

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



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

September 2014

Recent Macroeconomic Indicators

Review of the Current Situation - Implications for the Monetary Policy

The review of the current situation aims to give an overview of the recent macroeconomic data (June- August 2014) and to make a comparison with the latest macroeconomic projections (April 2014). This will determine the extent to which the current situation in the economy corresponds to the expected movements of the variables in the previous cycle projections. The review focuses on the changes in external assumptions and performance with domestic variables and the effect of these changes on the environment for monetary policy conduct.

The global economic environment has not undergone major changes compared to the period of the last assessments. After the stagnation of the economy in the second quarter, the high frequency economic indicators for the euro area do not give encouraging signals for resuming economic recovery in the third quarter. ECB has made downward revision of its growth projections for 2014 and 2015, and it further assesses the risks regarding the future economic outlook sees as largely downward. Inflation data for August point to further slowdown in price growth (annual growth of 0.3%). Along with the downward movements of the indicators for inflation expectations, such developments further strengthen the risk of deflation. In such circumstances, at its September meeting, the ECB cut its key interest rate and the interest rates on standing credits and deposits by 0.1 percentage points, and it also started a program for purchasing assets of the non-financial private sector, i.e. purchasing asset-backed securities (ABSs)¹. Also, the ECB introduced a new program for purchasing bonds, the so-called Covered bond purchase programme (CBPP3)², thus further increasing the degree of monetary accommodation. **Observed from a viewpoint of the individual quantitative external environment indicators for the Macedonian economy, the assessments for the foreign effective demand for the period 2014-2015 remain almost unchanged relative to the April projection. Changes in the expectations about the prices of primary commodities move in different direction.** Latest developments and assessments for the world oil prices further indicate lower price levels of this fuel in relation to the April expectations, and thus less pressure on inflation and terms of trade. The latest assessments for the metal prices point to more favorable developments in the terms of trade for this export sector than projected in April. This movement is especially pronounced in the nickel prices, which is mainly associated with the factors on the supply side. Regarding the food prices, recent data on the prices of cereals show their significant decline, indicating notably lower import pressures through this channel on domestic inflation and terms of trade, compared with the April projections. However, it should be borne in mind that the presence of geopolitical tensions in the world, which further boosted last month with the stronger political tensions between Russia and the USA/EU and the introduction of trade barriers and economic sanctions, creates great uncertainty about the future movements of prices primary products.

The comparison of latest macroeconomic indicators with their projected dynamics within the April cycle projections does not indicate larger deviation. In terms of the individual indicators relevant for the monetary policy, in the absence of new data on inflation, the conclusions for this indicator presented in the previous assessment remain valid. The data on inflation in July 2014 pointed to a slightly lower rate of inflation relative to the expected with the April projection, but also a narrowing of the gap between the realized and projected inflation. The prices of food and energy component of prices generally moved within the projections, while the pressures through core inflation were lower than projected. Lower baseline conditions and estimates for the lower pressures from import prices than previously expected, pointed to downward risks to the inflation projection for 2014. On the other hand, there are still upward risks regarding the prices of energy and food (related to the

¹ It is a Program for purchasing a wide and simple portfolio of securities collateralised by assets, consisting of claims on the non-financial sector in the eurozone within the ABS purchase program.

² Purchase of collateralised bonds denominated in euros and issued by monetary and financial institutions, whose domicile is the eurozone.

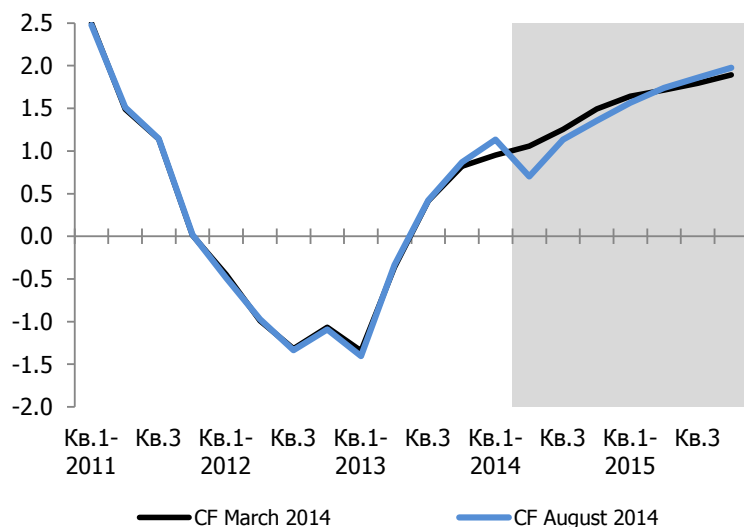
geopolitical tensions in Iraq, re-emerging of the Russian-Ukrainian conflict, and possible effects of the flooding in the region). We further assess that downward risks are predominant in the balance of risks regarding the projected movement of prices, although they are less pronounced compared to the previous period.

According to the latest available data for the third quarter of 2014, foreign reserves (adjusted for the price and exchange rate differences and price changes of securities) increased at a faster pace than projected in April. Most of this increase is due to the government borrowing on the international market, which was not included as an assumption in the projections for 2014. Excluding the effect of the government borrowing, foreign reserves registered a moderate growth, given the favorable movements in the foreign exchange market and the purchase of foreign currency. The number of available external sector indicators for the external sector is still limited, making it impossible to identify accurately the factors of changes in foreign reserves. From the indicators of the external sector, available are the data on the net purchase from currency exchange operations, which now point to somewhat higher net inflows from private transfers. On the other hand, data on foreign trade as of July give an indication of somewhat bigger trade deficit for the third quarter than expected. However, the evaluation period is very short and therefore reliable conclusions in this domain cannot be drawn. The analysis of foreign reserves adequacy indicators shows that they continue to move in a safe zone.

Signals that the new high frequency indicators for the economic activity send for the second quarter are favorable and consistent with current assessments. They suggest maintaining of the positive trends, and in certain key sectors (industry and trade) it is likely that the performance will be better compared to the first quarter. On the other hand after seven quarters of fast annual growth, in the second quarter of 2014 the value of performed construction work is reduced. Within the monetary sector, the final data on the credit market as of July 2014 indicate retaining of the solid annual growth of the credit flows. The annual growth rate of loans reached 8.4% (versus 7.3% projected for the end of the second quarter), with stabilization of the risk perceptions. The level of loans in July is close to the projected for the end of the third quarter. However, in terms of the growth in the previous two months, the monthly pace of credit growth in July slowed significantly, and the preliminary data for August suggest the retention of such a moderate pace of growth. Savings growth in July was slower than projected, but preliminary data for August point to solid growth in deposits and a possible narrowing of the gap relative to the projection. The latest assessments of EURIBOR indicate its lower level for 2014 relative to that projected in April, with significant downward revision of the expectations for 2015.

The latest macroeconomic indicators and estimates do not indicate major changes in the environment and risks perceptions compared to the assumptions provided in the April projections. Foreign reserves rose (without the government leveraging effect) and followed the projected path for the third quarter. Analyzing the indicators of foreign reserves adequacy, they continue to move in a safe zone. The risks from the external environment remain unfavorable and are further highlighted by the weaker than expected economic performance of the eurozone and the persistent geopolitical tensions. Inflation in July deviates from the projected path and suggests price pressures lower than expected. The risks around the inflation projection are still assessed as predominantly downward. However, upward risks were identified, associated with domestic and external factors, which could cause instability and major price shocks that could, in turn, influence the future inflation. Divergence in inflation is further explained by the variance in the factors on the supply side, amid assessments for movement in the demand within the expected range. Economic activity indicators suggest that the economy will continue to grow also during the second quarter of 2014, as expected. New credit flows are solid, making the total credits exceed projections. Thus, the downward risks regarding the projection are less pronounced, but still present.

Foreign effective demand (annual rates of change in %)



Source: Consensus Forecast and NBRM calculations.

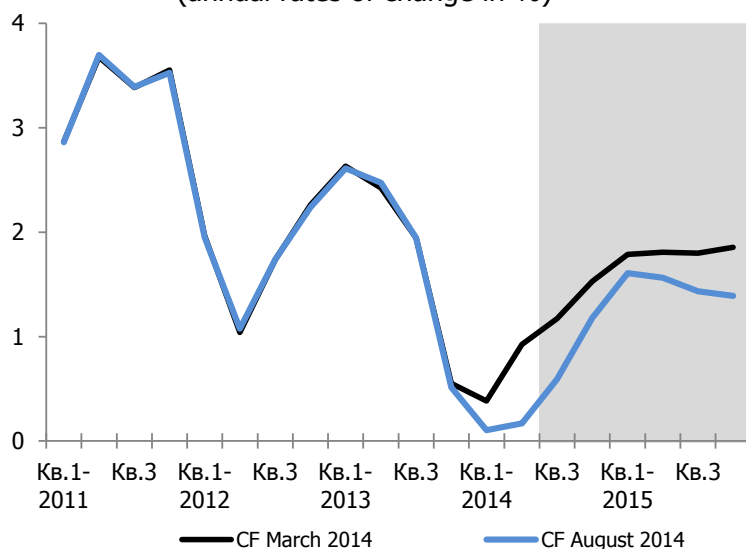
The latest assessment of the foreign effective demand for 2014 remained almost unchanged compared to the last projection...

...i.e., it is estimated that growth would be 1.1% (versus 1.2% in April) ...

... in conditions of downward revisions to the expected growth in part of the trading partners, with the largest downward revision being made in Serbia, which is explained by the negative effects of the bad weather conditions and with the intensified fiscal consolidation.

For 2015, as in the April projection, moderate acceleration of growth to 1.8% is expected.

Foreign effective inflation (annual rates of change in %)



Source: Consensus Forecast and NBRM calculations.

The latest assessment of the foreign effective inflation for 2014 is significantly lower compared to the last projection...

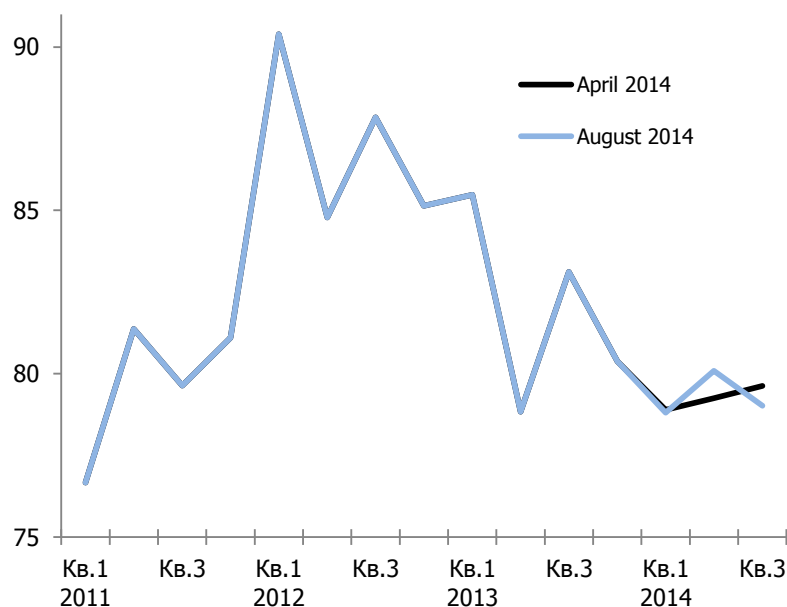
...i.e. currently, foreign prices are expected to increase by 0.5%, instead of 1% as projected in April.

The lower estimate results from the downward revisions of expected inflation rates for all trading partners...

... with the revisions in Bulgaria having the greatest contribution, where a decline rather than growth in the prices is expected, and in Germany, where lower price growth than projected in April is expected.

According to the latest assessment of foreign inflation for 2015, lower growth of 1.5% is expected, versus 1.8% in the April projection.

Brent oil
(quarterly average, EUR/Barrel)



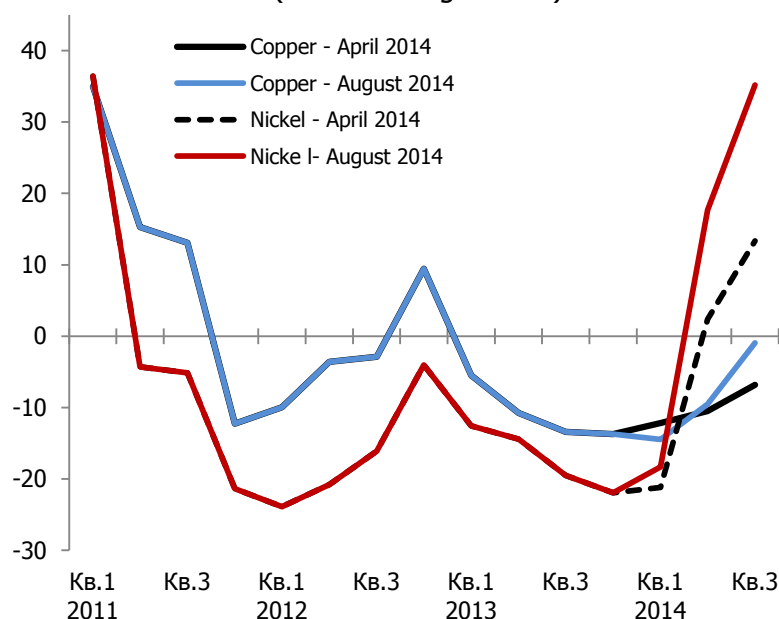
Source: IMF, Bloomberg and NBRM calculations.

In the first month of the third quarter of 2014, the price of crude oil was minimally lower, on average, compared with the April projection for the third quarter ...

... i.e., the average oil price was 79 Euros per barrel, versus the April projection of 79.6 Euros per barrel for the same period. The reduction in cost is mainly explained by the sufficient oil supply, in conditions of a reduced demand³.

In terms of future trends, significant upward pressure on oil prices are not expected⁴

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



Source: IMF, Bloomberg and NBRM calculations.

The latest prices of copper and nickel in the first month of the third quarter of the year are higher compared with the April projection.

Thus, the price of copper dropped by 0.9% (versus the projected decline of 6.8% for the entire quarter in April) mainly reflecting the increased demand from China and the United States...

... while the price of nickel registered a significantly higher growth of 35.2% (versus 13.3% projected in April), which is mainly explained by the introduced ban on the export of nickel from Indonesia⁵

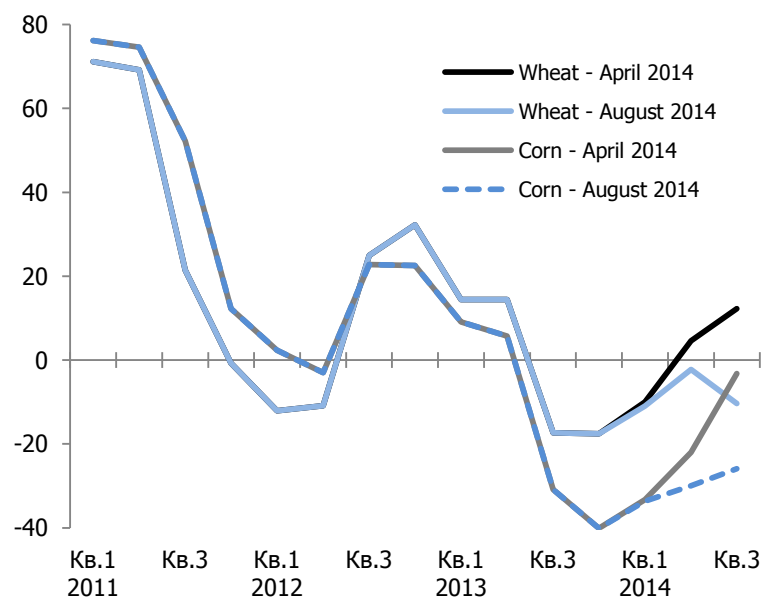
³ <http://www.imf.org/external/np/res/commmod/pdf/monthly/080114.pdf>

⁴ www.eia.gov/forecasts/steo/uncertainty/index.cfm

⁵ OPEC Monthly Oil Market Report, June 2014.

http://www.opec.org/opec_web/static_files_project/media/downloads/publications/momrjuly2014.pdf

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



Source: IMF, Bloomberg and NBRM calculations.

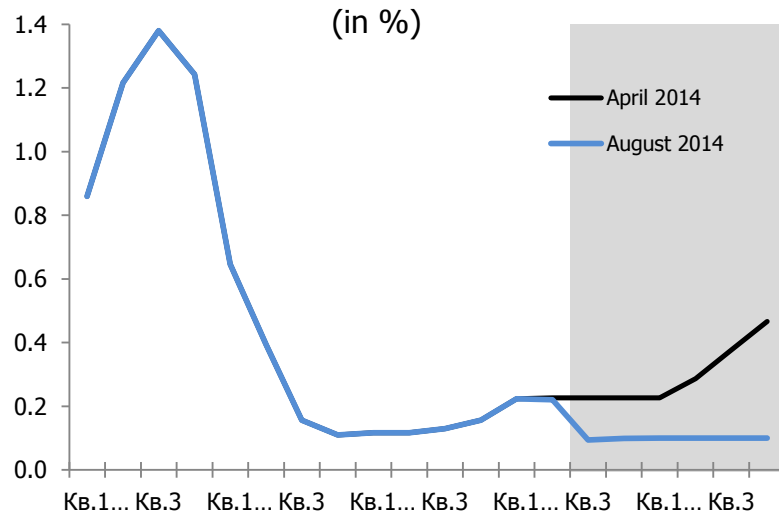
Prices of wheat products in the first month of the third quarter of 2014 are lower compared to the April expectations.

The price of wheat in the first month of the third quarter was lower by 10.3%, versus the expectations for a fast growth of 12.2% in the April projection, due to increased yields worldwide...

... while the price of corn fell by 25.9%, versus the expected small decline of 3.2% in April that is attributed to the very favorable conditions in the United States and the expectations for record high yields of the autumn harvest and growth of the global stocks of corn⁶

In the next period no significant upward pressures on prices of grains are expected, as a result of the favorable weather conditions in Europe and the United States and the improved prospects for the autumn harvest on that basis. Additionally, the impact of the geopolitical tensions in Ukraine on grain production in the Black Sea region are assessed as insignificant⁷.

1M Euribor
(in %)



Latest expectations for the movement of the short-term interest rate EURIBOR in 2014 have been revised downwards compared with the April projection...

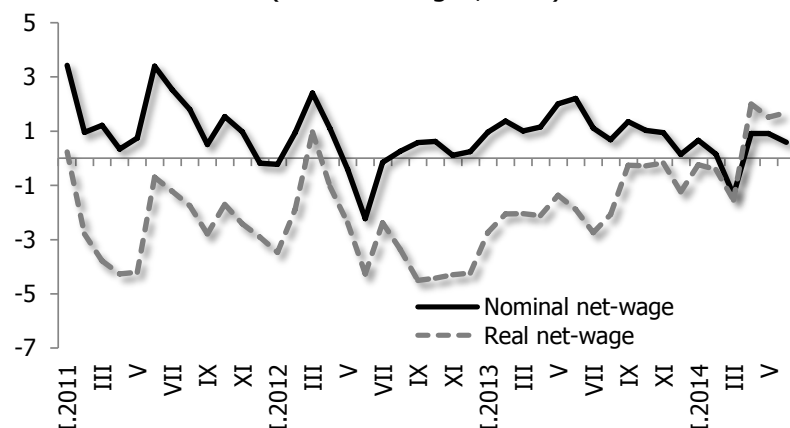
...where it is estimated that the one-month EURIBOR will average 0.16% (versus 0.23% in the April projection)...

The latest estimates for 2015 indicate a further cut of EURIBOR, and predict an average level of 0.1% (versus 0.34% in April).

⁶ <http://www.imf.org/external/np/res/commmod/pdf/monthly/080114.pdf>

⁷ http://www.opec.org/opec_web/static_files_project/media/downloads/publications/MOMR_August_2014.pdf

Average net-wage
(annual changes, in %)



Source: SSO.

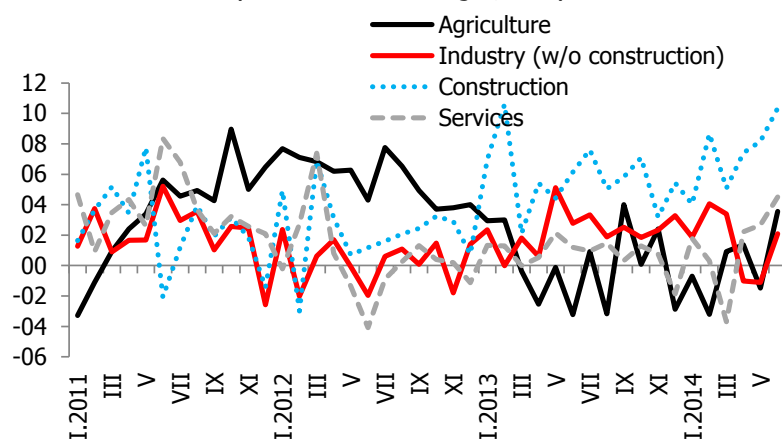
The average net wage in June 2014 recorded a nominal annual growth of 0.6%, which is a minor deceleration compared to the previous month...

..amid paid higher salaries in most of the activities.

A more significant wage growth was observed in construction and service industries, i.e. activities related to real estate, "professional, scientific and technical activities" and in financial activities ...

... while a wage decline was registered only in two sectors - hospitality and public administration.

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



Source: SSO.

Wage growth in the second quarter was 0.8%, which corresponds with the April projection (expected growth of 1.0%).

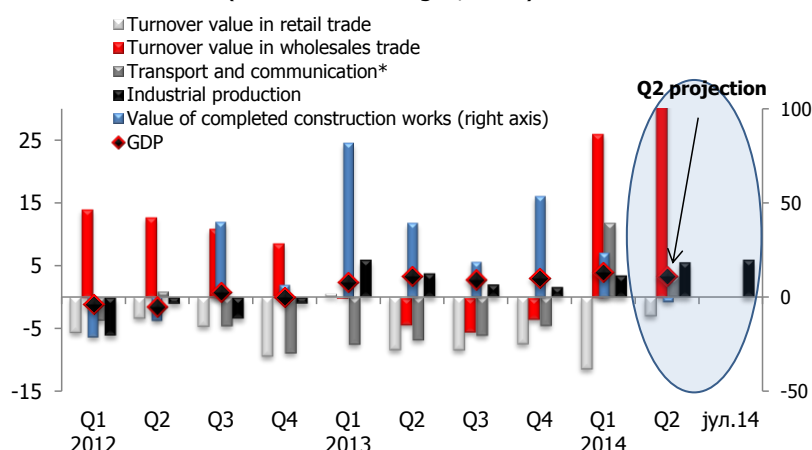
Amid negative annual change in consumer prices of 1.1%, the growth of real wages continued in June, when they recorded an annual growth to 1.7% (1.5% in May).

The available data for the second quarter of 2014 indicate further annual growth of the national economy, given the constant positive performance in the key economic sectors.

Industrial production continued to grow in the second quarter, at a relatively high annual rate of 5.5%...

...due to the increased production of machinery and equipment, motor vehicles, rubber products and plastic products, and electrical equipment, which largely reflects the growing production of the facilities in the technological industrial development zones...

Economic activities (real annual changes, in %)



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

Favorable developments can be observed in the trade sector, which has registered rapid growth in the second quarter, entirely derived from the growth in wholesale trade, while retail trade continued to decline, although the decline was significantly lower compared to the first quarter.

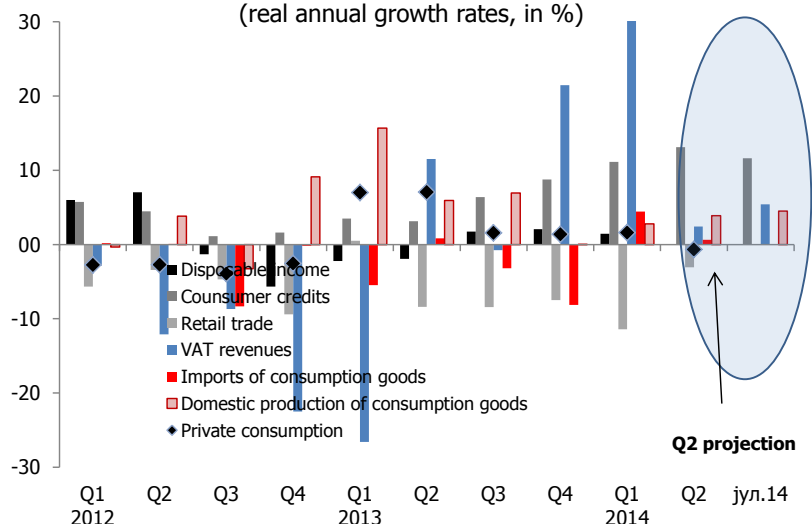
Positive are also the movements in the hotel and restaurants sector turnover, which also registered a moderate acceleration of the annual growth ...

... as in transport, where the growth reflects the increased road and air traffic.

On the other hand, after the intensive growth of construction in the previous seven quarters, in the second quarter of the year there was a small annual decline in the construction activity.

Available indicators of aggregate demand also point to economic growth in the second quarter of 2014, which is consistent with the expectation in the April projection.

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



Source: SSO and NBRM calculations.

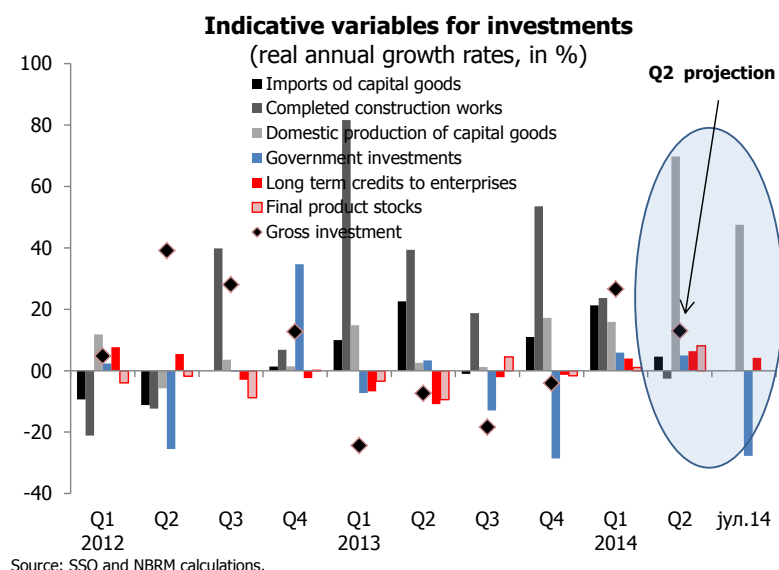
Indicators of private consumption are favorable and indicate its increase in the second quarter...

...as a result of the intensified lending to the household sector ...

...continuing growth of pensions (although at a slower pace), and growth in real wages and private transfers (as opposed to their decline in the previous quarter) ...

...and positive performances have also been noticed in the domestic production and import of consumer goods and in the net revenues from VAT.

...on the other hand, the negative trends in retail trade continued also during the second quarter, but with a significant slowdown in the pace of decline compared with the previous quarter.



Recent indicators of investment activity point to investment growth in the second quarter ...

...amid accelerated growth of the domestic production of capital goods and long-term lending to the domestic corporate sector ...

... moderate growth in the imports of investment goods ...

... and higher government expenditures for capital investment.

However, investment growth is likely to slow down compared to the previous quarter ...

...amid realized decline in the construction activity and lower inflows of foreign direct investment.

After the expansion in the first quarter, the nominal foreign trade data show deficit reduction in the second quarter, compared to the same period last year...

... which is in line with the expectations in the April projection for nominal narrowing of the trade balance.

Budget performances for the second quarter point to higher public spending, as projected in April...

...given the higher transfers for health care⁸ and wage expenditures on an annual basis.

Data for July 2014 suggest continued growth in the economic activity.

Industrial production rises by 5.9%, which represents a moderate acceleration of growth in line with the increased capacity utilization in the manufacturing industry⁹...

⁸ Most of these assets relate to expenditures for goods and services.

⁹ SSO's Business Tendency Survey in manufacturing industry.

...under the influence of the increased production of food products and metals, as well as production of the facilities in the technological-industrial development zones (mainly in the production of motor vehicles and electrical equipment) ...

...while a more significant decline in the production was recorded in mining and in the pharmaceutical sector.

High frequency data on private consumption in July, suggest a continuation of the favorable trends also in the third quarter of 2014 ...

...amid growth in the household lending and pensions, as well as higher production of consumer goods, although the pace of growth in all three indicators slows down.

Indicators of investments in July point to growth in the third quarter ...

...amid growth in the domestic production of capital goods, although significantly slower than in the previous month ...

...and moderate growth in corporate loans ...

...while government capital investment declined in July.

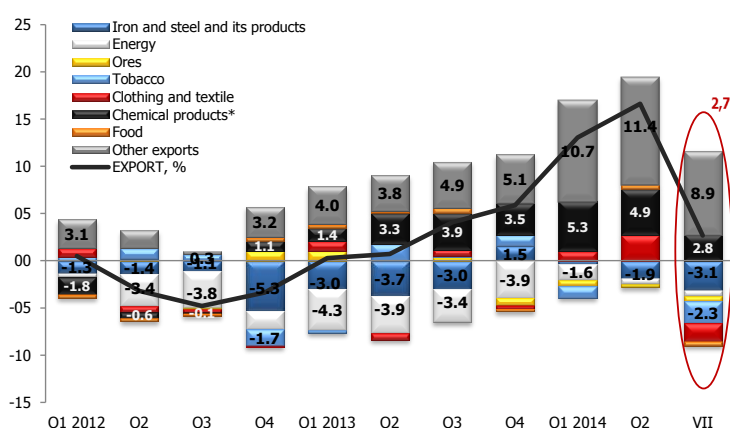
Data on foreign trade for July 2014 indicate expanding deficit, with higher growth of imports compared to exports of goods.

The realization of the budget as of July indicates a drop in public consumption as a result of the reduced transfers for health care¹⁰ and of the expenditures for goods and services on annual basis.

¹⁰ Most of these assets relate to expenditures for goods and services.

EXTERNAL SECTOR

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



Source: NBRM.

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

The faster annual growth of imports of goods relative to the export growth contributed to an expansion of the negative balance of foreign trade in July by 29.1% on an annual basis ...

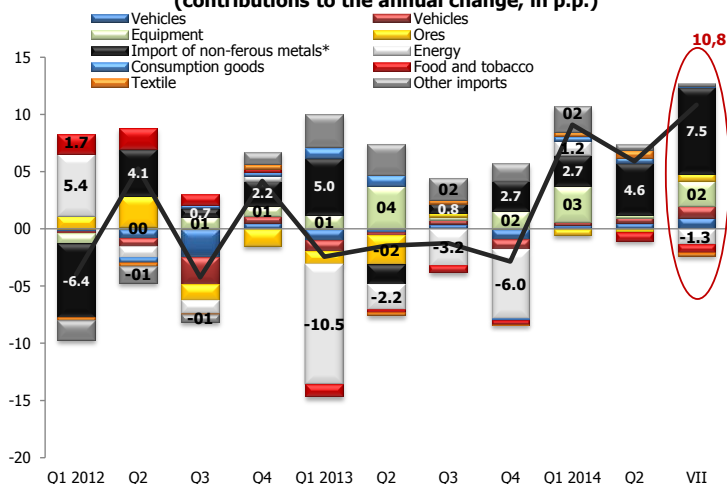
...contrary to the assessments in the April projection, which envisage more moderate expansion of the trade deficit in the third quarter.

In the second quarter, the exports of goods registered an annual growth of 2.7%, which was mostly due to the intensified export activity of the new export-oriented industrial capacities.

...while all other categories had a negative contribution, especially the decline in exports of iron and steel, as well as the lower exports of tobacco and clothing and textiles.

Compared with the April projection for the third quarter of 2014, exports in July were within expectations. Better performance relative to the projection were registered in the other exports (in part of the new production facilities), exports of clothing and textiles, tobacco and energy. In the other categories, the actual export was slightly lower than expected.

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



Source: NBRM.

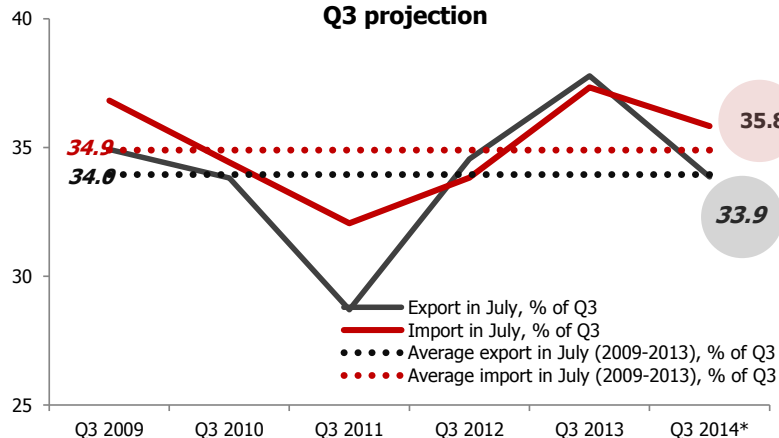
* The following data depict the overall exports of one major export capacity in the free industrial zone.

In the second quarter, imports of goods registered an annual growth rate of 10.8%, primarily driven by the increased import of raw materials for the new export capacities. Also, imports of iron and steel, vehicles and ores has a positive contribution to the annual growth ...

...while small annual decline or stagnation is registered in all other components of imports.

The import is slightly higher than expected for the third quarter. Analyzed by different import categories, the largest upward deviation was registered in the import of raw materials for the new facilities, imports of vehicles, energy and mining, while almost all other components are in line with projections.

Share of the export and import in July compared to Q3 projection



Source: NBRM.

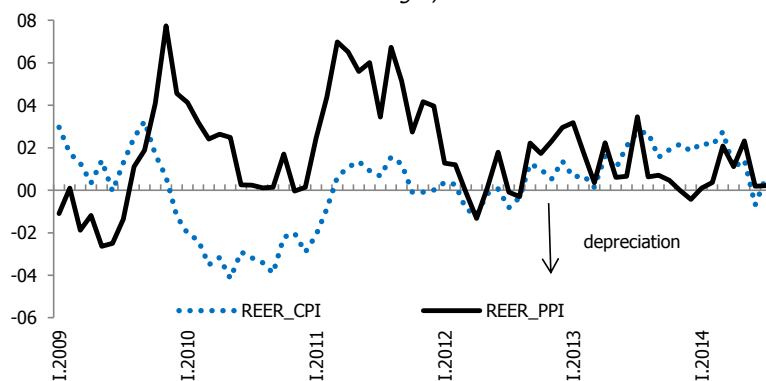
* Share of the export/import in July in the projected export/import for Q3 2014, projection April 2014.

Movements in exports and imports of goods point to somewhat larger trade deficit in July, compared to that projected for the third quarter of the year.

However, one should bear in mind that the data pertain to a very short period, insufficient for reliable conclusions.

The fact that the upward deviation in imports is driven by the import of raw materials for the new facilities, intended for export, indicates a possible temporary deviation of the deficit.

REER
annual changes, in %

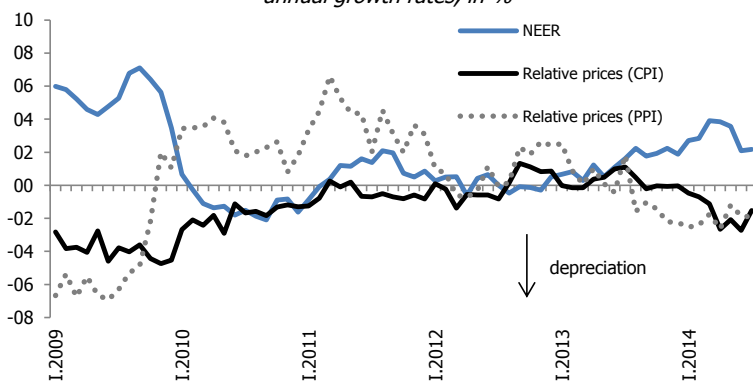


Source: NBRM.

In July 2014, a slight deterioration in the indicators of price competitiveness of the local economy on annual basis was registered.

Compared to the same month last year, both indices show small rates of appreciation. The REER deflated by consumer prices appreciated by 0.6% on an annual basis, while the REER deflated by producer prices appreciated by 0.2%.

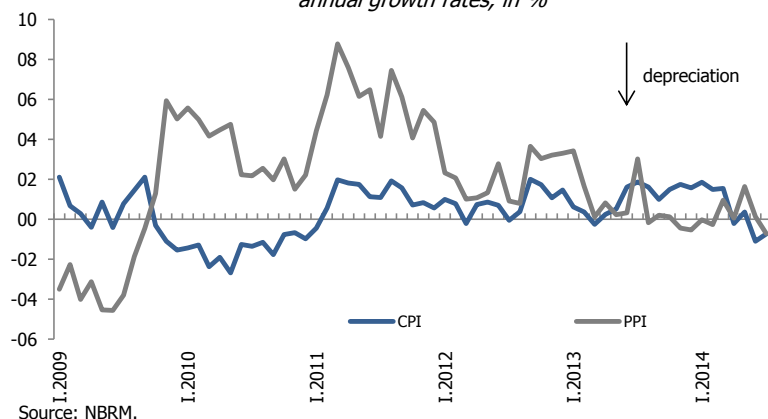
NEER and relative prices
annual growth rates, in %



Source: NBRM.

The annual appreciation of the nominal effective exchange rate (by 2.2%) caused upward pressures on REER, caused by the rapid depreciation of the Ukrainian hryvnia, Russian ruble and Turkish lira against the denar. On the other hand, the larger annual growth of foreign over domestic costs of living, and the growth of foreign versus the fall in domestic prices of industrial products, has led to a decline in relative prices by 1.5% and 1.9%, respectively.

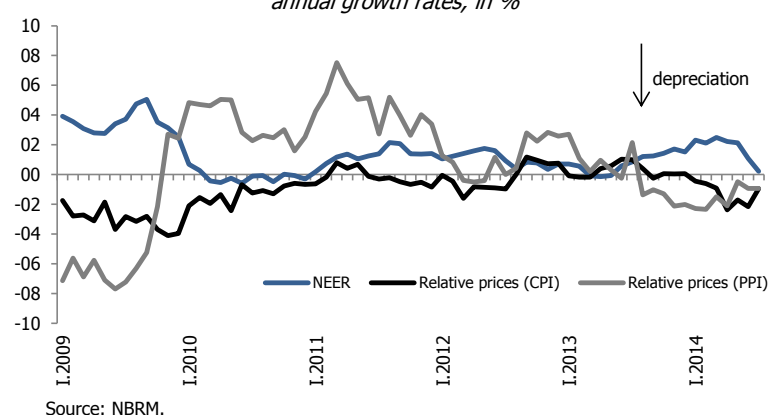
REER, excluding primary commodities
annual growth rates, in %



On the other hand, the analysis of the movement of the REER indices calculated with weights based on the foreign trade without primary commodities¹¹, indicates positive changes in the domestic price competitiveness.

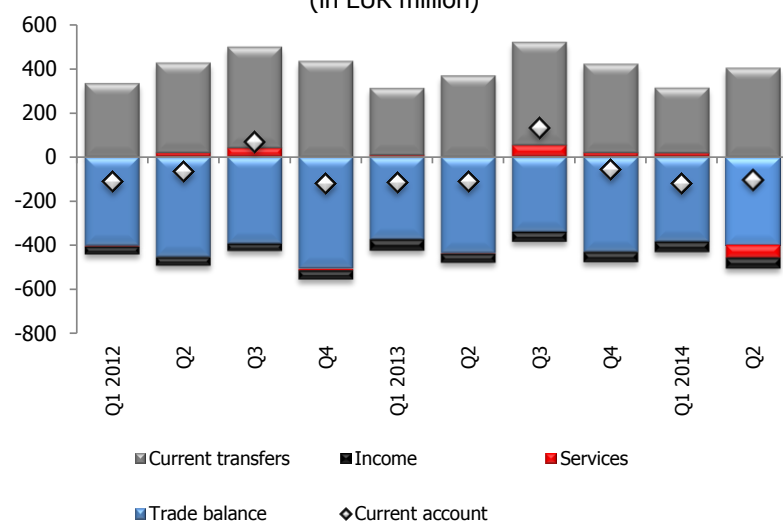
In July both, REER indices (based on consumer prices and prices of industrial products) had depreciated by 0.7% annually.

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



Relative prices registered an annual decline of 0.9% in both indices. The decline in relative prices was realized amid growth of foreign versus a decline in domestic consumer prices, as well as amid larger decline of domestic relative to foreign prices of industrial products. On the other hand, NEER appreciated by 0.2%, due to the depreciation of the Turkish lira and the Serbian dinar against the denar.

Main components of the current account
(in EUR million)

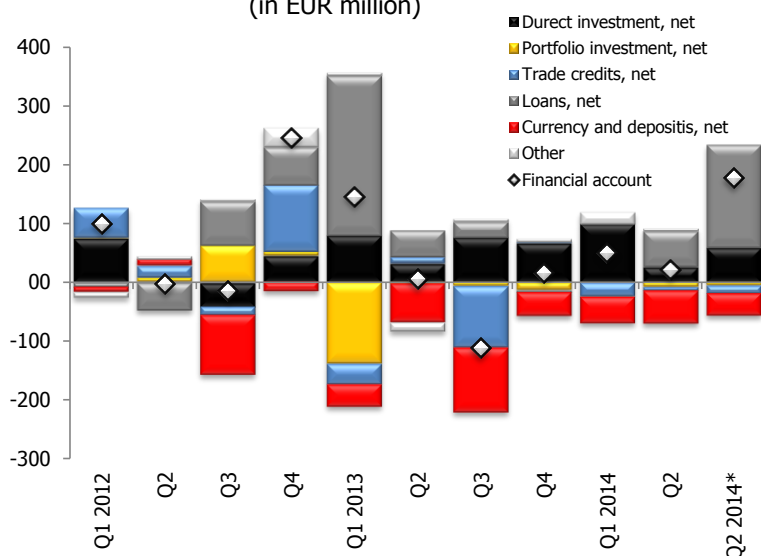


In the second quarter of 2014, the balance of payments current account registered a deficit of Euro 102.2 million or 1.3% of GDP. The realized current account deficit is almost twice lower than expected for the analyzed period according to the April projection.

Positive deviations relative to the projection, in terms of individual components, are registered in higher current transfers and a lower deficit in the balance of goods and services, while the performances in the income deficit are in line with the expectations.

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

Financial account components
(in EUR million)

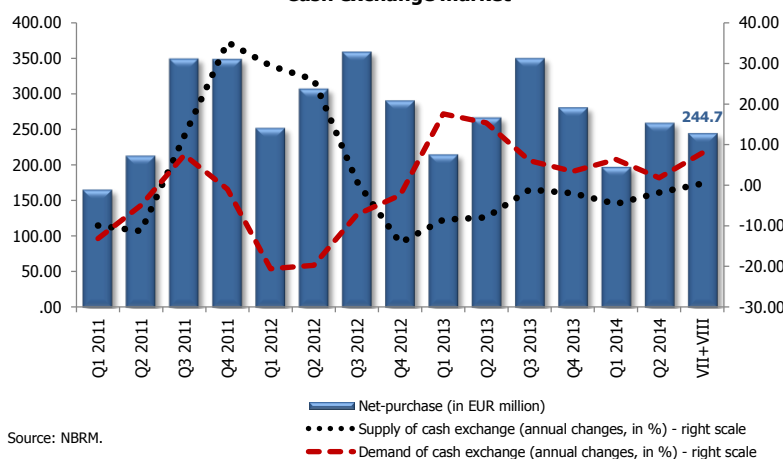


Source: NBRM.

In the second quarter, the capital and financial account registered net inflows of Euro 23.9 million (or 0.3% of GDP), which is less than projected for the second quarter of the year.

Deviations are mostly resulting from the significantly lower net inflows of foreign borrowing in the long term (lower utilization in the private sector, amid simultaneously higher repayments of the banking sector). Lower inflows were registered in direct investments, while higher than expected outflows were registered in currency and deposits of other sectors.

Cash exchange market



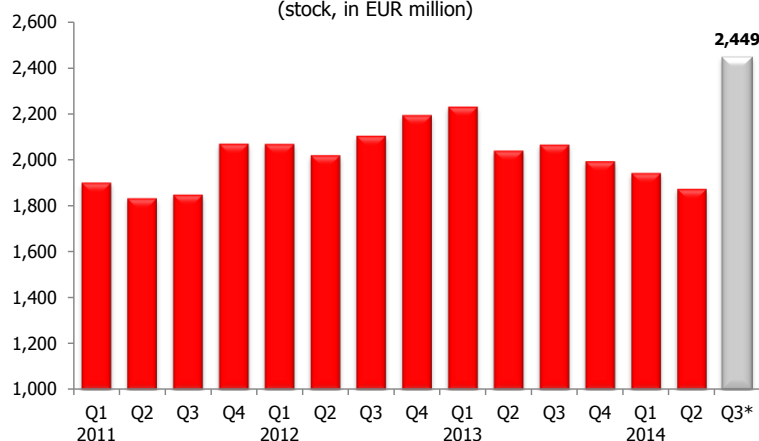
Source: NBRM.

Recent data on currency exchange operations, as of end August 2014 indicate growth in the supply of foreign currency, after last month's decline and further upward trend in the demand for foreign currency on annual basis.

The net purchase in the currency exchange market in the period July-August 2014 totaled Euro 244.7 million, which is a small annual decline of 1.2%.

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

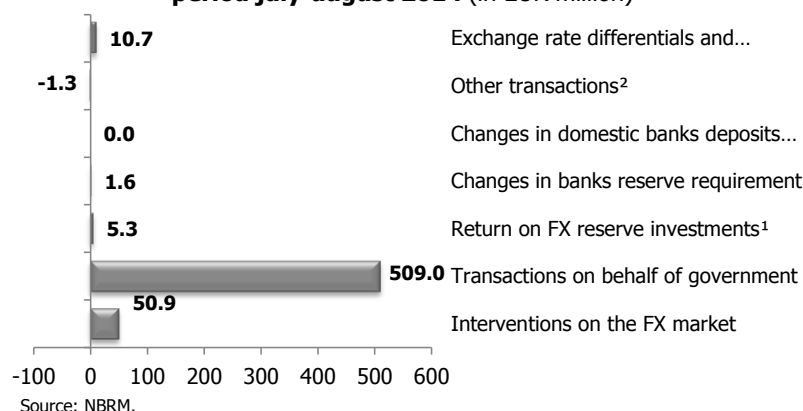
Foreign exchange reserves
(stock, in EUR million)



* Latest data as of 31.08.2014.
Source: NBRM.

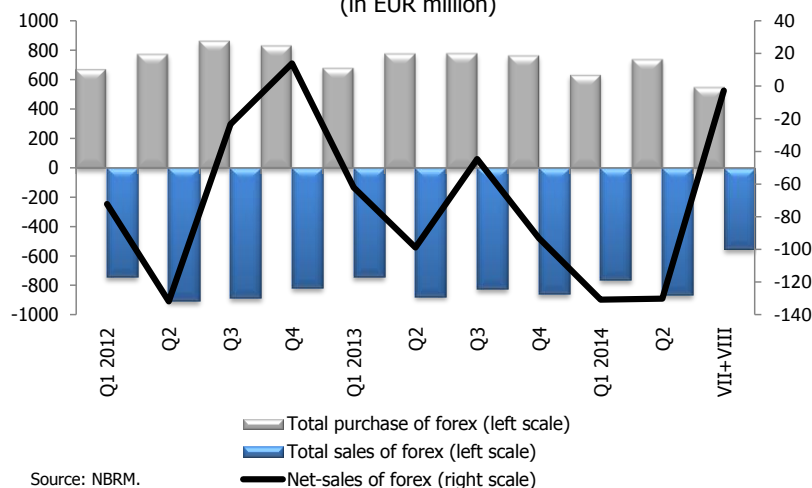
As of 31 August 2014, the gross foreign reserves totaled Euro 2,449.2 million, which is an increment of Euro 576.2 million compared to the end of the second quarter of 2014. The fast growth in foreign reserves is mostly due to transactions for the account of the government, i.e. foreign exchange inflows from the Eurobond, and the Development Policy Loan¹² with additional positive effect of the net purchase of foreign currency by the NBRM in the foreign exchange market.

Factors of change of the foreign reserves in the period July-August 2014 (in EUR million)



Source: NBRM.

Forex market
(in EUR million)



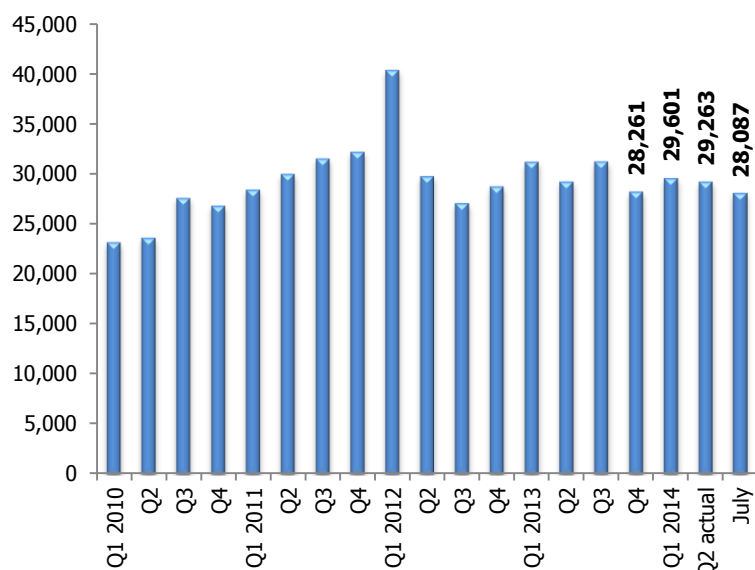
Source: NBRM.

In the period July-August 2014, the foreign exchange market with the banks registered a net purchase of Euro 2.7 million, versus the net sale of Euro 11.1 million realized in the same period last year. This annual change is a combined effect of the annual growth in supply and the fall in demand for foreign currency (1.2% and 0.3%, respectively).

The analysis by sector shows better performance in all individual components on annual basis, i.e. higher net purchase with natural persons, exchange offices and non-residents, and lower net sales to companies.

¹² In July, the government borrowed from the international financial markets by issuing a seven-year Eurobond, and in August there was an inflow of funds from the Development Policy Loan.

Monetary policy instruments, in MKD million

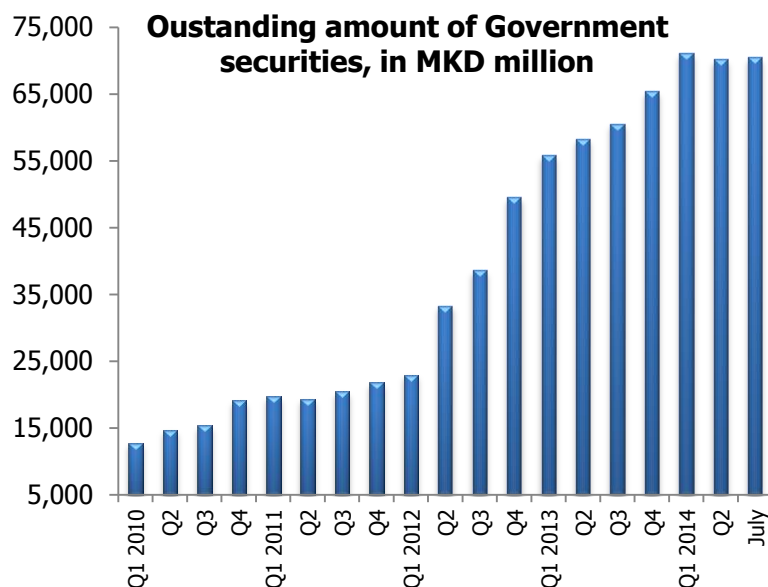


Source: NBRM.

Data as of July showed liquidity creation through monetary instruments relative to the end of the second quarter, versus the expected withdrawal of liquidity in the third quarter, as projected in April...

...in circumstances of moderate monthly growth of net foreign assets of the NBRM, which is within the projected trends for the third quarter, but at a slower pace...¹³

...and liquidity creation through total deposits, consistent with the expected trends for the third quarter.

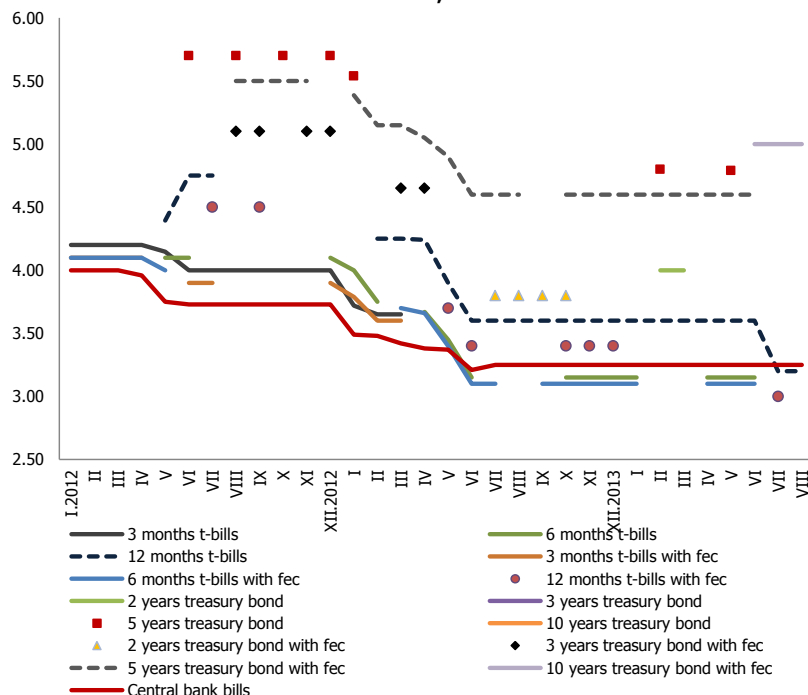


Source: NBRM.

The stock of government securities in the domestic market amounted to Denar 70,916 million at the end of August, and compared to June 2014, it is higher by Denar 703 million.

¹³ The explanations for the NBRM's balance sheet exclude the amount of the Eurobond issued. Namely, in July, the government issued the third Eurobond in the amount of Euro 491.1 million. In the balance sheet of the NBRM, this amount was recorded in the NFA of the NBRM on the assets side, while on the liabilities side it was recorded in the item government deposits, making it have a neutral effect on the liquidity of the system. The analysis of contributions in the changes in money supply and credits, from a balance of payments point of view, presented in the next section of the text, also does not take into account the effect of the Eurobond

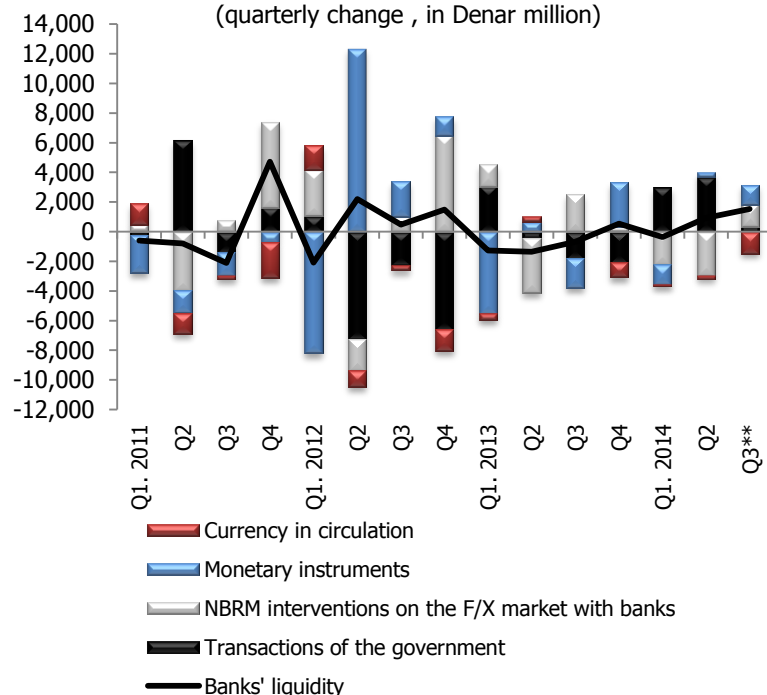
Interest rates of treasury bills, treasury bonds and central bank bills, in %



Source: NBRM.

Liquidity of the banking system*

(quarterly change, in Denar million)



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

** including July

Source: NBRM.

In August, one auction of government securities was held.

Securities on the maturity segment of 12 months were offered at the auction, and the interest rate remained unchanged and equaled 3.2%. Also, at the auction a 10-year government bond with currency clause was issued, and the interest rate remained unchanged at 5%.

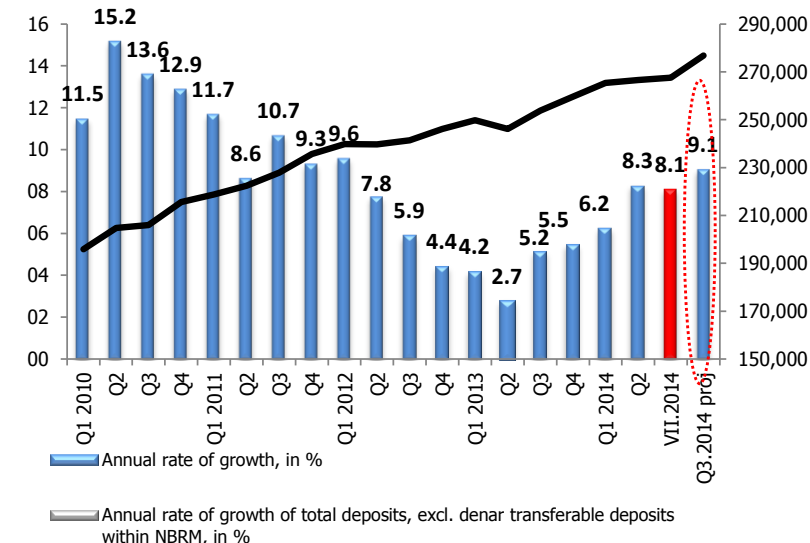
In terms of the flows of creating and withdrawal of liquidity, in July, liquidity was created through interventions on the foreign exchange market, and in a very small amount also through government deposits, while currency in circulation acted towards liquidity withdrawal. Liquidity was created through monetary instruments.

Considering these developments, in July total liquidity increased.

In late July, the level of reserve money was higher than the level projected for the third quarter...

... where both components, the currency in circulation and total liquid assets exceed the projected levels for the third quarter.

Total deposits



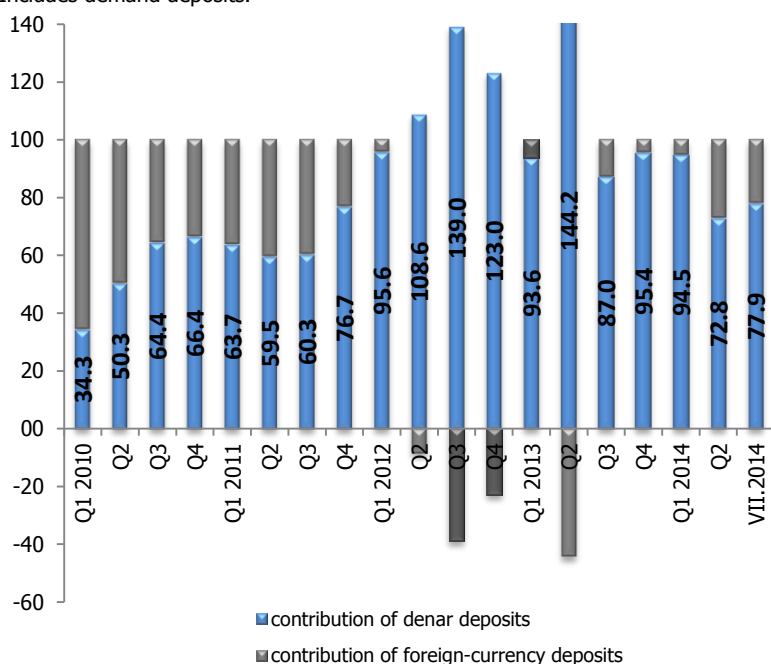
*Includes demand money
Source: NBRM.

According to data as of July, total deposits continued to grow on a monthly basis, but with almost twice lower intensity compared to the previous month. The growth in total deposits during this period was entirely due to the increase in household deposits, with a small negative contribution of corporate deposits.

At the end of July, the annual growth rate of total deposits equaled 8.1%, which is below the projected growth of 9.1% for the third quarter of 2014. In addition, during July, total deposits increased by Denar 974 million representing 13% of the expected quarterly increase for the third quarter, according to the April projection.

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

*Includes demand deposits.

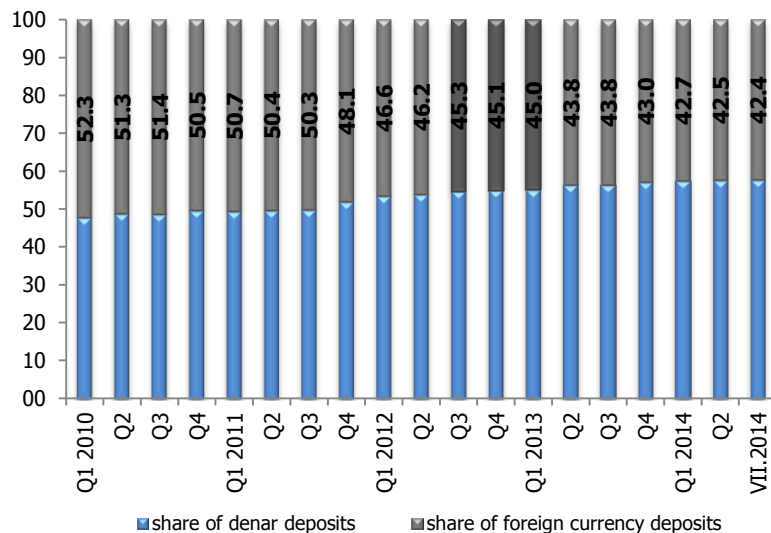


Source: NBRM.

The achieved annual growth of total deposits was mainly driven by the increased Denar deposits but also a significant contribution in this direction was given by foreign currency deposits which show moderate growth also during July.

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

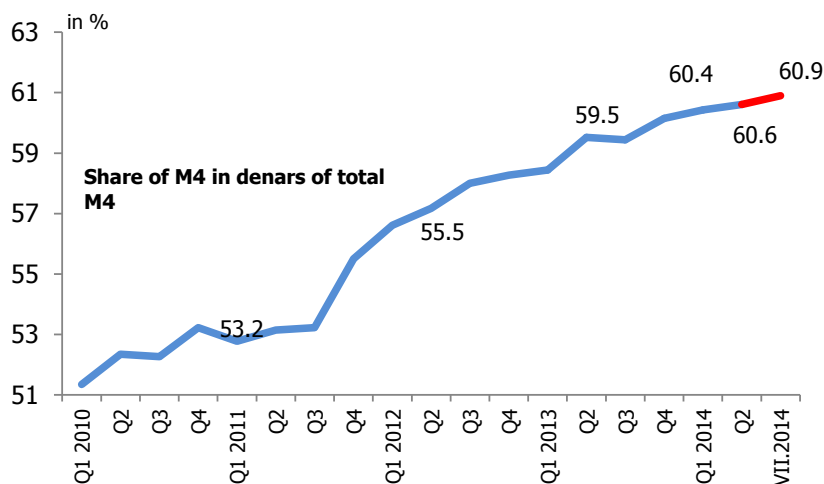
*Includes demand deposits.



Source: NBRM.

Similarly to the previous month, the Denar deposits continued to have greater share in total deposits.

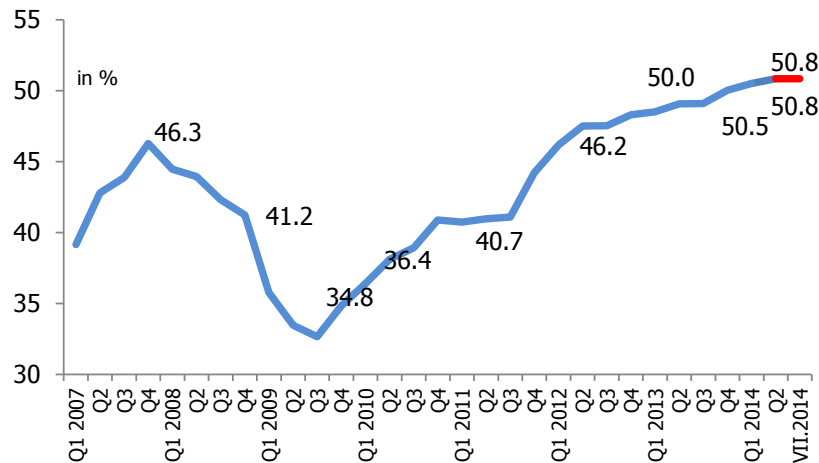
Share of M4 in denars in total M4



Source: NBRM.

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

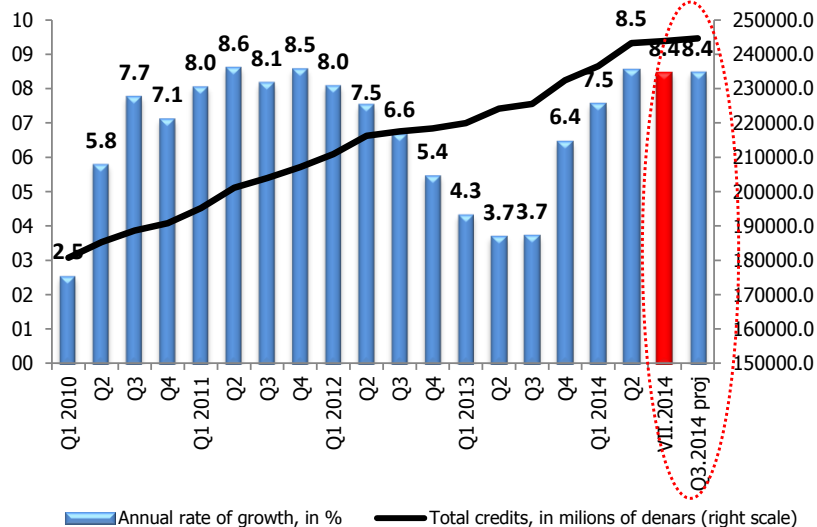
*Includes demand deposits.



Source: NBRM.

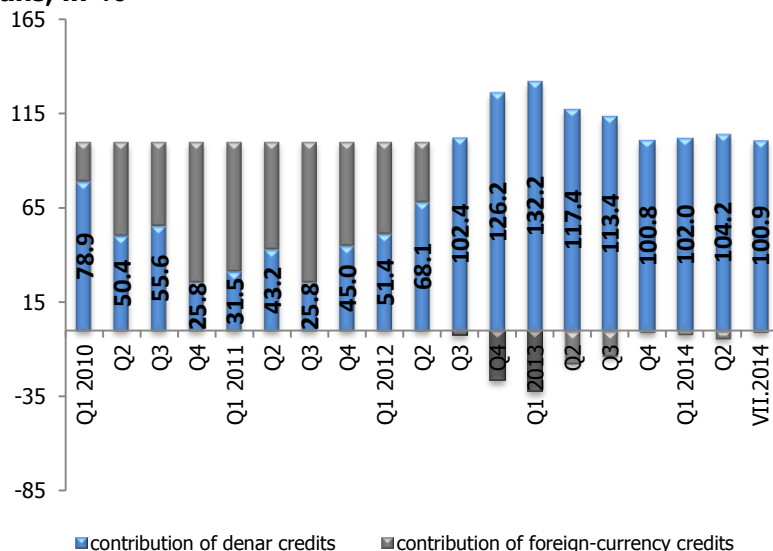
Total household deposits continued to grow also in July, with the monthly growth of denar deposits being almost equal to the monthly increase of foreign currency deposits.
The share of denar deposits in the total household deposits remained at the level of 50.8%.

Total loans



Source: NBRM.

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



Source: NBRM.

According to data as of July, total loans to the private sector register further monthly increase, but at a significantly slower pace compared to the previous two months.

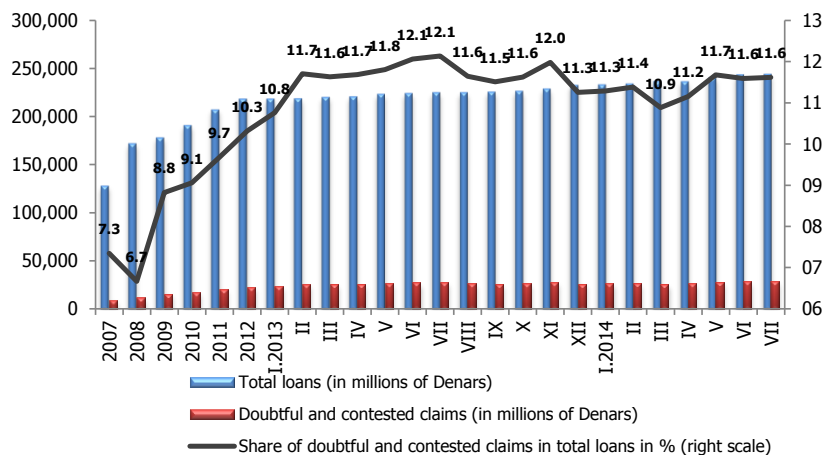
The monthly increase is completely a result of the growth of household loans. Corporate loans, which in the last two months explained over half of the growth in total loans showed a moderate decline during July.

At the end of July, the annual growth rate of total loans equaled 8.4% which is consistent with the projected annual growth for the third quarter, according to the April projection.

However, during July, total loans increased by Denar 612 million, which is a realization of only 15% of the projected growth for the third quarter of 2014, according to the latest projection.

The achieved annual growth of total loans is entirely driven by the favorable movements in denar loans, amid slower decline in foreign currency loans.

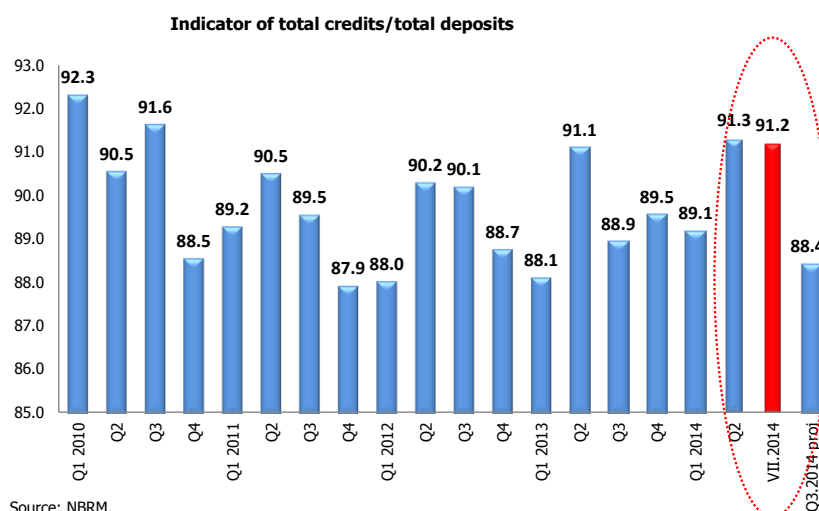
Share of doubtful and contested claims in total loans, in %



Source: NBRM.

During July, the share of doubtful and contested claims to total loans¹⁴ remained unchanged compared with the previous month, mainly due to the stabilized growth of non-performing loans to the corporate sector.

Ratio of total loans to deposits, in %



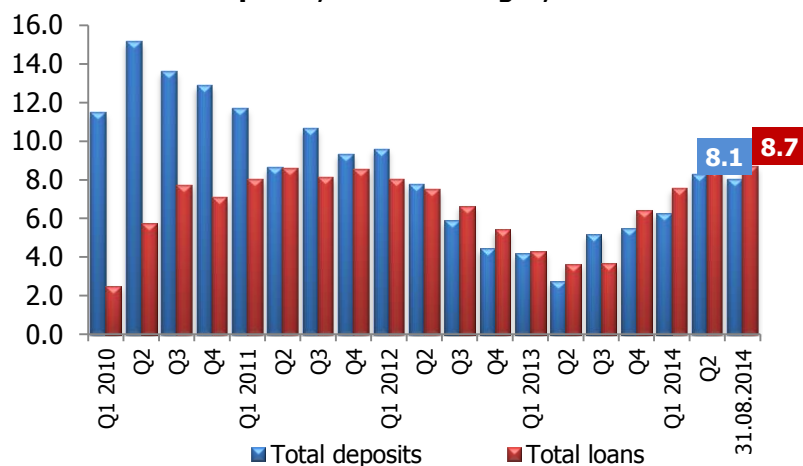
Source: NBRM.

The utilization of the deposit potential for lending to the private sector during July did not register significant changes compared with the previous month ...

...due to the moderate increase in total loans, but also of the deposit base.

The loans to deposits ratio achieved in July indicates higher utilization of deposits for financing the private sector compared to expected, as part of the April projection.

Total loans and deposits, annual changes, in %



Source: NBRM.

After the moderate increase in July, preliminary data as of end August 2014 show a significant monthly increase in the total deposits of banks. Increase was registered with both the corporate sector and households, amid greater contribution to the growth by corporate deposits.

Preliminary data for August showed moderate growth of total loans on a monthly basis, which is fully allocated among households, amid a decline in corporate loans.

On annual basis, total deposits increased by 8.1%, while total loans registered a yearly growth rate of 8.7%.

¹⁴ The indicator refers to the total loans to the financial and non-financial sector.

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

January 2013

- A Decision amending the Decision on reserve requirement (adopted in November 2012) came into force, allowing reduction of the reserve requirement base of banks for the amount of new loans to net exporters and domestic producers of electricity, as well as for the investments in debt securities in domestic currency without a currency clause, issued by the aforementioned companies. This decision fully exempts the banks from allocating reserve requirement for liabilities based on debt securities issued in local currency with an original maturity of at least two years. The Decision will apply throughout 2014, after which, depending on the results, the need for further application will be reconsidered.
- A Decision on reducing CB bill interest rate was adopted to cut the policy rate from 3.75% to 3.5%. At the same time, the interest rate on seven-day deposit facility and on overnight deposit facility was cut from 2% to 1.75% and from 1.0% to 0.75%, respectively.

March 2013

- A Decision on credit risk management was adopted, which has been applied since 1 December 2013.

July 2013

- A Decision on reducing CB bill interest rate was adopted to cut the policy rate from 3.5% to 3.25%. At the same time, the interest rate on the seven-day deposit facility was cut from 1.75% to 1.5%.
- A Decision amending the Decision on the reserve requirement was adopted, which reduces the reserve requirement rate for banks' liabilities in domestic currency from 10% to 8% and increases the reserve requirement rate for liabilities in foreign currency from 13% to 15%. In addition, the amendments stipulate a reserve requirement rate of 0% for banks' liabilities to nonresident financial companies with contractual maturity of over one year, as well as for all liabilities to nonresidents with contractual maturity of over two years. A rate of 13% still applies to short-term liabilities to nonresident financial companies in foreign currency with contractual maturity of up to one year. To maintain the reserve requirement in denars and in euros relatively stable, the amendments increase the reserve requirement in euros that is fulfilled in denars from 23% to 30%.

October 2013

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

November 2013

- A Decision amending the Decision on the reserve requirement was adopted, which exempts the NBRM from paying reserve requirement remuneration (previously, this remuneration equaled 1% for denar reserve requirement and 0.1% for euro reserve requirement). The Decision is being applied since 1 January 2014.

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

February 2014

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

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