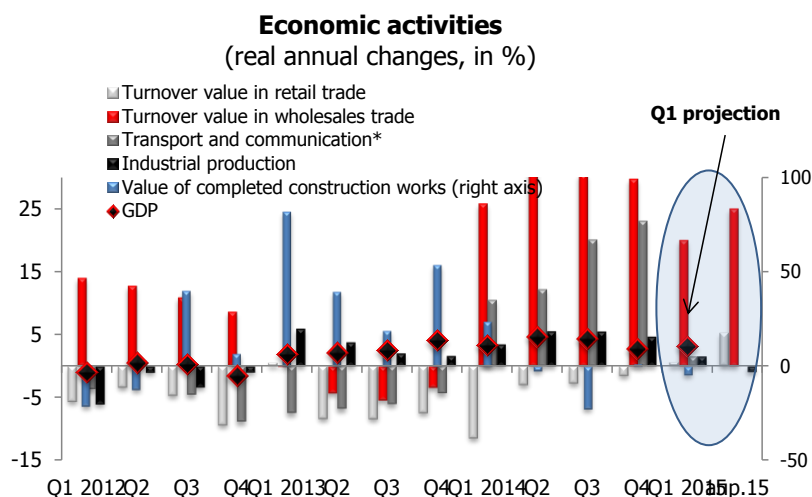
... while a significant decline in manufacturing was registered in mining, tobacco and non-metallic minerals.

Based on the signals obtained from the Business Tendency Survey in the manufacturing industry, the positive outturn can be associated with the increased utilization of industrial capacities<sup>5</sup> ...

... and additionally, in the first quarter, an annual increase (although slower) was recorded also in the turnover of inventories<sup>6</sup> in the industry, which points to increased profitability of the business entities in this sector.

The favorable developments in the **"trade"** sector continued in the first quarter ...

.. amid further high real growth in the wholesales and in the trade with motor vehicles, as well as growth, albeit moderate, in retail trade, for the first time after the constant decline in real terms in



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

<sup>5</sup> SSO's Business Tendency Survey in manufacturing industry.

<sup>6</sup> 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.

the last seven quarters.

In the first quarter, growth was registered also in the **transport** activity, but with a significant slowdown compared with the previous quarter...

... where the slowdown is general, i.e. it applies to almost all types of transport.

Annual growth at a slower pace compared to the previous quarter was registered also in the realized turnover in **catering**.

Contrary to the moderate growth recorded in the previous quarter, the data for the first quarter on the "**construction**" sector are unfavorable and lower value of completed construction works compared to the same period last year was registered. However, analyzed by months, construction registered an annual growth in March, contrary to the decline in the first two months of the year.

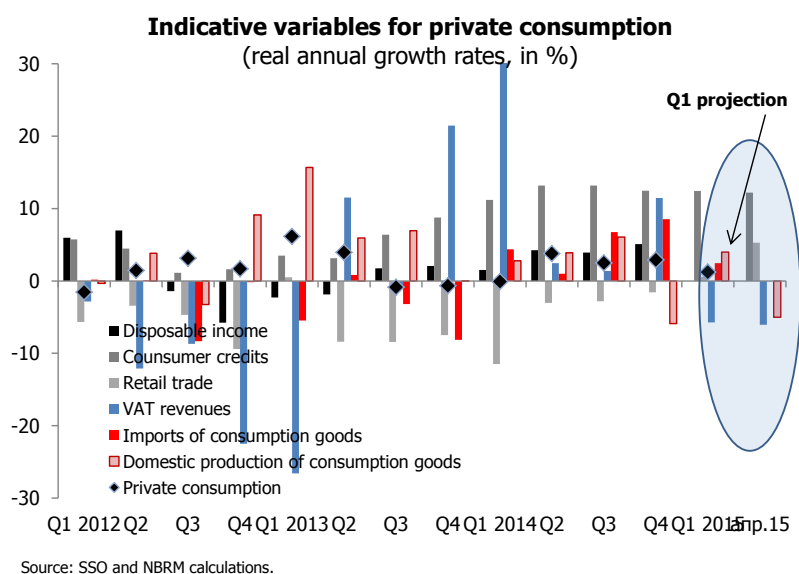
**Available indicators of aggregate demand in most part also point to economic growth in the first quarter of 2015, which is consistent with the expectation in the April forecasting round.**

According to the high-frequency data on **private consumption**, its further growth is expected in the first quarter of 2015...

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

... and more dynamic growth of private transfers and continuing solid pace of growth in lending to households.

The households' consumption growth is evident also from the growth of domestic production of consumer goods (as opposed to the fall in the previous quarter), the growth in imports of consumer goods, as well as moderate real growth of retail trade.

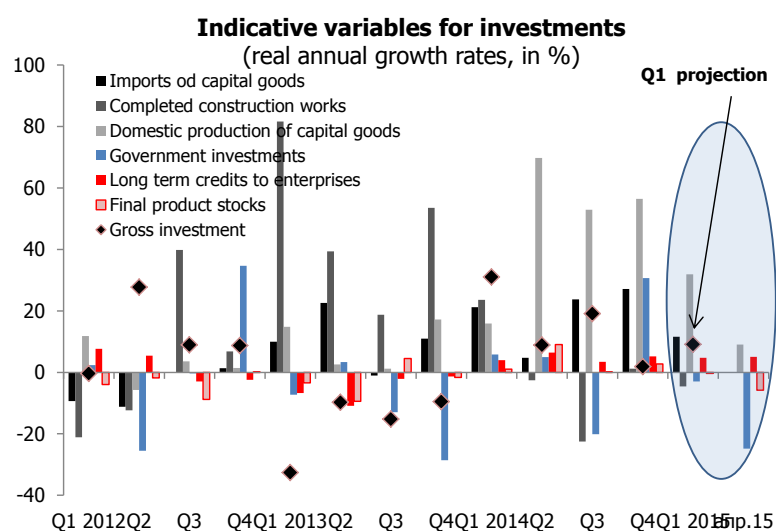


On the other hand, annual decline was recorded in the net revenues from VAT.

The available high frequency indicators of **investment activity**, in general, point to possible investment growth in the first quarter...

...amid continuing growth in the lending to the corporate sector ...

...with relatively high annual growth recorded in the domestic production of capital goods and imports of investment products (although at a slower pace compared to the previous quarter).



Source: SSO and NBRM calculations.

On the other hand, data for the first quarter on construction, budget capital expenditures and foreign direct investment point to a slowdown of investment activity in the first quarter of the year.

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

**Budget performances in the first quarter point to expectations for growth in public consumption in this period**, which generally corresponds to the estimates for small growth from the April forecasting round...

... amid an annual increase in the expenditures for wages and for goods and services.

Generally, the favorable movements of high frequency indicators point to the conclusion that non-economic factors related to political developments in the country had no significant negative impact on the domestic economy in the first quarter of 2015.

**Most data for April 2015 indicate a continuous growth of economic activity.**

However, it should be emphasized that these assessments are based on very few data available. Domestic non-economic factors related to the political situation in the country, which were particularly popular in the second quarter of the year, further increase the uncertainty regarding the assessments of the economic activity in the second quarter.

In April, industrial production registered minimum annual decline of 0.9% ...

...due to the reduced production of tobacco, construction materials and beverages...

...while there was a more significant increase in the production of machinery and equipment, processed wood, as well as activities related to the production of food products.

However, the higher levels of capacity utilization and the more optimistic perceptions of the managers in the manufacturing sector regarding the production volume in the next three months point to indications of possible positive annual growth in the activity of this sector in the second quarter of 2015.

Unlike industry, positive developments in **domestic trade** continued in April, amid real annual growth in all types of trade.

High frequency data on **private consumption in April** give mixed signals regarding the movement of private consumption in the second quarter of 2015 ...

... in circumstances of real growth of retail trade...

...somewhat weaker pace of growth in lending to households and minimum small decline in pensions ...

... and a decline in revenues from VAT and the production of consumer goods.

Indicators of **investment** in April point to

further growth of investment activity in the second quarter ...

...amid growth in the domestic production of capital goods ...

...accelerated growth in corporate loans ...

.. while government capital investments declined.

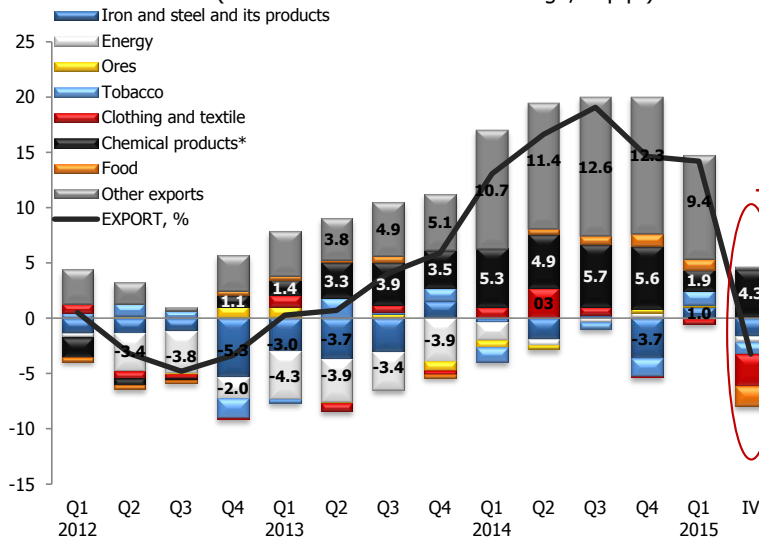
Data on **foreign trade** for April 2015 point to prospects for widening of the deficit in the second quarter.

Budget performances as of April suggest growth of **public consumption** in the second quarter, which is consistent with the expectations from the April projection.

These shifts in public consumption are associated with the growth in the expenditures for wages and were further influenced by the annual growth in transfers for health care.

## 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

In April 2015, the foreign trade deficit widened by 29.1% on an annual basis due to increased import pressures and lower export of goods ...

... with these developments pointing to slightly higher trade deficit than expected according to the April projection.

**Exports** of goods in April registered an annual decline of 3.2%, due to the weaker performance of the traditional export sectors, i.e. lower exports of clothing and textiles, food, iron and steel and tobacco ...

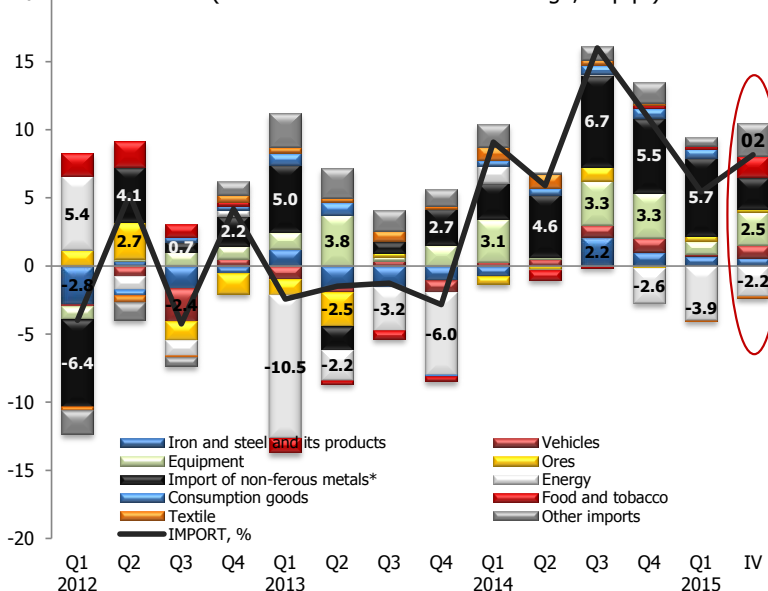
...as opposed to the positive contribution from the new industrial facilities.

*Compared with the April projection, realized export in April points to weaker than expected export performance for the second quarter.*

The downward deviation from projected exports is mostly due to lower exports of the traditional sectors in the economy (clothing and textiles, tobacco and iron and steel).

## Imports by components

(contributions to the annual change, in p.p.)



Source: NBRM.

\* The following data depict the overall imports of one major export capacity in the free

**Imports** rose by 8.2% on an annual basis in April, as a result of the increase of raw materials imported for the new facilities, as well as the somewhat larger import of food ...

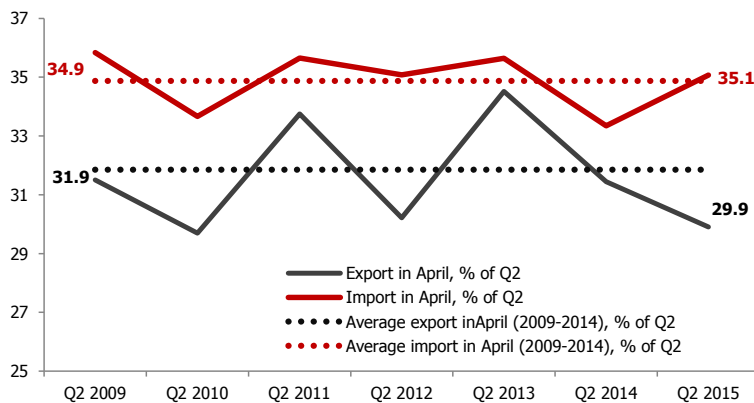
... while the reduced energy imports acted in the opposite direction, reflecting the effect of lower import prices of energy amid higher amounts of imported oil derivatives.

*Import performance in April is generally in line with the projected flows for the second quarter of the year, according to the April projection.*

**Given the weaker performance on the part of the exports, versus imports which are within the expectations and the historical average, there is a possibility for a slightly higher trade deficit in the second quarter compared to the projected.** However,



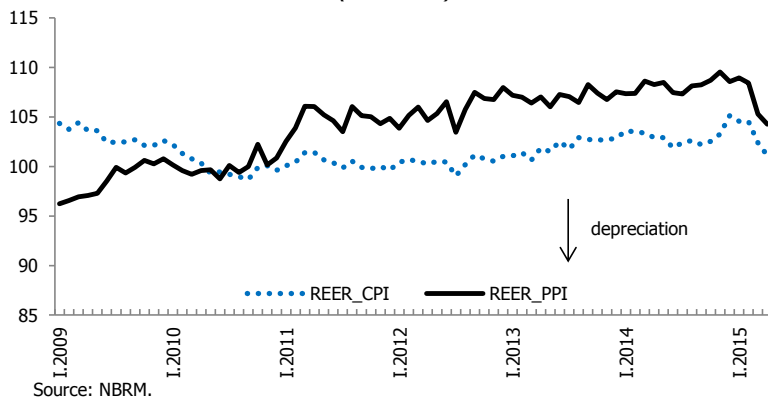
Share of export and import of goods in April relative to Q2 projection



one should bear in mind that the data pertain to a very short period, insufficient for reliable conclusions and that the deviation may be temporary.

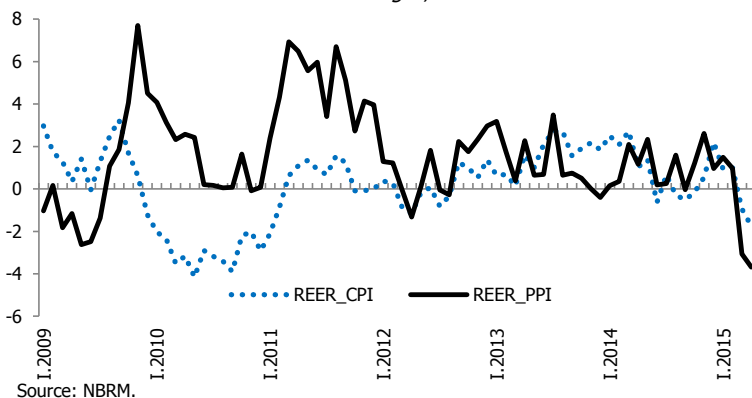
Recent assessments of the movement of global stock exchange prices of oil point to less favorable trends in the current year compared with the April projection. Namely, in 2015, the price expressed in euros is expected to register somewhat more moderate annual decline. Regarding metals, during the current and in the next year, on average, more favorable changes in the world prices of nickel and copper are expected. Also, the latest expectations for the world food prices point to better terms of trade compared with the April projection.

REER  
(2010=100)

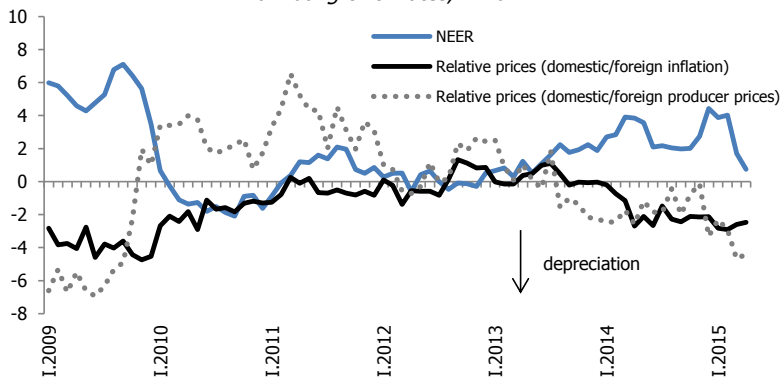


**In April 2015, an improvement in the indicators of price competitiveness of the local economy on annual basis was registered.** Compared to the same period last year, both indices depreciated. The REER deflated by consumer prices depreciated by 1.8% on an annual basis, while the REER deflated by producer prices depreciated by 3.7%.

REER  
annual changes, in %



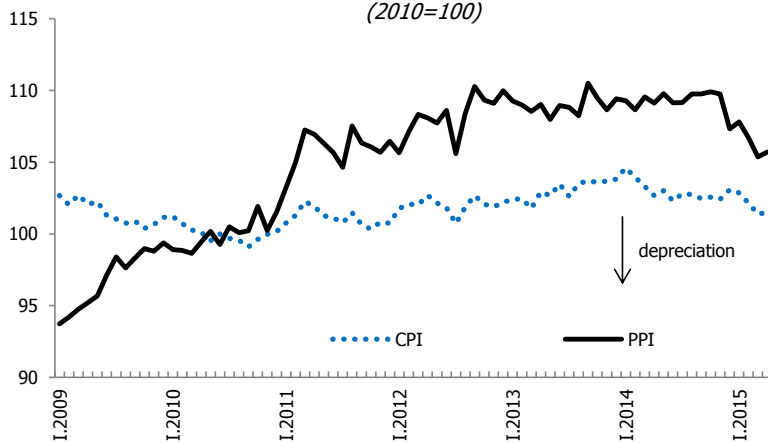
**NEER and relative prices**  
annual growth rates, in %



Source: NBRM.

Such performances are entirely due to the reduction in relative prices. Namely, the relative consumer prices registered an annual decline of 2.5%, amid slower growth in domestic relative to foreign prices, while the relative prices of industrial products decreased by 4.4%, amid a drop in domestic versus rise in foreign prices. The movement of the nominal effective exchange rate acted in the opposite direction, and appreciated by 0.7% as a result of the depreciation of the Russian ruble and the Ukrainian hryvnia against the Denar.

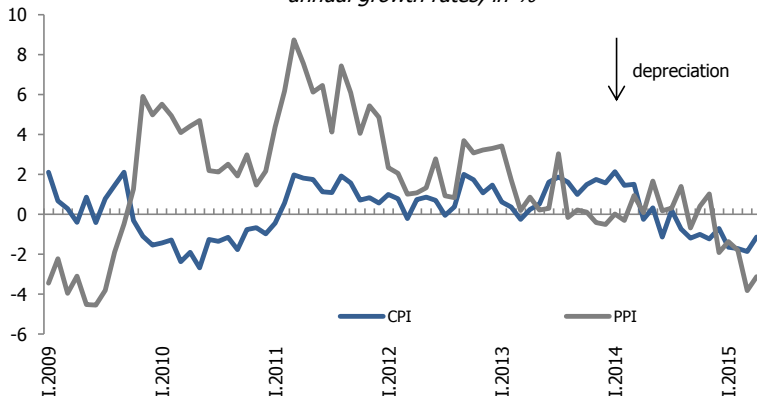
**REER, excluding primary commodities**  
(2010=100)



Source: NBRM.

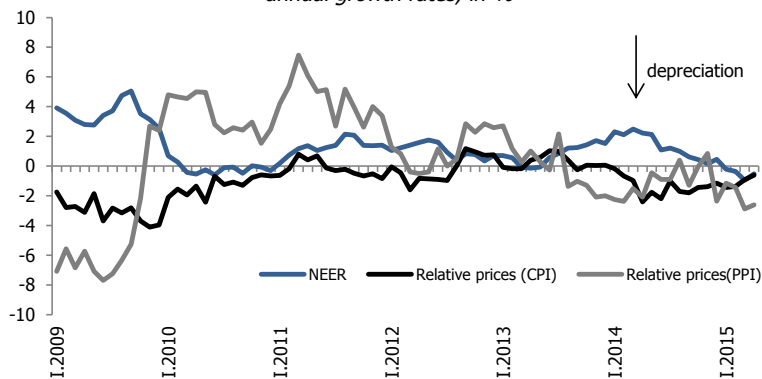
**The analysis of the movement of the REER indices calculated with weights based on the foreign trade without primary products, also indicates improvement in the domestic price competitiveness.** The REER deflated by consumer prices depreciated by 1.1% on an annual basis, while the REER deflated by producer prices depreciated by 3.1% on an annual basis.

**REER, excluding primary commodities**  
annual growth rates, in %



Source: NBRM.

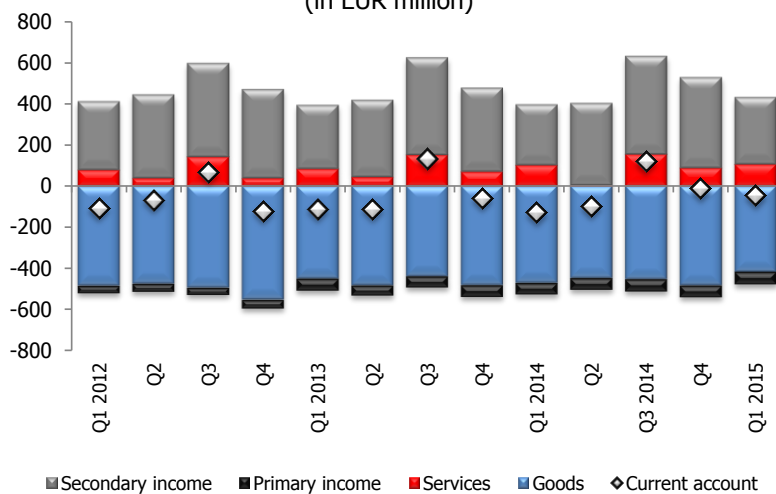
**NEER and relative prices, excluding primary commodities**  
annual growth rates, in %



Source: NBRM.

The improvement in both REER indices was partly a result of the annual decline in the relative consumer prices and prices of industrial products (by 0.6% and 2.6%, respectively). The increase in the competitiveness was also supported by the depreciation of such calculated NEER (of 0.5%), primarily due to the appreciation of the US dollar against the denar.

**Main components of the current account**  
(in EUR million)

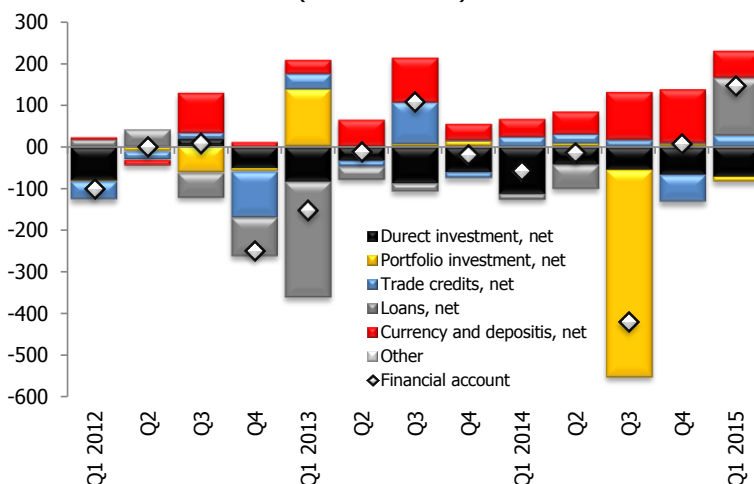


Source: NBRM.

**In the first quarter of 2015, the balance of payments current account registered a deficit of Euro 44.3 million (or 0.5% of GDP), and is slightly lower than the deficit expected according to the April projection ...**

... improved performances are almost entirely due to the lower deficit in the balance of goods and services, while the deficit in the primary income and the surplus in the secondary income are in line with the April projection.

**Financial account components**  
(in EUR million)



Source: NBRM.

**In the first three months of the year, net outflows of Euro 147.3 million (or 1.6% of GDP) were realized through the financial account, which is slightly higher than the expected net outflows according to the April projection<sup>7</sup>.**

Such deviations result mainly from the lower realized direct investment than expected, and the realized net repayments in trade loans versus the expected small net inflows. On the other hand, loans registered smaller than projected net outflows (realized net borrowing as opposed to the projected small net repayments in long-term loans to the private sector), but also lower net outflows in currency and deposits (due to withdrawal of banks' funds from their

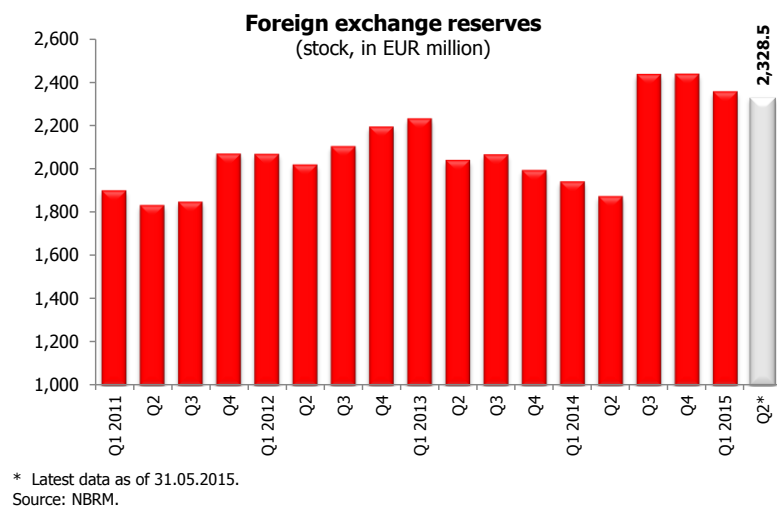
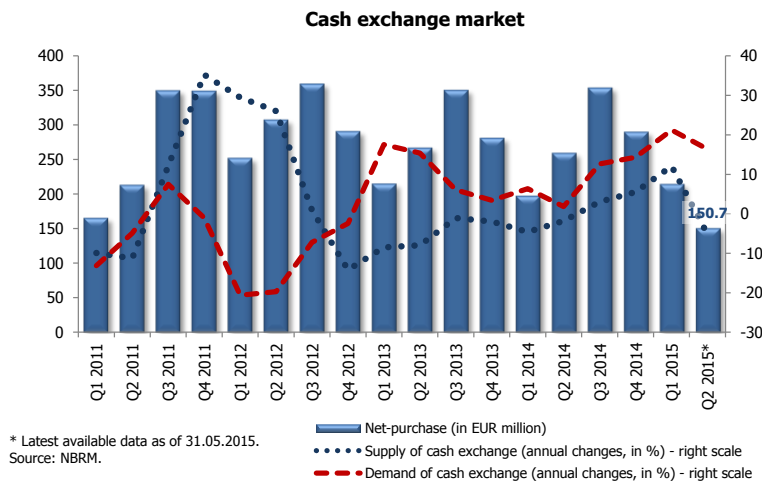
<sup>7</sup> According to the new methodology for compilation of the balance of payments (BPM6), the terms net inflows and net outflows denote net incurrence of liabilities and net acquisition of financial assets, respectively.

accounts abroad), compared with the April projection.

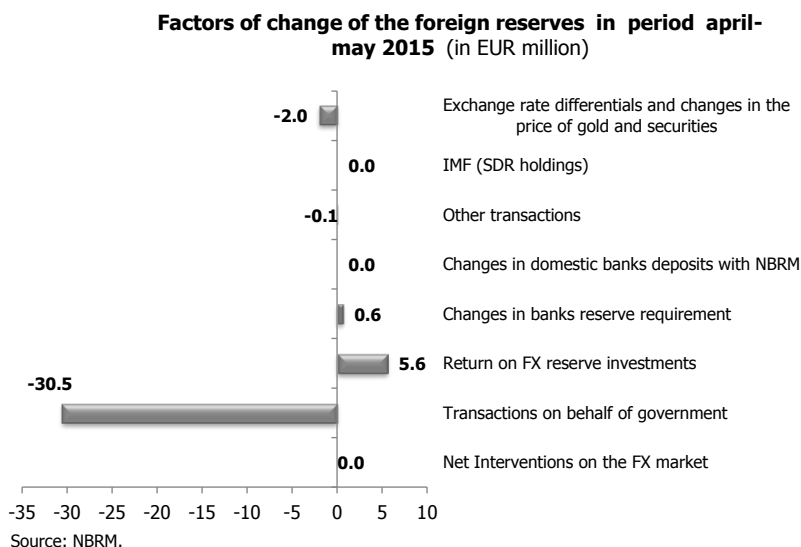
**Recent data on currency exchange operations, as of May 2015, after the nine-month annual growth, point to a decline in the supply of foreign currency, amid further annual growth in the demand for foreign currency.**

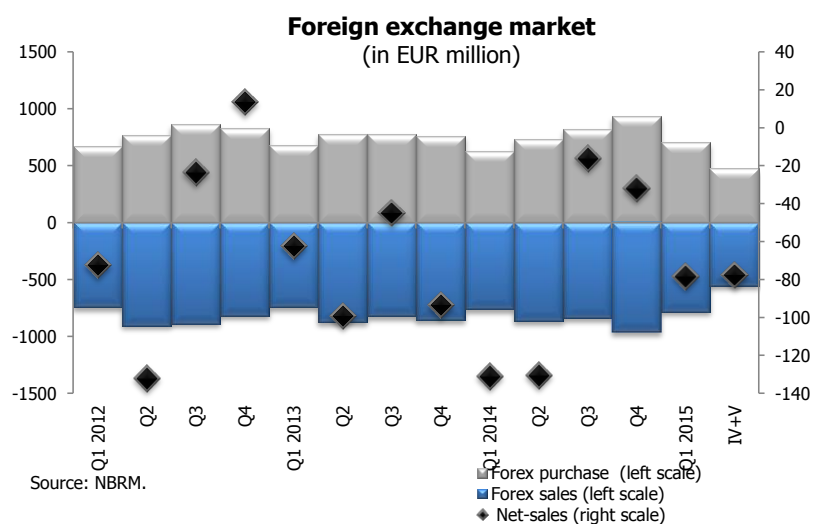
In the period April-May 2015, the net purchase in the foreign exchange market totaled Euro 150.7 million, which is an annual decline of 11.9%.

The latest information from the currency exchange market indicate that the performances could be slightly lower than the expected net inflows of private transfers in the second quarter of 2015, as projected in April.



**As of 31 May 2015, the gross foreign reserves stood at Euro 2,328.5 million, down by Euro 26.5 million compared to the end of the first quarter of 2015. The reduction of foreign reserves is mostly due to transactions for the government account, with the net purchase of foreign currency in the foreign exchange market by the NBRM acting in the opposite direction.**





In the period April-May 2015, the **foreign exchange market** of the banks realized net sales of Euro 77.4 million, representing an annual decline of 8.5%. This annual change is a result of the somewhat sharper decline in demand compared to the annual decline in the supply of foreign currency (of 6% and 5.6%, respectively).

The analysis by sector shows that these annual performances are mainly due to significantly lower net sales of companies.

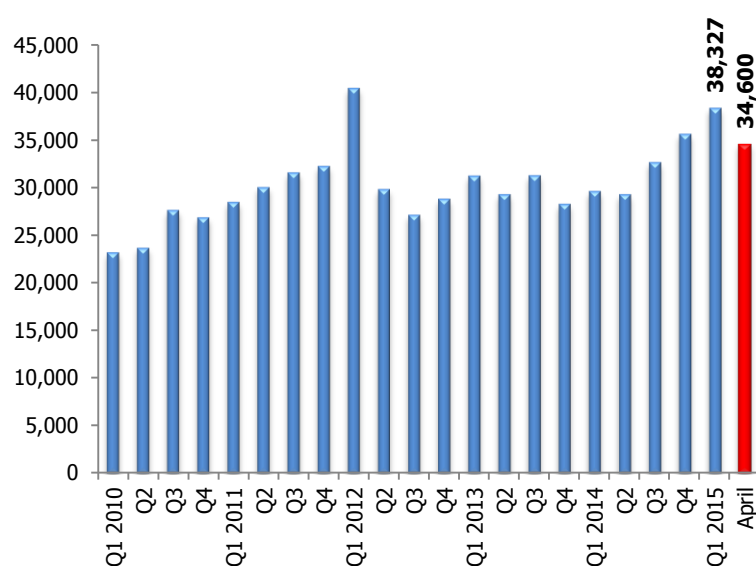
Data as of April point to creating liquidity through monetary instruments relative to the end of the first quarter, but in higher volume compared with that projected for the second quarter, according to the April projection.

Regarding the flows of creating and withdrawing liquidity (in terms of the balance sheet) in April, net foreign assets of the NBRM registered a moderate decline compared to March, which is within the projected reduction in the second quarter. On the other hand, total government deposits with the NBRM are higher compared to the level in the first quarter, which is fully a result of the monthly increase of Denar deposits with the NBRM. Such performances are contrary to the expected moderate reduction of total government deposits during the second quarter.

Consequently, the more intensive creation of liquidity through monetary instruments corresponds to the changes in government deposits, which in April were aimed at withdrawing liquidity versus creating liquidity projected for the second quarter.

According to the latest available data, in April slightly higher budget revenues<sup>8</sup> were registered compared with the realized monthly expenditures, so that after a longer period of time<sup>9</sup>, the Budget of the Republic of Macedonia registered a slight surplus of Denar 8 million. Since the beginning of 2015, the budget deficit amounted to Denar 6,293 million (or 1.1% of GDP<sup>10</sup>), representing 34% of the projected budget deficit for 2015. Despite the surplus realized in April, the Government borrowed in the domestic market through net issuance of government securities, most of which remained deposited in the deposit account with the NBRM.

**Monetary policy instruments, in MKD million**



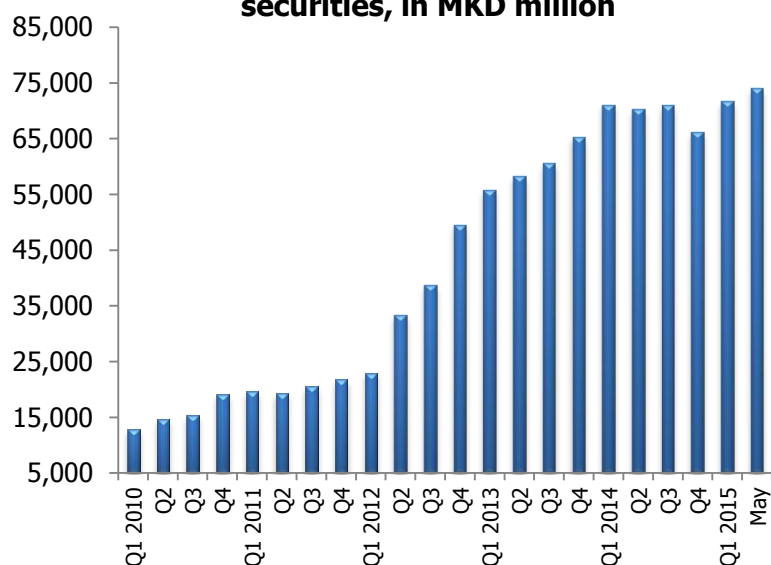
Source: NBRM.

<sup>8</sup> Since the beginning of 2015, improved performance on the revenue side of the budget compared to the previous year was registered, which is largely driven by increased revenues from profit tax due to the abolition of the anti-crisis measure, according to which retained earnings was not taxed.

<sup>9</sup> The last budget surplus on a monthly basis was registered in April 2013 (surplus of Denar 141 million).

<sup>10</sup> According to the latest NBRM projection for the nominal GDP. The Ministry of Finance's budget deficit projection also equals 1.1% of GDP.

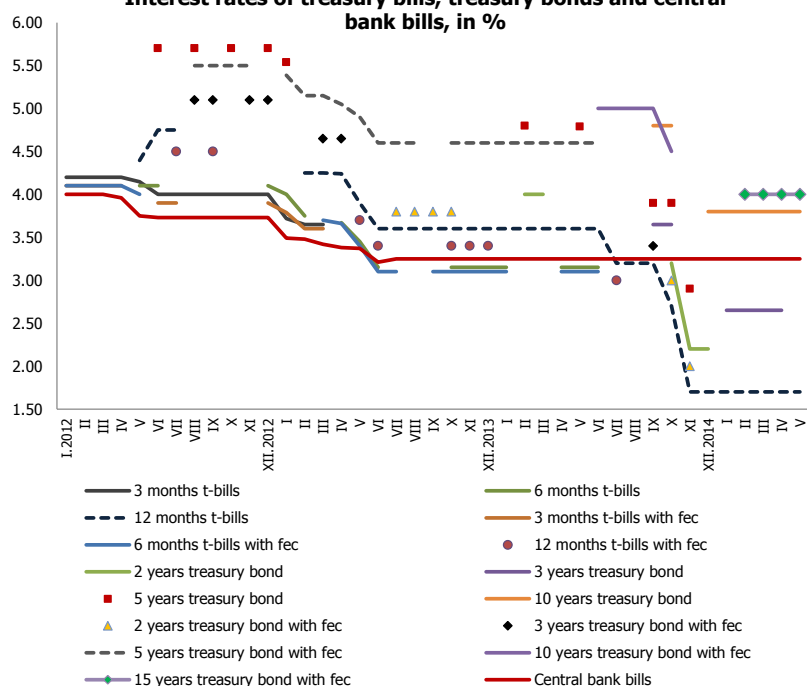
## Oustanding amount of Government securities, in MKD million



Source: NBRM.

The outstanding government securities on the domestic market as of May amounted to Denar 74,043 million, which is an increase of Denar 2,360 million compared with the end of the first quarter of 2015. On a cumulative basis, in the first five months of 2015, net issuance of government securities in the amount of Denar 7,881 million was made.

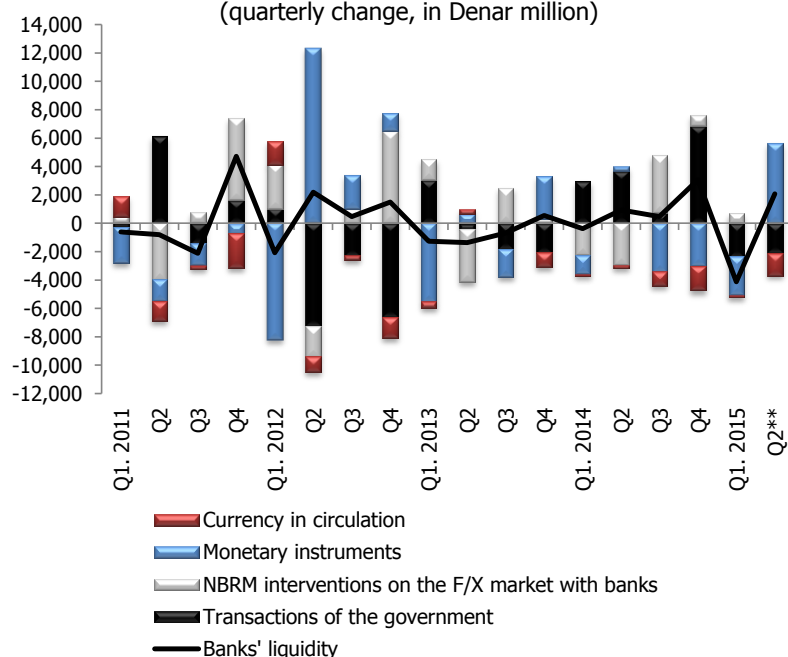
## Interest rates of treasury bills, treasury bonds and central bank bills, in %



Source: NBRM.

Interest rates on treasury bills offered at the auctions held in May amounted to 1.25% and 1.7% for 6-month and 12-month treasury bills, respectively. The government continued to borrow through government bonds, thus extending the maturity of the portfolio of government securities. Interest rates on government bonds ranged from 2.2% for the 2-year government bonds without foreign currency clause, 3.5% and 3.8% for the 10-year government bonds (with and without foreign currency clause, respectively) up to 4% for the 15-year government bonds with foreign currency clause. Interest rates on government securities issued in May remain unchanged compared with the auctions in the previous month.

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



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

\*\*Refers to April and May.

Source: NBRM.

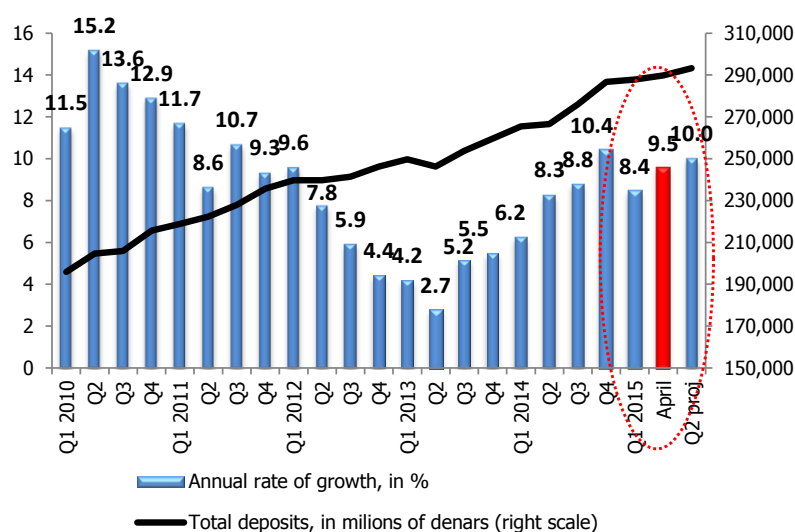
According to the data as of May, the liquidity of the banking system was for the most part created through monetary instruments, which was predominantly achieved through changes in the deposit facilities, and to a lesser extent by reducing the level of CB bills<sup>11</sup>. Government transactions made small contribution to creating liquidity, as a result of the registered decline in government Denar deposits with the NBRM. On the other hand, currency in circulation contributed to the withdrawal of liquidity. Foreign exchange transactions of the NBRM with the market makers had a neutral effect on liquidity. Against such background, in May the total liquidity increased on a monthly basis.

At the end of April, reserve money grew compared to the end of March, as a result of the simultaneous moderate increase in currency in circulation and total liquid assets of banks.

The realized growth represents about half of the projected increase in the second quarter, according to the April projection.

In April an increase in total deposits was registered, as opposed to their monthly decline in the previous month. The achieved growth was due mainly to the increase in corporate deposits, amid simultaneous growth of household deposits, but at a slower pace compared to the previous month.

**Total deposits**



\*Includes demand money

Source: NBRM.

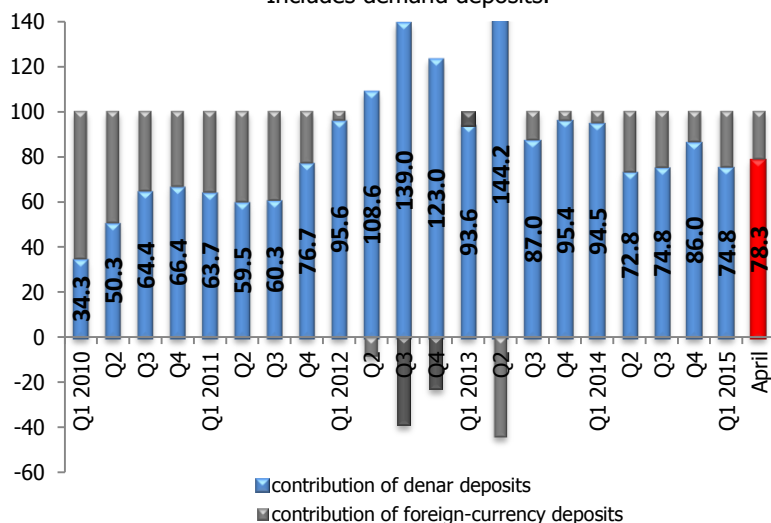
**At the end of April, the annual growth rate of total deposits equaled 9.5%, which is below the growth of 10% projected for the second quarter of 2015.** As of April, performances in total deposits were within the projection, with generated 36% of the projected quarterly growth in total deposits. However, one-month data are insufficient for drawing a conclusion on the likelihood of achieving the projected growth.

<sup>11</sup>At the auction held in May, the demand for CB bills was slightly lower than the amount offered (by Denar 107 million or 0.4%) whereby the CB bills amounted to Denar 25,393 million.



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

\*Includes demand deposits.

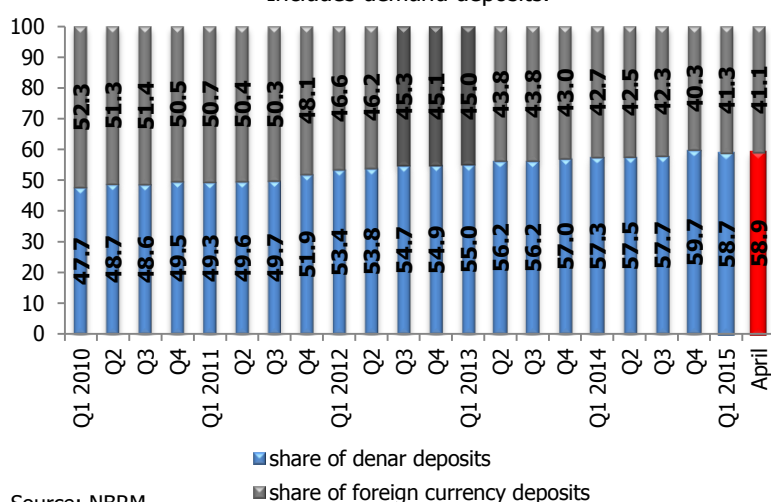


Source: NBRM.

The annual growth of total deposits still stems mainly from the increased denar deposits, amid moderate positive contribution of foreign currency deposits. The contribution of foreign currency deposits was moderately lower in April compared to March ...

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

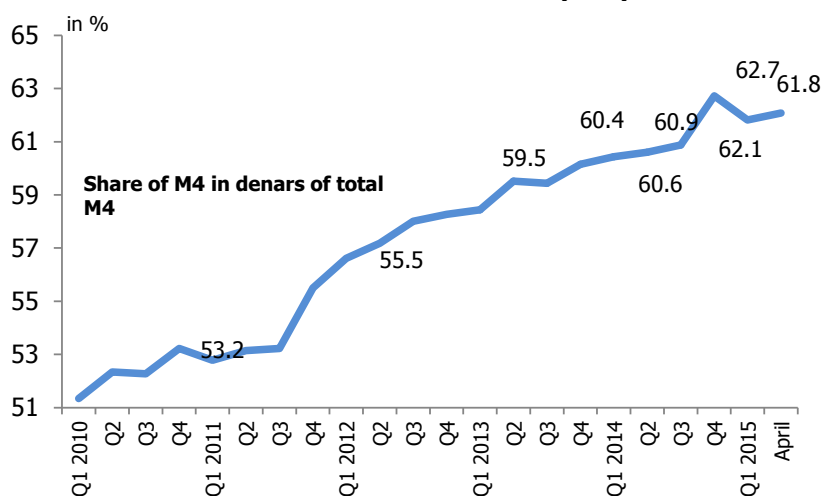
\*Includes demand deposits.



Source: NBRM.

...resulting in a slight decline in their share in total deposits.

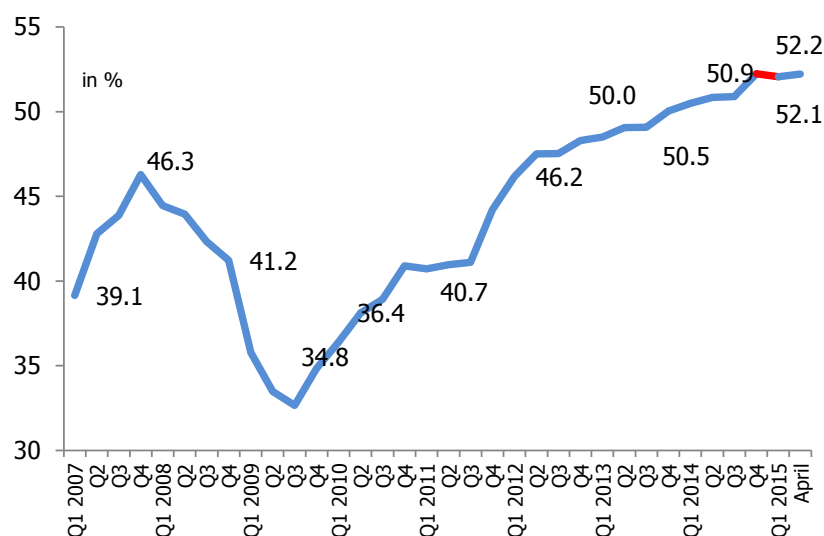
## Share of denar M4 in total M4 (in%)



Source: NBRM.

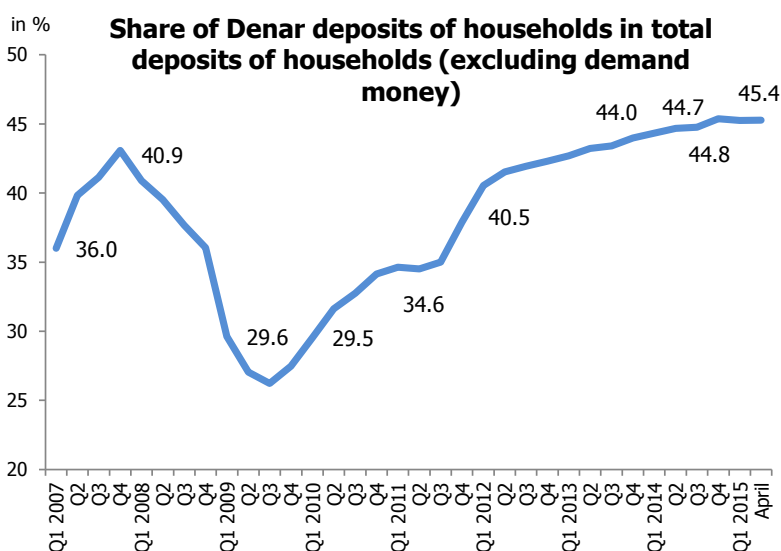
## Share of denar deposits in total household deposits, in %

\*Includes demand deposits.



Source: NBRM.

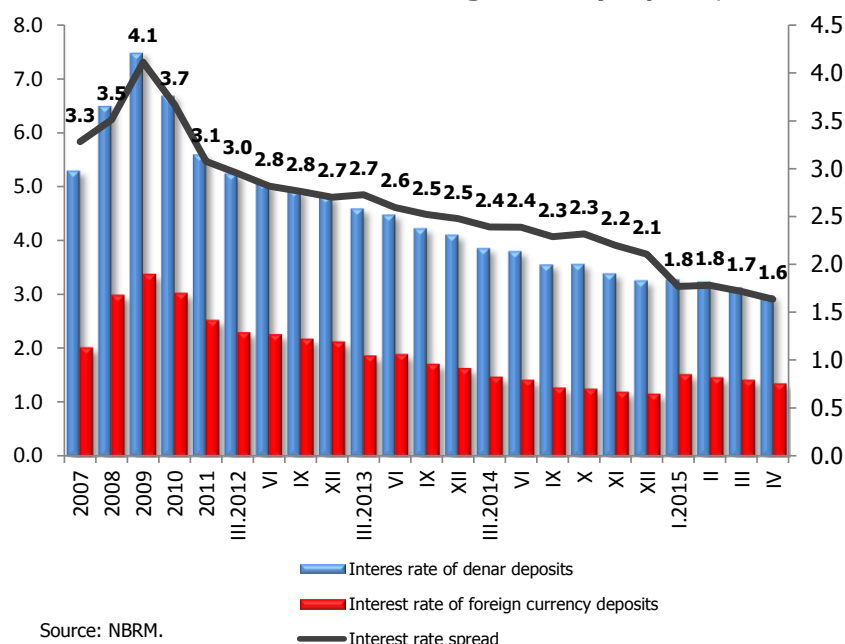
During April, monthly increase of total household deposits was registered, smaller compared to the increase in the previous month, which is entirely due to the increased savings in domestic currency amid a small decline in the foreign currency deposits. These developments have contributed to a small increase in the share of denar deposits in total household deposits (accounting for 52.2%).



Source: NBRM.

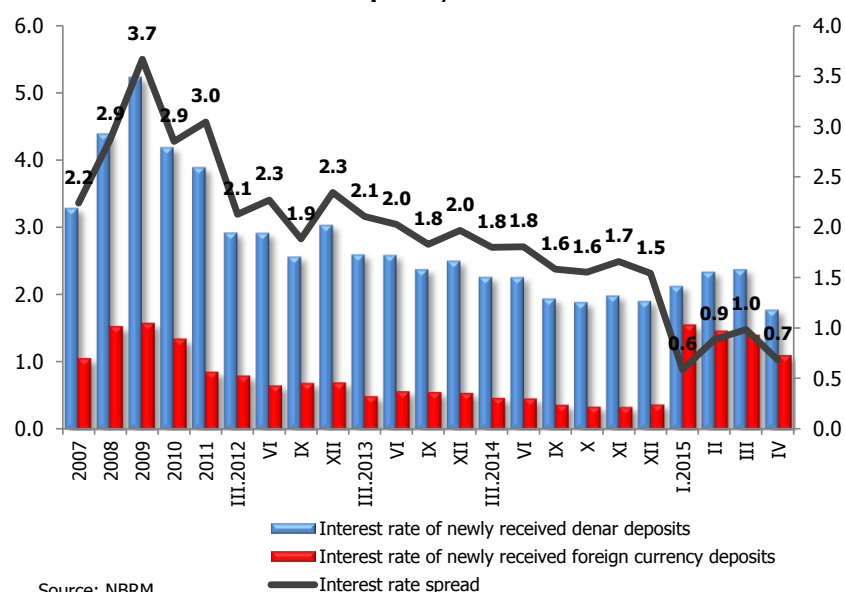
The analysis of total household deposits (excluding demand deposits) indicates a slight decrease on a monthly basis (of Denar 38 million), due to the reduction of foreign currency deposits, while the denar deposits registered a small increase (of Denar 8 million on a monthly basis).

**Interest rates on denar and foreign currency deposits, in %**



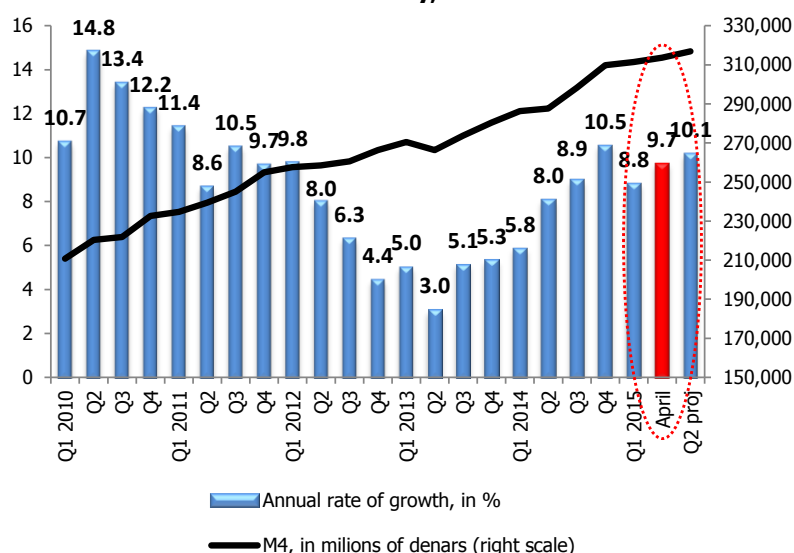
In April, the interest rate spread between denar and foreign currency deposit interest rates<sup>12</sup> recorded a slight decline compared to the previous month. This is due to the minimum reduction of denar interest rates, amid unchanged foreign currency interest rates. Newly accepted deposits registered a decrease in their interest rates on both denar and foreign currency deposits, with greater intensity in the denar deposits. These developments resulted in narrowing of the interest rate spread between them by 0.3 percentage points on a monthly basis. However, one should keep in mind that the interest rates on newly accepted deposits are characterized by volatile movements, given that they are driven by the volume of newly accepted deposits (which can vary from month to month) and their interest rate.

**Interest rates on newly accepted denar and foreign currency deposits, in %**



<sup>12</sup>As of January 2015, interest rate data of banks and savings houses have been collected under the new interest rate methodology, while data for the previous period were collected under the old methodology. For more detailed information see <http://www.nbrm.mk/default.asp?ItemID=29C1C73ED1A4B745B70EE9C3E423029A>.

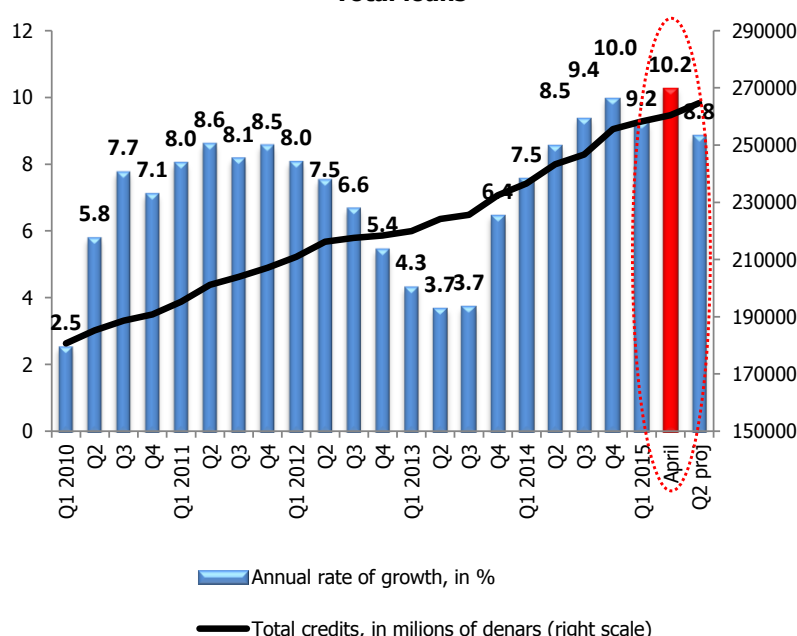
### Broad money, M4



Source: NBRM.

According to the data as of April, the broad money grew compared to the previous month mainly due to the increase in the deposit base and the moderate growth of currency in circulation. Thus in April, the annual growth rate of the broad money equaled 9.7%, which is below the projection for the second quarter of 2015 (projected annual growth of 10.1%). As of end-April, 42% of the projected quarterly growth in money supply was realized, whereby performances in M4 are within the projection so far. However, one-month data are insufficient for drawing a conclusion on the likelihood of achieving the projected growth of the broad money.

### Total loans

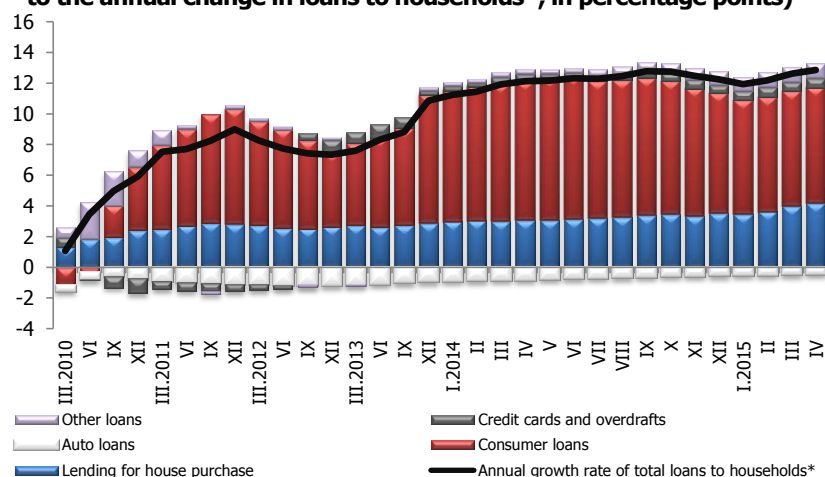


Source: NBRM.

Growth in total loans continued in April, with moderately lower intensity compared to the previous month. The increase in credit activity is mostly a result of the monthly growth of loans to households, amid simultaneous growth of loans extended to companies. Moreover, both sectors recorded slower credit growth compared to the previous month, with greater intensity in corporate loans.

**At the end of April, the annual growth rate of total loans equaled 10.2%, which is above the annual growth of 8.8% projected for the second quarter of 2015.** As of April, 33% of the quarterly credit growth projected for the second quarter was realized. However, as with deposits, data on loans are also limited, which prevents us from drawing reliable conclusions about the pace of credit growth relative to the projection.

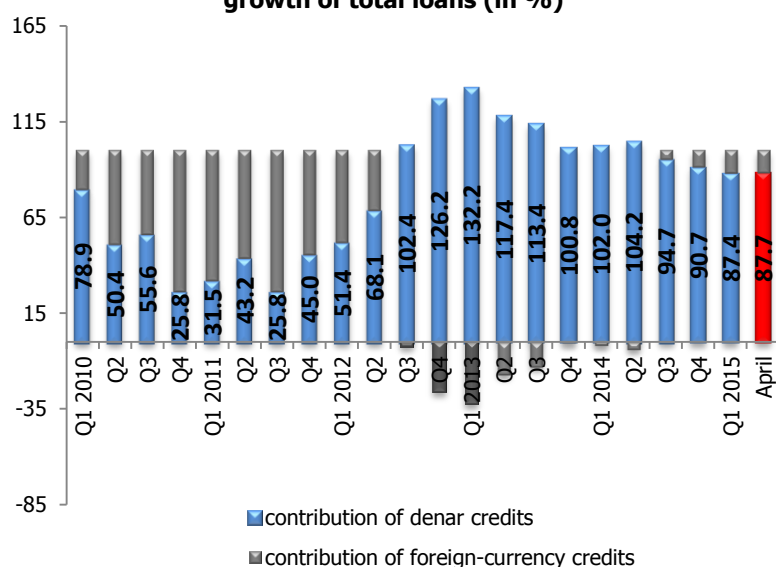
**Loans of banks and savings houses extended to households (contribution to the annual change in loans to households\*, in percentage points)**



\*Total loans to households do not include loans to self-employed individuals.

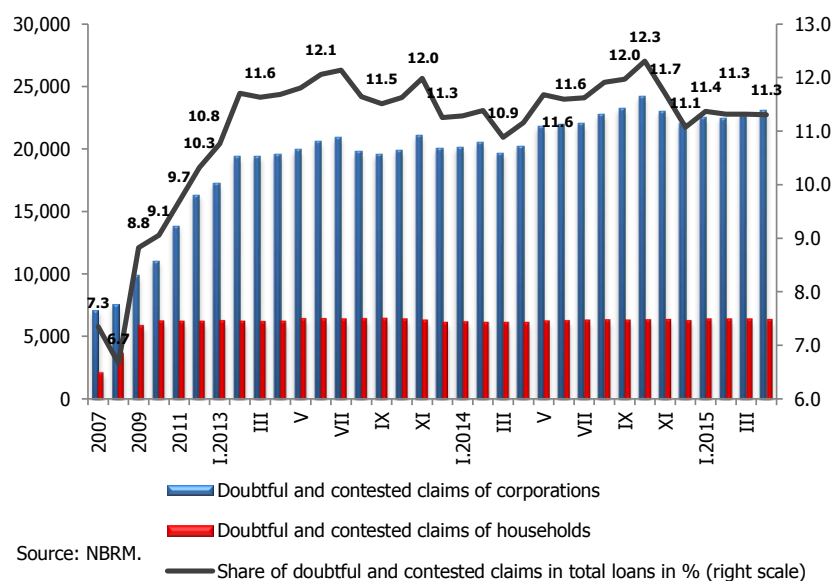
Source: NBRM.

**Contribution of denar and foreign currency loans to the annual growth of total loans (in %)**



Source: NBRM.

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

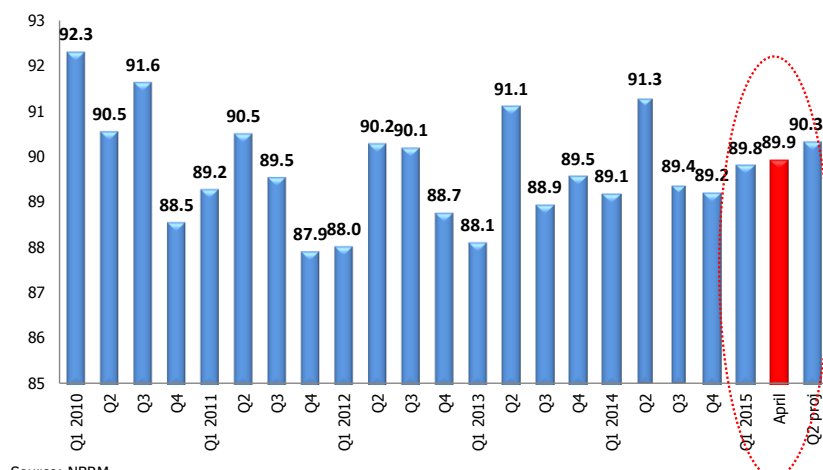


Source: NBRM.

The annual growth of total loans still mostly results from the growth of denar loans, amid moderate positive contribution of foreign currency loans.

In April, doubtful and contested claims continued to grow moderately, but with lower intensity compared to the previous month. The growth is entirely due to the increase of doubtful and contested corporate claims, with a monthly decline in such claims on households. In such conditions and amid registered growth of the overall lending activity, the share of doubtful and contested claims in total loans remained at the same level as in the previous month (11.3%). On an annual basis, total non-performing loans further increased, at a slower pace compared to the previous month.

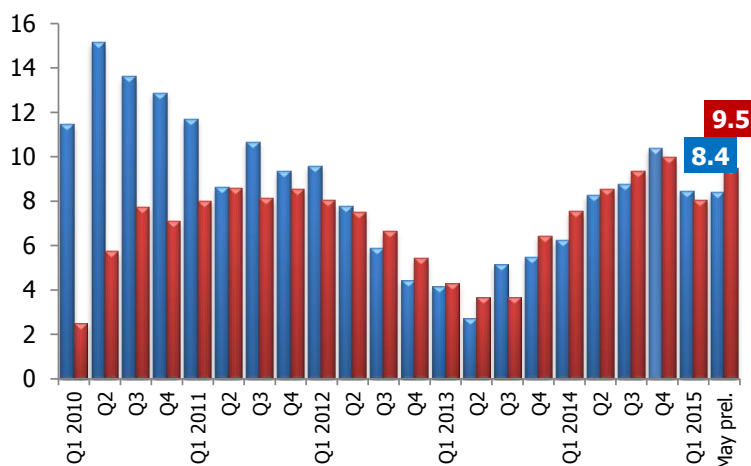
Loan-deposit ratio, in %



Source: NBRM.

The utilization of deposit potential for lending to the private sector at the end of April remained at a stable level relative to the previous month (minimum increase of 0.1 percentage point), amid growth of both components.

Total loans and deposits, annual changes, in %



Source: NBRM.

■ Total deposits

■ Total loans

Preliminary ten-day data as of May 2015 show a decline in total deposits of 1% on a monthly basis (versus the increase registered in the previous month of 0.7%), amid registered decline in both corporate and household deposits. In the corporate sector, the decline in total deposits partly reflects the effect of the payment of dividend by one large domestic company to the government and the foreign investor, resulting in outflows of deposits from the accounts of companies with the banking sector. In May, household deposits decreased on a monthly basis by 0.6%, which comes after the growth of 0.3% registered in the previous month. The reduction is mostly driven by the fall in the denar deposits (contribution of 70%) amid registered decrease also of foreign currency deposits. In total loans, preliminary data as of May show growth of 1% on a monthly basis, which is a moderate acceleration of growth compared to the previous month (0.8%). The increase in total loans in May is mostly driven by the increased lending to households (contribution of 76%), amid registered growth also of the loans to the corporate sector, but with a slightly weaker intensity compared to the previous month. **On an annual basis, total deposits in May grew by 8.4%, while the annual growth of total loans was 9.5%.**

## **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 - 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% 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 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 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 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<sup>13</sup>, 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.

<sup>13</sup>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.