National Bank of the Republic of Macedonia

MONETARY POLICY AND RESEARCH DEPARTMENT

Recent Macroeconomic Indicators
Review of the Current Situation

September 2016

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Review of the Current Situation - Implications for the Monetary Policy

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

In the period following the April projection the global economic environment deteriorated as a consequence of the decision of the Great Britain to exit EU (BREXIT). This result led to downward revisions of the projected growth of the world economy[1], amid significantly increased economic, political and institutional uncertainty. However, it is estimated that the short-term effects on the activity in the euro area will not be significant, taking into account the performance in the first half of the year. Thus, the recovery of the euro area continued in the second quarter, when a quarterly rate of GDP growth of 0.3% (1.6% annually) was reported, which is a minimal slowdown compared to the first quarter. The recovery of the European economy has certain positive effects on the labor market, whereby the unemployment rate slightly decreased from 10.2% in April to 10.1% in July. The latest ECB's forecasts suggest **a continuation of the recovery in the euro area with minimally lower rates of GDP growth in the period ahead** compared to the previous forecasts[2], primarily due to the lower export growth, which mostly reflects the lower foreign demand amid weaker demand from Great Britain after the referendum. On the other hand, it is expected that growth will continue to be mostly due to domestic demand, amid stimulating monetary policy, still low oil prices, improved labor market developments and progress of the process of deleveraging. The risks to the growth of the euro area were predominantly downward and are mainly associated with the uncertainty about the external environment. In terms of inflation, data as of August show restraint of the pace of annual growth of headline inflation of 0.2%, as well as a minimum deceleration of core inflation to 0.8%. The latest ECB's forecasts **do not contain significant revisions of the expected inflation rates in the euro area** in the period ahead[3]. In 2016, the expected minimal inflation is a result of the negative contribution of the oil price. In the next two years inflation will gradually accelerate as a result of the depletion of the downward effect of the oil prices, as well as of the continued economic recovery and the growth of the import prices. In such circumstances, the ECB continues to conduct accommodative monetary policy. At the last ECB meeting on the monetary policy, held in early September, the policy rate was maintained at a low level, and the non-standard monetary policy measures were unchanged.

[1] World Economic Outlook, IMF, update July 2016.

[2] Source: ECB, the latest forecasts according to which the growth rate of real GDP for 2016, 2017 and 2018 is estimated at 1.7%, 1.6% and 1.6%, respectively. The previous (June) projections estimated that the growth will be 1.6%, 1.7% and 1.7% for 2016, 2017 and 2018, respectively.

[3] The latest inflation forecast are 0.2%, 1.2% and 1.6%, for 2016, 2017 and 2018, respectively, compared to the June forecasts of 0.2%, 1.3% and 1.6% for 2016, 2017 and 2018, respectively.

Observed from a viewpoint of the individual quantitative indicators for the external environment of the Macedonian economy, the current assessment is that the decision of Britain to exit EU will not affect the foreign effective demand in 2016, while the negative effects are expected in 2017. More precisely, the assessment for growth in foreign demand in 2016 has not changed compared to the April cycle, while larger downward revision was made for 2017. The expectations for **foreign effective inflation** for 2016 and 2017 have been revised downward. **Decrease in the prices of primary commodities in 2016 and their recovery in 2017 is expected,** amid divergent directions of revisions by individual products. Thus, **world oil prices** are expected to be lower in 2016, while for 2017, they are expected to increase slightly faster, and therefore, the price level will be slightly higher than previously expected. In **metal prices**, the latest perceptions for 2016 are divergent, whereby the nickel price is expected to decline at a slower pace, while the copper price is expected to decline faster than previously forecasted, while 2017 is expected to experience higher increase in the nickel price and minimally lower increase in the copper price. With regard to world **prices of food,** there are no expectations for pressures on domestic inflation in 2016, amid expected significantly faster decline in wheat and corn prices, given the improved perceptions for production. For 2017, prices of food are envisaged to grow at a slower pace than previously forecasted. However, it should be kept in mind that the estimations for the prices of these primary commodities are extremely volatile. The latest assessments indicate that during the current and the next year, **EURIBOR will follow similar path as in the April forecasts,** which corresponds to the unchanged ECB's monetary policy setup.

The comparison of the latest macroeconomic indicators with their projected dynamics within the baseline scenario from the April forecasting round presents a divergent picture of the deviations in the individual segments of the economy. According to the published estimated data on GDP, in the second quarter, economic activity increased at a similar growth pace as in the first quarter, dynamics which does not correspond to the shifts in the high-frequency indicators that pointed to a slowdown of growth in the second quarter. With regard to the projection, same as in the first quarter, growth is lower than expected in the second quarter, mainly due to the lower growth of gross investments compared to the expectations. The available high-frequency indicators of the movements in individual economic sectors suggest a continuation of growth in the third quarter, but the assessment is based on few available data. **In summary, the performance in the first half of the year is lower than in the April projection, indicating a potential downward deviation from the forecasted economic growth for the entire 2016.** Also, domestic non-economic factors related to the political developments in the country further raise the uncertainty about the performance and evaluation of the economic activity. In terms of inflation, in August the consumer prices continued to decrease on an annual basis, but less intensively compared to the second quarter of the year. Same as in the previous month, in August, the decline in food and energy prices continued, while core inflation remained in the positive zone. The key input assumptions were corrected in different direction, in an environment of still low global prices. The price movements in August 2016 along with the change in input assumptions, so far indicate small downward divergence from the inflation projection for 2016.

Recent foreign reserves data (adjusted for the effects of price and exchange rate differentials and price changes of securities), suggest higher growth than expected for the third quarter of the year, according to the April forecast. The deviations are largely due to the higher than expected amount of the external government borrowing in this quarter for this year. Thus, analyzed through the factors of change, the increase in reserves results mainly from transactions on behalf of the government, due to the issued Eurobond, and then, in a smaller part, from the foreign currency deposits of domestic banks with the NBRM and the NBRM interventions on the foreign exchange market, which in July and August registered a net purchase of foreign currency. Observing external sector indicators, data on net purchase from foreign exchange operations have been available as of August, which indicate that the remittances move within the projected level. At the same time, data on foreign trade as of July give an indication of somewhat lower 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 hover in a safe zone.

In terms of developments in the monetary sector, during July 2016, monetary instruments acted towards creating small liquidity relative to the end of the second quarter, versus the more intensive withdrawal for the third quarter, according to the April forecast. From the balance sheet aspect, the lower level of monetary instruments is explained by the higher government position with the NBRM and the deviations in reserve money. **The final data as of July** show widening of the deposit base by 0.2% on a monthly basis, followed by the continuous decrease in the previous three months. The positive trends are due to the stabilization of the corporate deposits, amid further solid increase in household deposits for the second consecutive month. Such performance is a clear signal of the further stabilization of domestic economic agents' perceptions. On an annual basis, total deposits in July grew by 3.4%, which is below the projection of 7.4% for the third quarter of 2016. In terms of the credit market, in July, total loans registered a monthly decline of 0.3%, compared to the significant decrease of 1.9% in June. The realized decline was entirely due to the lower corporate loans, amid moderate increase in household loans. Such performance is still under the influence of the effects of the transfer of part of the doubtful and contested bank claims to the off-balance sheet record, pursuant to the NBRM decision[4], but with a significantly weaker effect compared to the previous three months. On annual basis, the total loans went up by 3% (8.2% if we isolate the effect of the transfer), which is close to the projection of 7.9% for the third quarter, according to the April forecast).

In the period January-July 2016, a deficit in the Budget of the Republic of Macedonia of Denar 8,953 million was registered, which constitutes 38.7% of the projected budget deficit according to the Budget Revision for 2016[5]. The deficit was mostly financed through government borrowing by issuing Eurobond on the international financial markets.

The latest macroeconomic indicators and assessments indicate changes in some key variables for monetary policy and more pronounced risks to the baseline scenario provided in the April forecasts. Recent foreign reserves data (adjusted for price and exchange rate differentials and price changes of securities) suggest higher growth than expected for the third quarter of the year, mainly as a result of external government borrowing. Also, the foreign exchange market stabilized significantly, and the NBRM intervened with net purchase of foreign currency during July and August. All foreign reserves adequacy indicators show that they continually hover in a safe zone. Available high frequency indicators of economic activity suggest a continuation of growth in the third quarter of 2016. However, the performance in the first half of the year was lower than the

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[4] On 17 December 2015, the National Bank Council adopted the Decision on amending the Decision on credit risk management that requires from banks by 30 June 2016 to write off (and to continue to write off) all claims that have been fully booked for more than two years, and where the bank has identified and fully covered the credit risk of default at least two years before. Despite the write-off of these claims, i.e. their transfer to the off-balance sheet record, banks reserve the right for their collection.

[5] Refers to the Budget Revision for 2016 of 30 August 2016.

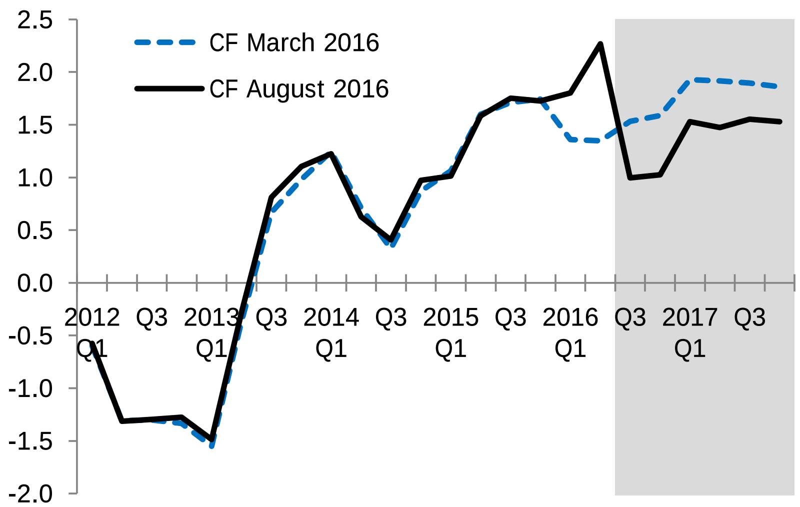
expectations, suggesting potentially lower than expected GDP growth in 2016. In terms of inflation, the current performance and assessments of the import prices so far indicate little downward deviations from the inflation projection for 2016. Within the monetary sector, the data for July indicate an evident stabilization of expectations, amid growth of total deposits and growth in household savings in domestic currency. On the credit market, if we exclude the effects of regulatory changes, in July, credit activity registered a slight decrease compared to the previous month, mainly driven by the decline in corporate loans, while household loans registered a monthly increase. The realization in deposits at the end of July is poorer than expected for the third quarter of 2016 and indicate deviations from the level in the April projection. Credit activity, without the effects of regulatory changes, is in line with the projections, but given the weak dynamics of deposits, the main source of financing, the risks for the future developments in the credit market are present.

Given the set of measures undertaken in early May by the National Bank, further stabilization of expectations and normalization of flows is anticipated. In any case, the uncertainty associated with the domestic political upheavals and the global surrounding is still present. The above creates the need for continuous monitoring of the performance and regular reassessment of risks and their relevance in the context of achieving monetary goals.

Selected economic indicators /1				2015					2016									
	2012	2013	2014	Q1	Q2	Q3	Q4	2015	Jan.	Feb.	Mar.	Q1	Apr.	May	Jun.	Q2	Jul.	Aug.
I. Real sector indicators																		
Gross domestic product (real growth rate, y-o-y) /2	**-0.5**	**2.7**	**3.5**	**3.8**	**3.4**	**3.6**	**3.9**					**2.0**						
Industrial production /3																		
y-o-y	-2.8	3.2	4.8	1.5	0.1	5.7	11.7	4.9	8.0	15.2	8.9	10.7	3.6	5.3	-4.4	1.3		
cumulative average	-2.8	3.2	4.8	1.5	0.8	2.5	4.9	4.9	8.0	11.7	10.7	10.7	8.7	8.0	5.6	5.6		
Inflation /4																		
CPI Inflation (y-o-y) /5	4.7	1.4	-0.3	-0.9	0.3	-0.2	-0.4	-0.3	0.1	0.0	-0.4	-0.1	-0.7	-0.7	-0.7	-0.7	-0.3	
CPI Inflation (cumulative average)	3.3	2.8	-0.3	-0.9	-0.3	-0.3	-0.3	-0.3	0.1	0.1	-0.1	-0.1	-0.2	-0.3	-0.4	-0.4	-0.4	
Core inflation (cumulative average)	2.1	3.0	0.6	-0.4	0.1	0.3	0.5	0.5	1.6	1.6	1.7	1.7	1.6	1.6	1.6	1.6	1.5	
Core inflation (y-o-y)	2.1	3.0	0.6	-0.4	0.7	0.7	1.0	0.5	1.6	1.6	1.8	1.7	1.6	1.2	1.5	1.5	1.2	
Labor force																		
Unemployment rate	31.0	29.0	28.0	27.3	26.8	25.5	24.6	26.1				24.5						
II. Fiscal Indicators□																		
(Central Budget and Budgets of Funds)																		
Total budget revenues	138,115	140,248	145,929	37,779	40352.0	39,314	43,762	161,207	12,923	12,925	14,742	40,590	14,820	13,344	13,261	41,425	14,985	
Total budget expenditures	155,840	159,505	168,063	44,080	43572.0	43,667	49,313	180,632	14,611	15,696	15,917	46,224	14,318	14,529	13,889	42,736	16,992	
Overall balance (cash)	-17,725	-19,257	-22,134	-6,301	-3220.0	-4,353	-5,551	-19,425	-1,688	-2,771	-1,175	-5,634	502	-1,185	-628	-1,311	-2,007	
Overall balance (in % of GDP) /1	-3.8	-3.8	-4.2	-1.1	-0.6	-0.8	-1.0	-3.5	-0.3	-0.5	-0.2	-1.0	0.1	-0.2	-0.1	-0.2	-0.3	
III. Financial indicators /6																		
Broad money (M4), y-o-y growth rate	**4.4**	**5.3**	**10.5**	**8.8**	**9.2**	**6.2**	**6.8**	**6.8**	**4.5**	**5.4**	**6.2**	**6.2**	**3.8**	**3.7**	**2.5**	**2.5**	**3.6**	
Total credits, y-o-y growth rate	**5.4**	**6.4**	**10.0**	**9.2**	**9.0**	**8.8**	**9.5**	**9.5**	**8.6**	**8.7**	**8.4**	**8.4**	**7.5**	**6.4**	**3.5**	**3.5**	**3.0**	
Total credits - households	6.5	10.2	11.8	12.1	12.4	12.8	12.9	12.9	12.6	12.8	13.0	13.0	12.8	12.2	8.8	8.8	8.1	
Total credits - enterprises	4.5	3.8	8.6	7.1	6.7	6.0	7.1	7.1	5.5	5.8	5.1	5.1	3.7	2.0	-0.5	-0.5	-0.8	
Total deposits (incl. demand deposits), y-o-y growth rate	**4.9**	**6.1**	**10.4**	**8.4**	**8.9**	**5.7**	**6.5**	**6.5**	**4.3**	**5.3**	**6.2**	**6.2**	**3.1**	**3.7**	**2.3**	**2.3**	**3.5**	
Total deposits - households	7.2	6.7	8.9	8.1	6.2	5.0	4.1	4.1	3.6	3.5	3.1	3.1	0.9	-0.4	0.2	0.2	0.2	
Total deposits - enterprises	-1.6	3.1	15.7	9.0	17.8	7.1	13.0	13.0	6.4	11.8	16.0	16.0	9.2	14.5	5.6	5.6	11.8	
Interest rates /7																		
Interst rates of CBBills	3.73	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	4.00	4.00	4.00	4.00	4.00
Lending rates																		
denar rates (aggregated, incl. denar and denar with f/x clause)	8.5	8.0	7.5	7.3	7.1	7.0	6.9	7.1	6.8	6.7	6.7	6.7	6.7	6.6	6.6	6.6	6.6	
f/x rates	7.0	6.5	6.3	6.0	5.9	5.8	5.8	5.9	5.7	5.7	5.6	5.6	5.5	5.5	5.5	5.5	5.4	
Deposit rates																		
denar rates (aggregated, incl. denar and denar with f/x clause)	5.1	4.4	3.7	3.2	3.0	2.7	2.6	2.9	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	
f/x rates	2.2	1.8	1.4	1.5	1.3	1.2	1.1	1.3	1.1	1.1	1.1	1.1	1.1	1.1	1.0	1.1	1.0	
IV. External sector indicators																		
Current account balance (millions of EUR)	**-240.0**	**-134.1**	**-68.7**	**-46.5**	**-82.1**	**130.9**	**-129.6**	**-127.3**	**27.6**	**-5.1**	**-34.0**	**-11.5**	**-82.5**	**-64.2**	**-22.6**	**-169.4**		
Current account balance (% of GDP)	*-1.6*	*-1.6*	-0.8	-0.5	-0.9	1.4	-1.4	-1.4	0.3	-0.1	-0.4	-0.1	-0.9	-0.7	-0.2	-1.8		
Trade balance (millions of EUR) /8	**-1,946.7**	**-1,748.1**	**-1757.9**	**-378.1**	**-446.5**	**-362.3**	**-538.7**	**-1725.7**	**-65.8**	**-131.6**	**-175.8**	**-373.2**	**-160.8**	**-175.7**	**-164.8**	**-501.4**	**-118.9**	
Trade balance (% og GDP)	*-25.7*	*-21.6*	-20.7	-4.2	-4.9	-4.0	-5.9	-19.0	-0.7	-1.4	-1.9	-3.9	-1.7	-1.9	-1.7	-5.3	-1.3	
import (millions of EUR)	-5,070.6	-4,983.3	-5504.5	-1308.1	-1481.7	-1394.0	-1593.2	-5776.9	-354.1	-477.5	-525.0	-1356.5	-529.4	-531.2	-497.1	-1557.6	-510.3	
export (millions of EUR)	3,124.0	3,235.2	3746.6	929.9	1035.2	1031.7	1054.4	4051.2	288.3	345.9	349.2	983.3	368.5	355.4	332.3	1056.2	391.4	
rate of growth of import (y-o-y)	0.3	-1.7	10.5	5.4	8.2	-0.7	6.9	4.9	-3.1	16.8	-1.6	3.7	6.3	13.1	-3.3	5.1	0.9	
rate of growth of export (y-o-y)	-2.8	3.6	15.8	13.9	9.9	4.5	5.4	8.1	-1.2	15.6	3.0	5.7	24.8	-1.0	-12.8	2.0	12.8	
Foreign Direct Investment (millions of EUR)	**131.1**	**229.4**	**197.4**	**68.0**	**46.5**	**5.5**	**50.7**	**170.7**	**-0.2**	**36.5**	**30.0**	**66.4**	**30.9**	**34.2**	**-16.1**	**49.0**		
External debt																		
Gross external debt (in milllions of EUR)	5171.7	5219.7	5992.3	6251.5	6359.8	6240.1	6353.7	6353.7				6707.4						
public sector	2162.1	2172.4	2846.8	3024.7	3059.8	3036.6	2935.4	2935.4				3282.3						
public sector/GDP (in %)	28.5	26.7	33.4	33.3	33.7	33.4	32.3	32.3				34.7						
private sector	3009.5	3047.4	3145.5	3226.9	3300.0	3203.5	3418.3	3418.3				3425.2						
Gross external debt/GDP (in %)	68.2	64.0	70.3	68.8	70.0	68.6	69.9	69.9				70.9						
Gross official reserves (millions of EUR) /9	**2,193.3**	**1,993.0**	**2,436.5**						**2,246.9**	**2,253.4**	**2,266.3**		**2,193.8**	**2,164.3**	**2,158.8**		**2,588.2**	**2,676.6**

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

Foreign effective demand
(annual changes in %)



Source: "Consensus Forecast" and NBRM calculations.

The latest estimations for the increase in the foreign effective demand[6] in 2016 remained the same as in the April projection, despite the outcome of the British referendum...

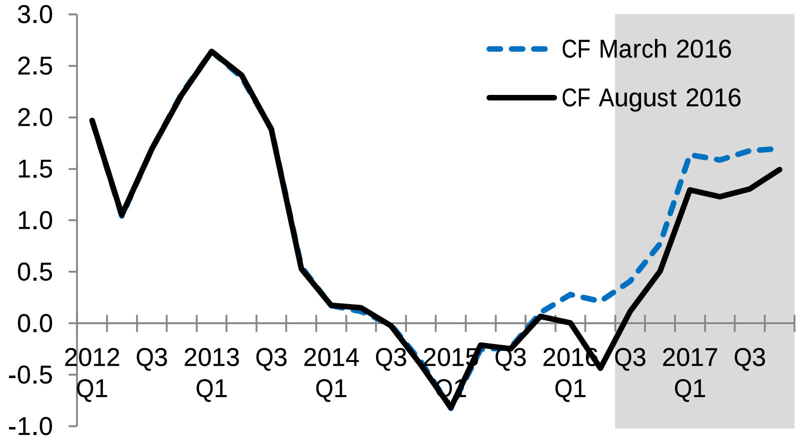
...i.e., it is still expected that the annual growth will reach 1.5%.

Greater economic effects of Brexit are expected in 2017, with most of the trading partners...

...whereby the increase in the foreign demand is now being assessed at 1.5%, as opposed to the April projection of 1.9%...

...which mainly arises from the reduced economic growth expectations of Germany, and less, to Italy and Greece.

Foreign effective inflation
(annual rates in %)



Source: "Consensus Forecast" and NBRM calculations.

Compared to April, the foreign effective inflation was revised downwards throughout the entire projection period.

Thus, the latest estimates indicate unchanged level of the foreign prices in 2016 (a rate of 0%), despite the expected growth of 0.4% in the April forecast...

...given the downward revisions in almost all partner countries, with the highest contribution of the neighboring countries (Serbia[7] and Bulgaria), amid expectations for decrease instead of increase in the prices.

Downward revision was made for 2017, as well, when it is expected that the foreign inflation will equal 1.3% (1.7% in April)...

...primarily as a result of lower expected growth in prices in Serbia, Croatia and Germany.

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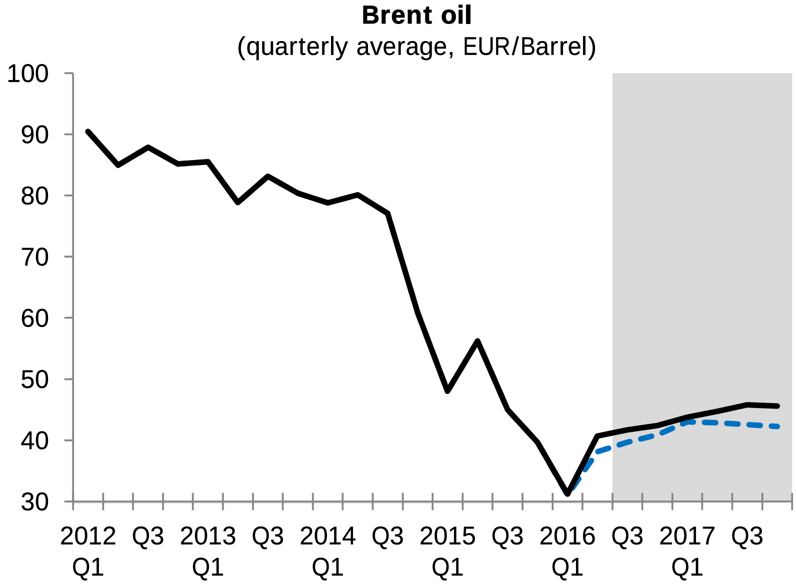
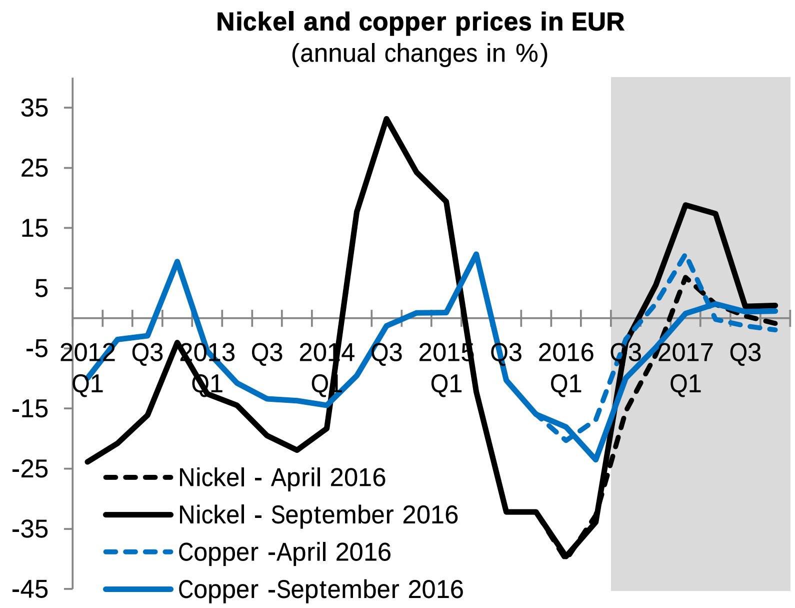
[6] The analysis of the foreign effective demand and inflation is based on the projections of the international company for economic surveys "Consensus Forecast".

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



Source: IMF and NBRM calculations.



Source: IMF and NBRM calculations.

According to the latest estimations[8], the projections for the Brent oil price are minimally revised compared to the April forecasts...

...now expecting the fall in prices in 2016 to be slightly lower, and the growth in 2017 slightly higher than previously expected.

No major change was expected in the future movement in the oil price, taking into account the still weak demand, further production growth of the OPEC countries, high inventories and expectations for strengthening of the US dollar. Although there are certain signals for a possible increase in the oil prices, associated with the announced discussions of the OPEC countries and Russia for renegotiation over the level of production, however, such an agreement is followed with scepticism by market participants.

The revisions in the metal prices were made in different directions, amid more favorable expectations in the nickel price, and less favorable in the copper price.

Thus, smaller decrease in the price of nickel is now expected in 2016...

...amid higher level being registered in the beginning of the third quarter and expectations to maintain that level by the end of the year, due to the expectations for a reduction of global production (lower offer from the Philippines9)...

... while the price of copper is projected to decrease more, amid further increase in inventories...

In 2017, metal prices are expected to recover. Compared to the April forecasts, the nickel price is now expected to increase more, while the copper price is expected to

[8] For the analysis of prices of oil, metals and primary food products, various reports of the IMF, World Bank, FAO, OPEC, the ECB and the specialized international economic portals are used...

[9] New authorities in the Philippines launched a review of the operation of mines in terms of their impact on the environment, which could lead to the closure of certain mines which cause damage to the environment. At the same time, moratorium on issuing new permits for mining were put.

register minimally lower growth.

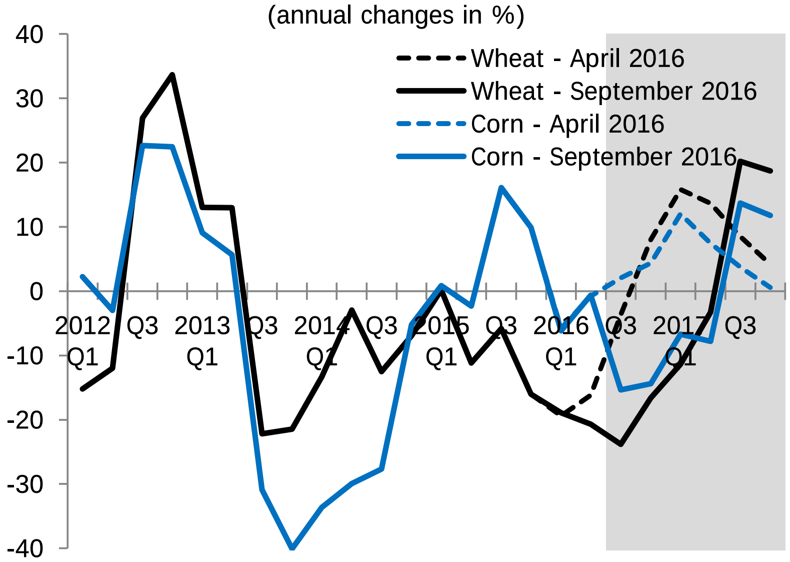
The prices of the primary food products were revised downwards throughout the entire projection period.

Thus, the latest estimations for **2016** for the wheat price show a twice-higher drop compared to the April forecast, which is explained by improved production prospects, especially in the Black Sea region...

...and sharper forecasted decline than previously expected was registered in the prices of corn, due to the more favorable weather conditions in the main production regions of the US and higher potential of the current year yields.

In 2017, the prices of crops are expected to register growth, which will be lower than in the April forecasts.

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



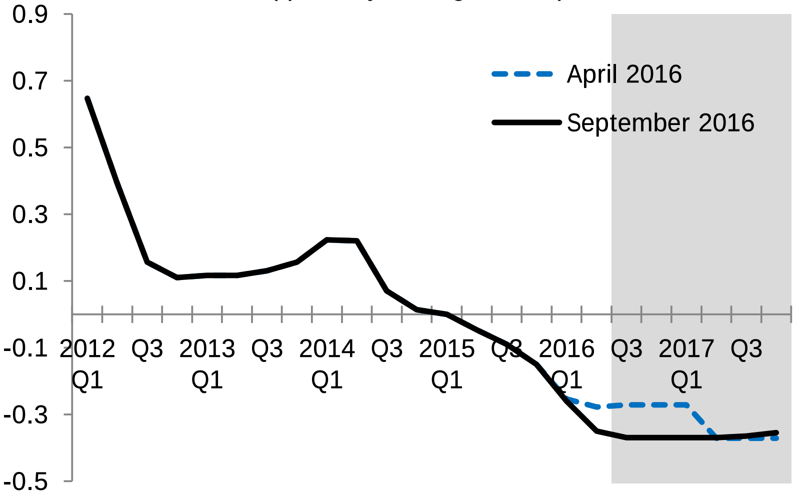
Source: IMF and NBRM calculations.

In accordance with the ECB's relaxed monetary policy, European markets are further expected to maintain the interest rates on low or negative level. Consequently, there are no major changes in current estimates in terms of the future trend of the monthly Euribor compared to April estimates.

However, it is still expected that the short-term interest rate on the money market will remain in the negative zone for a longer period...

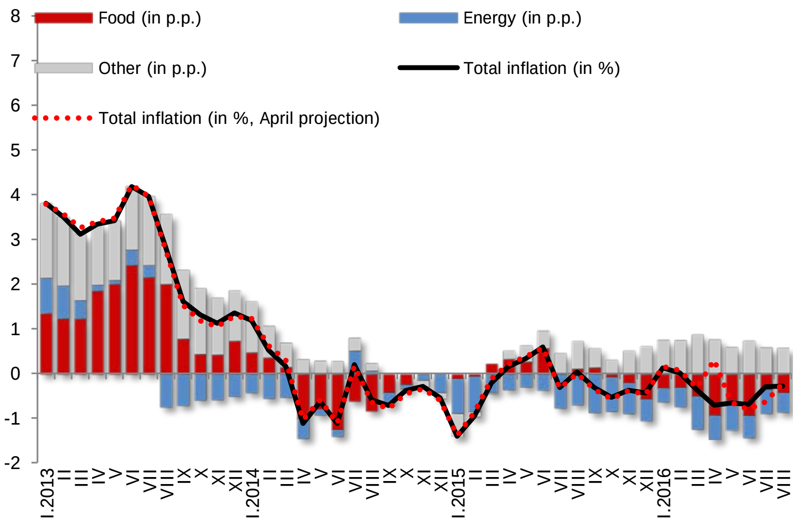
...whereby this interest rate is expected to average -0.34% in 2016 and -0.37% in 2017, compared to -0.27% and -0.35%, respectively, in the April forecast.

1-month Euribor
(quarterly average, in %)



Source: "Consensus Forecast" and NBRM calculations.

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

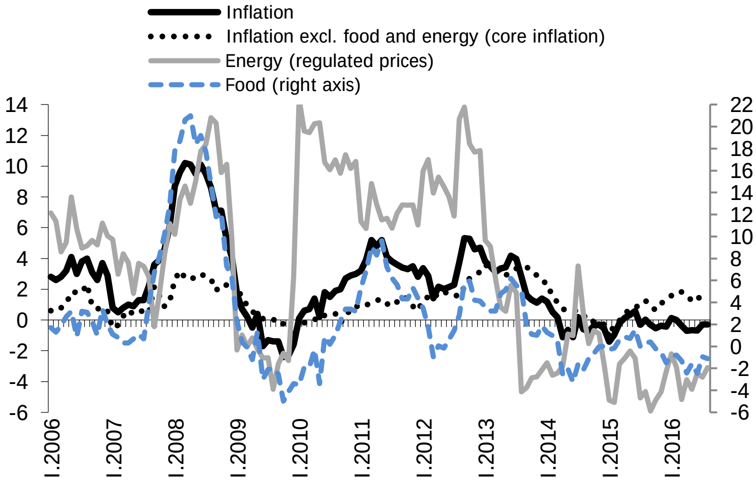


Source: SSO and NBRM.

In August 2016 the domestic consumer prices went down by 0.1% on a monthly basis...

...due to the lower energy prices, while the core inflation continued to mount. Food prices remained at the same level as in the previous month.

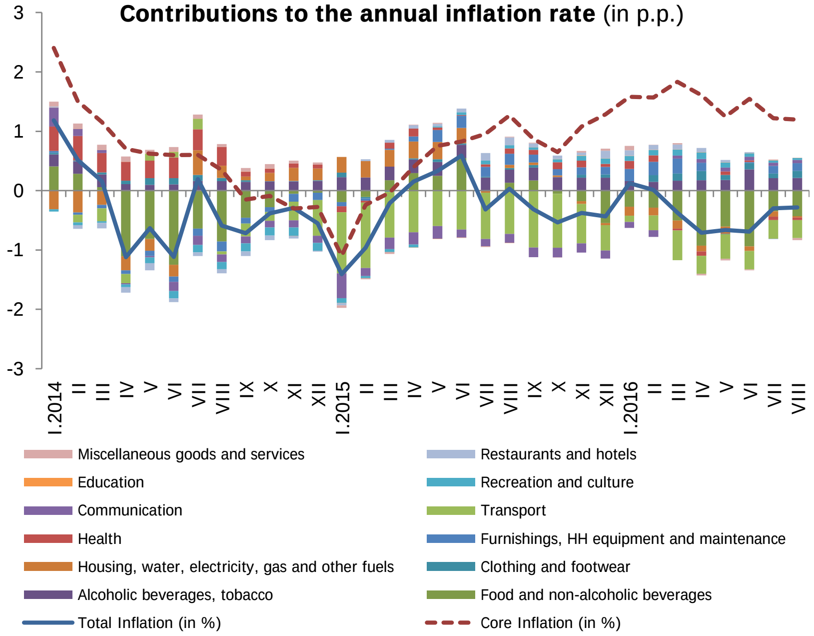
Inflation and volatility of food and energy
(annual growth rates, in %)



Source: State statistical office and NBRM calculations.

In accordance with the monthly decrease, the annual rate of inflation in August remained in the zone of negative growth and stood at -0.3%, which still represents a substantial slowdown of annual decline of 0.7% registered in the second quarter of the year.

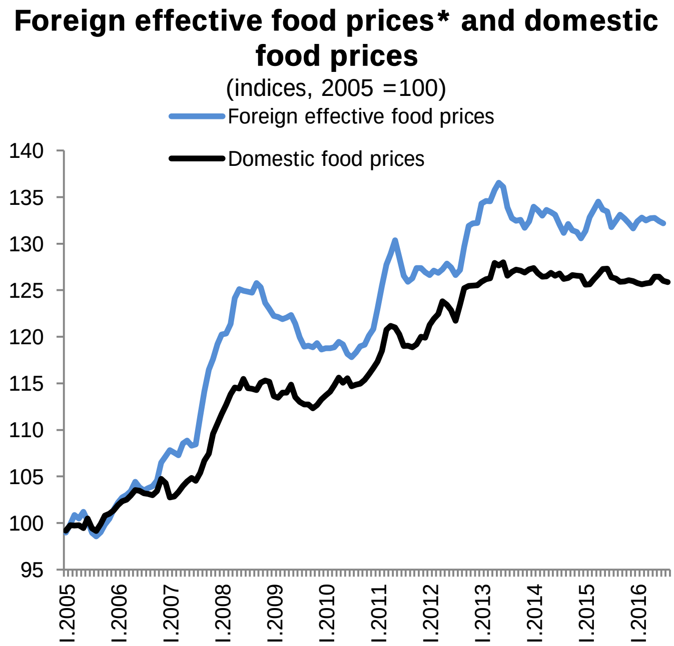
With regard to the projection, the changes in domestic prices in August 2016 indicate a possible slight downward deviation compared with the expected inflation rate for 2016 within the April cycle projections.



Source: SSO and NBRM.

In August, the core inflation rate registered a monthly growth of 0.2%, while on an annual basis was 1.2%, same as in the previous month.

Regarding the core inflation structure, in August, there was a small rise in the prices of most categories within core inflation, with the highest contribution of tobacco prices[10], footwear, the prices in the category "furniture, household equipment and household maintenance" and transport prices.



* 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 2016, which are included in the inflation projection, have been revised in divergent directions...

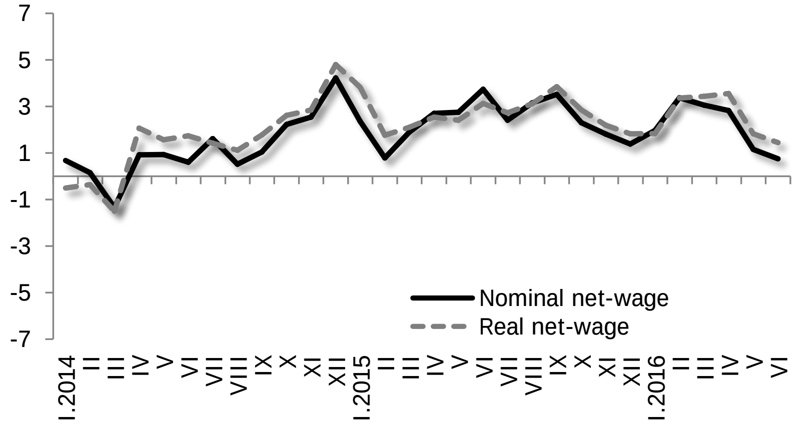
...amid minimal upward correction in oil prices, and downward correction of the expected price of wheat, corn, and foreign effective inflation.

However, global prices remained low, thus it is not expected that the minimal upward correction in oil prices to create pressures on domestic price movement.

The domestic price performances in August, as well as the changes in the expected trajectories of exogenous variables, so far indicate little downward deviations from the inflation projection for 2016. **The risks with regard to the inflation projection** remain mainly associated with the uncertainty about the expected movement in prices of primary commodities.

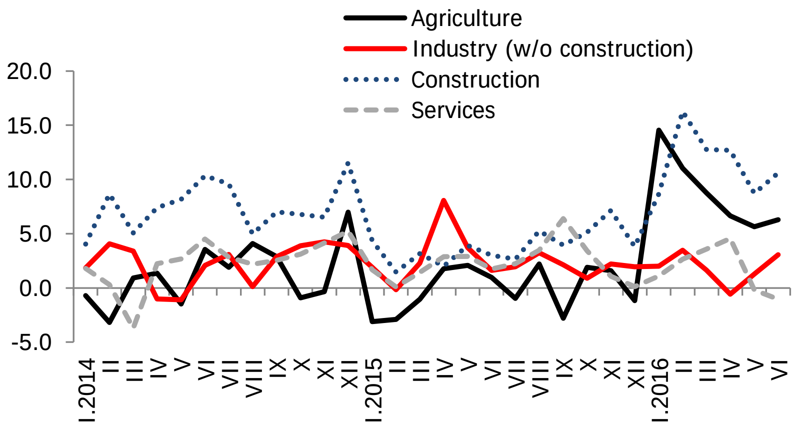
[10] The annual growth of tobacco prices in August is a combination of the flat increase in cigarette prices by five denars per box in March 2016 and increase in the price of a certain type of cigarettes in June 2016. In July 2016, the excise on cigarette additionally increased (from July 1, 2017 to July 1, 2023 the excise duty will increase by 0.20 denars each year), but the monthly change in prices of tobacco in July and August showed no price adjustments.

Average net-wage
(annual changes, in %)



Source: SSO.

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



Source: SSO.

In June 2016, the growth of the average net wage continued to decelerate and reduced to 0.7% (versus 1.1% in May and 2.8% in the first quarter of the year).

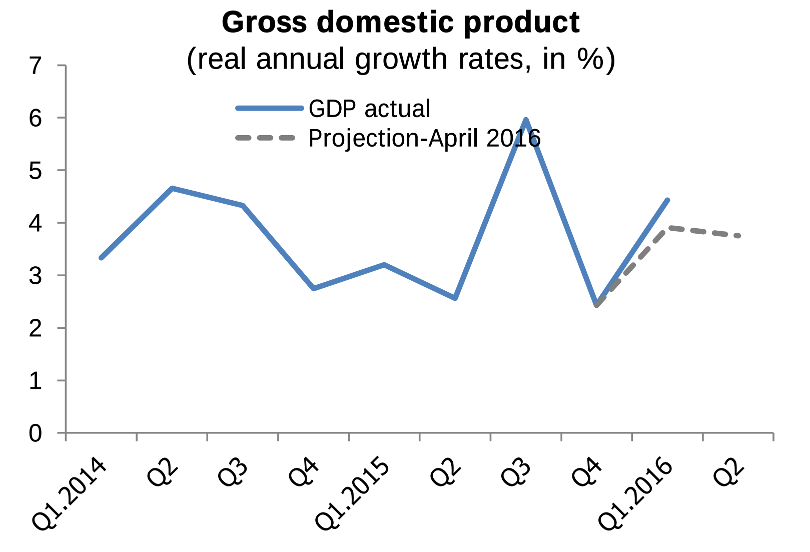
Analyzed by individual sectors, upward movement in wages in June was registered in agriculture, industry and construction.

On the other hand, the services sector generally registered lower wages whereby the reduction was most pronounced in the financial sector, real estate activities, "professional, scientific and technical activities" and "art, sport and recreation".

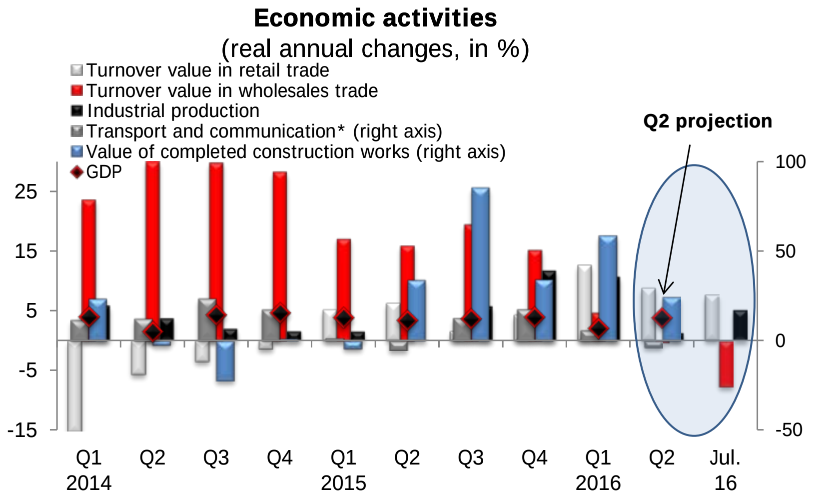
Given the decrease in consumer prices, in June, the **real wages** increased by 1.4%.

In the second quarter, the net salary recorded nominal and real annual growth of 1.6% и 2.6%, respectively. The real wage growth generally corresponds to the expected movement for the quarter as expected in the April projection, while a certain downward deviation is registered in the nominal wages.

In the second quarter of 2016, the real annual GDP growth was 2.2%, which is a growth pace similar to the achieved in the first quarter. However, such dynamics does not correspond to shifts in the high-frequency indicators during the second quarter that indicated significant slowdown of growth in this period. Compared to the April forecast, the growth in the second quarter is lower than the forecasted rate (3.8%).



Source: SSO and NBRM projections.



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

Analyzing the demand, growth in the second quarter was driven by domestic demand, while net exports declined. Observing by component, the greatest contribution to the growth was made by gross investment, which is in line with expectations according to the April forecast, but the growth pace is slower than expected. Growth in the second quarter was also recorded in exports and in private consumption, while public consumption declined.

Observing the production side, growth of the value added is mostly explained by the developments in the construction sector. On the other hand, some economic sectors registered a decrease in the value added[11].

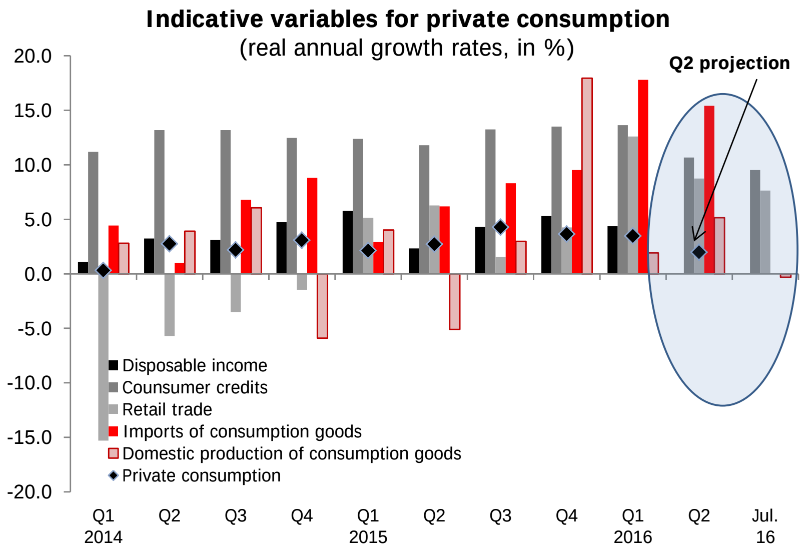
High-frequency data for the third quarter of 2016 point to further growth of the domestic economy. However, it should be emphasized that these estimates are based on few available data, which coupled with the current domestic non-economic factors, increases the uncertainty about the estimations for economic activity in the third quarter.

In July, **industrial output** registered an annual growth of 5.1% (compared to the decrease of 4.4% in June), which was mostly explained by higher production in the manufacturing industry, while growth is registered also in the production in the energy sector.

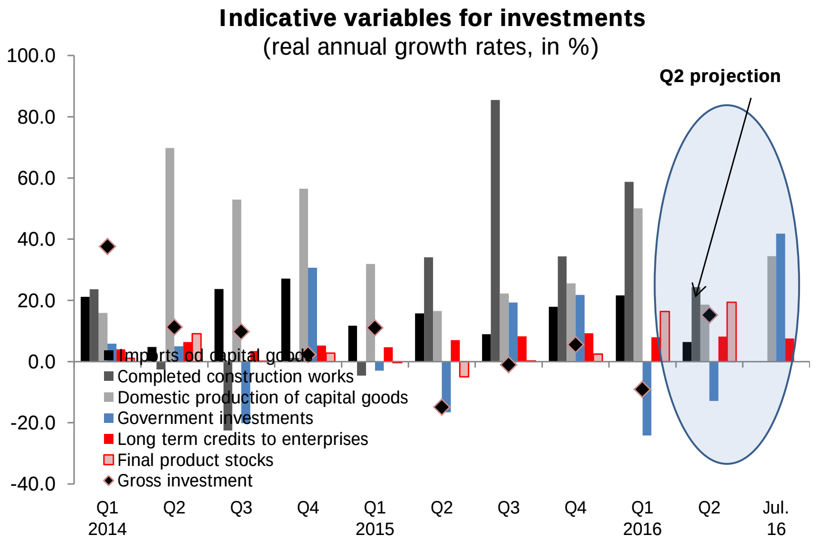
Analyzing the manufacturing industry, manufacture of machinery and equipment, and manufacture of motor vehicles, i.e. activities where foreign export facilities are present made the highest contribution to the growth.

Contrary to the favorable developments in the industry, in July, there was a decrease in the value of the turnover in total **trade**, reflecting mostly the lower turnover in

[11] In the second quarter, the added value has decreased in industry (including the manufacturing industry), activities related to real estate and in the categories of public administration and defense, compulsory social security, education, health and social care, as well as in arts, entertainment and recreation, other services, activities of households as employers, activities of households that produce commodities and provide services for own purposes.



Source: SSO and NBRM calculations.



Source: SSO and NBRM calculations.

wholesale trade, while the turnover in retail trade increased.

Available aggregate demand indicators mainly confirm the estimates for growth of economic activity in the third quarter of 2016, which is consistent with the expectation in the April forecast.

High-frequency data on **private consumption** point to its further increase for the third quarter of 2016...

...amid further solid growth of household lending, pensions and turnover in retail trade.

Regarding the indicative private consumption categories, in July, a slight decline was noticed in gross revenues from VAT and domestic production of consumer goods.

Available short-term indicators of **investment activity** point to an annual growth of investments in the third quarter of 2016...

...amid further growth of long-term lending to the corporate sector.

At the same time, in July, there was double-digit growth of the government capital expenditures and domestic production of capital goods significantly increased.

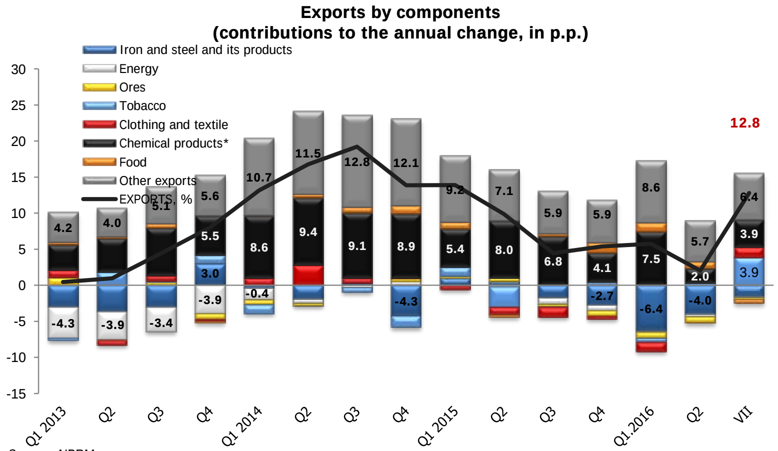
In July 2016, nominal data on **foreign trade balance** show small decrease of deficit...

... given the significantly higher increase in exports compared to imports of goods.

In July, the budget performances indicate a decline in **public consumption**...

...due to decreased expenditures for goods and services, while wage expenses for the employees in the public sector and health care transfers[12] increased.

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



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

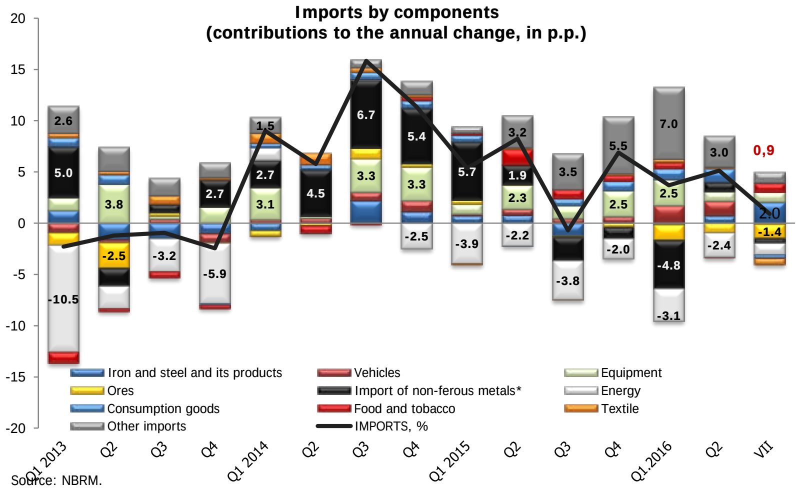
During July 2016, the intensified growth of exports compared to the increase of imports of goods led to **significantly narrowed foreign trade deficit by 25.1% on an annual basis**...

...while for the third quarter, according to the April forecast, a widening of the trade deficit is envisaged.

In July, **export of goods** registered an annual growth of 12.8%, due to the improved performance of the new production facilities, as well as the higher export of tobacco, and clothing and textile...

...while weaker export performance was registered in export of iron and steel.

Compared with the April projection, exports in July point to the possibility of higher performance in the third quarter. This deviation results from the export of the new export-oriented capacities and tobacco, while the export of food is somewhat weaker than expected.

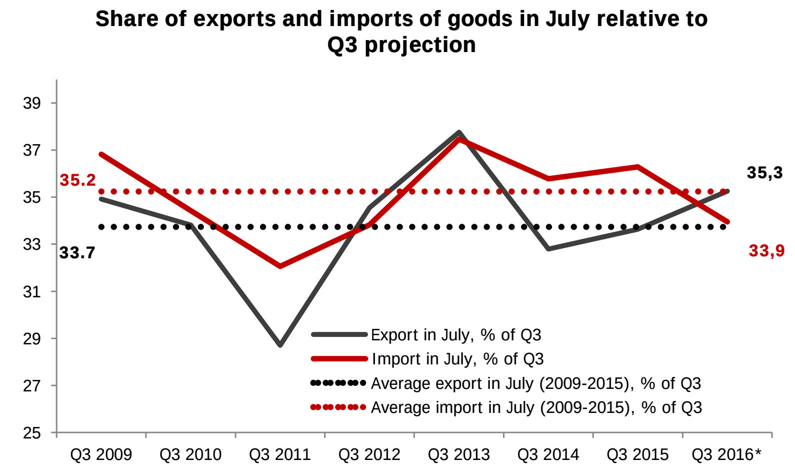


Source: NBRM.
** The following data depict the overall imports of one major export capacity in the free industrial zone.*

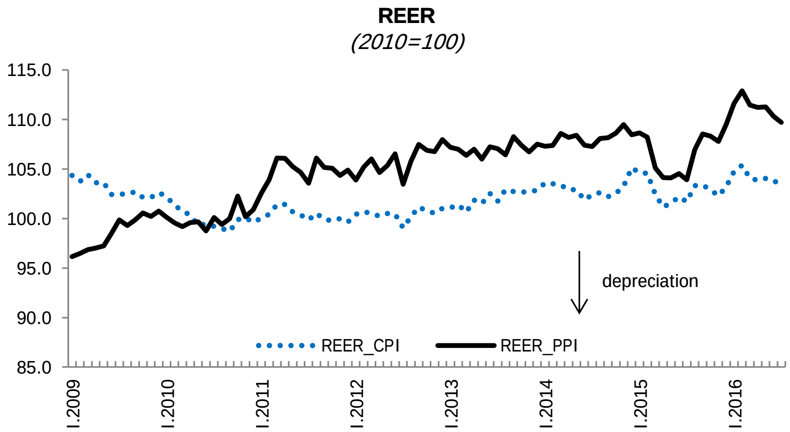
In July, **imports of goods** increased by 0.9% on an annual basis, amid growth of imports of iron and steel, and to a lesser extent, growth of imports of raw materials for some of the new industrial facilities and the import of food...

...which was largely offset by the fall in the import of ores and energy.

Import performance in July is generally in line with the expected for the third quarter according to the April projection. Analyzing by category, energy imports, other imports and imports of textile and clothing are lower than envisaged, despite the upward deviation in imports of iron and steel and in import of food.

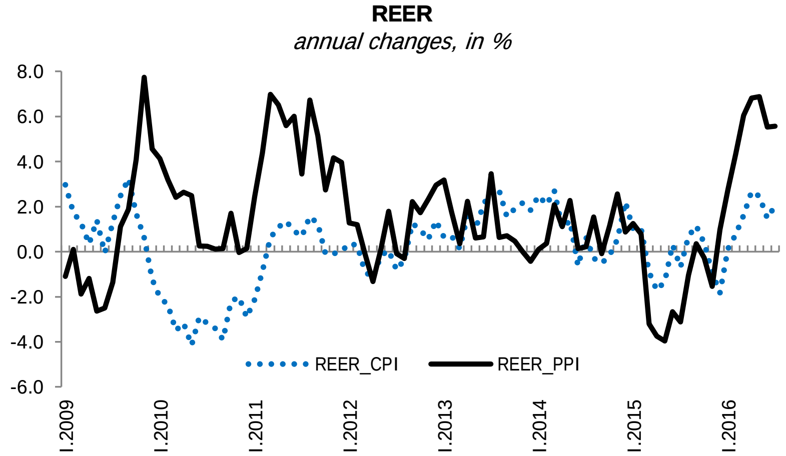


Performance of the components of the foreign trade in goods in July indicate likelihood of lower trade deficit than expected for the third quarter according to the April projection. Still, the data refer only to one month, which is not sufficient to reach reliable conclusions for the entire quarter.



Source: NBRM.

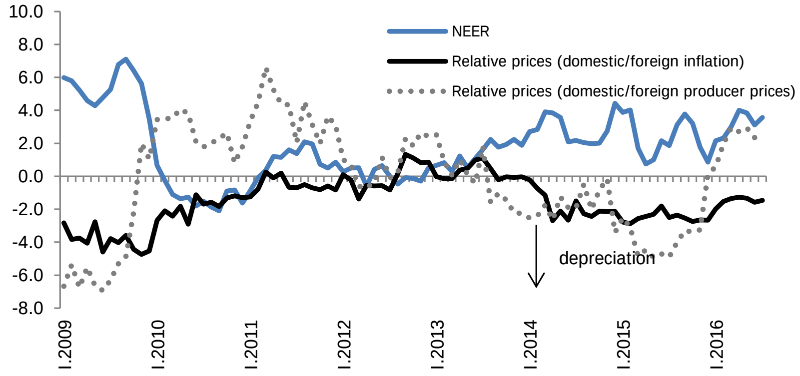
In July 2016, price competitiveness indicators of the domestic economy have pointed to annual appreciation. The REER index deflated by consumer prices have appreciated by 2% and the REER index deflated by producer prices have registered a more significant appreciation of 5.6%.



Source: NBRM.

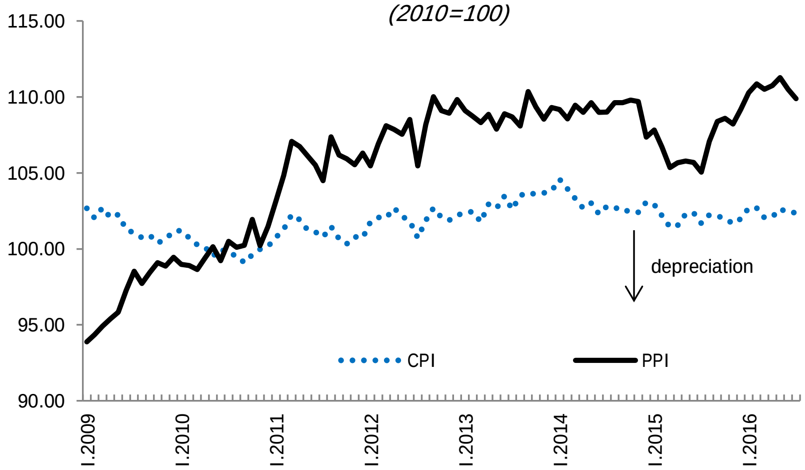
These developments are mainly due to the NEER dynamics, which appreciated by 3.6% on an annual basis, as a result of the depreciation of the British pound, the

NEER and relative prices
annual growth rates, in %



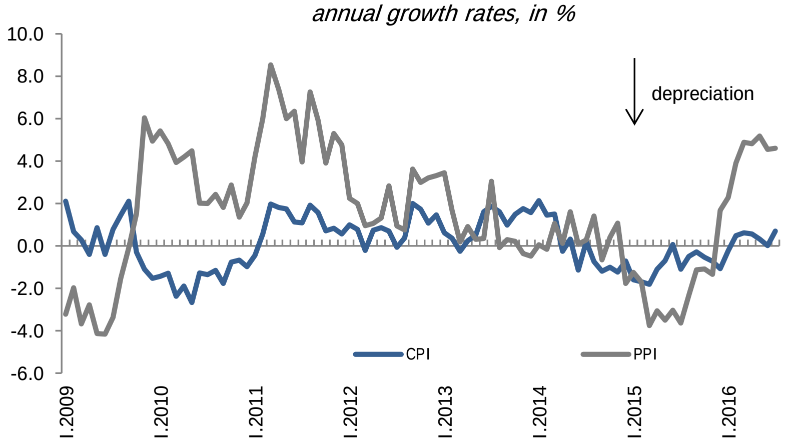
Source: NBRM.

REER, excluding primary commodities
(2010=100)



Source: NBRM.

REER, excluding primary commodities
annual growth rates, in %

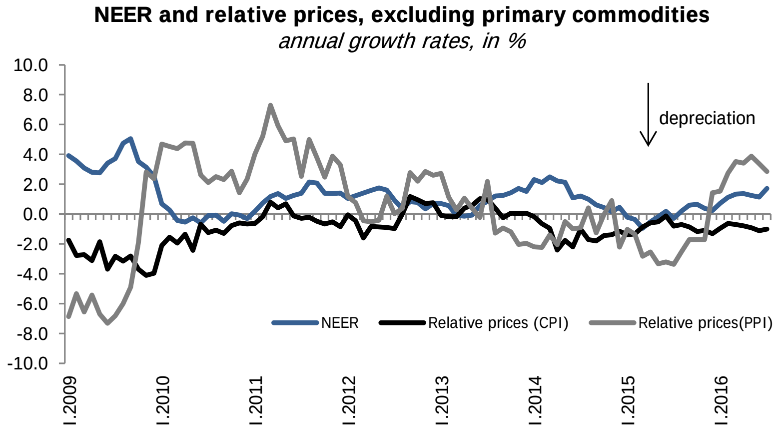


Source: NBRM.

Russian ruble and the Turkish lira against the Denar. Annually, the relative prices of industrial products have increased by 1.9%, while the relative consumer prices have decreased by 1.5%.

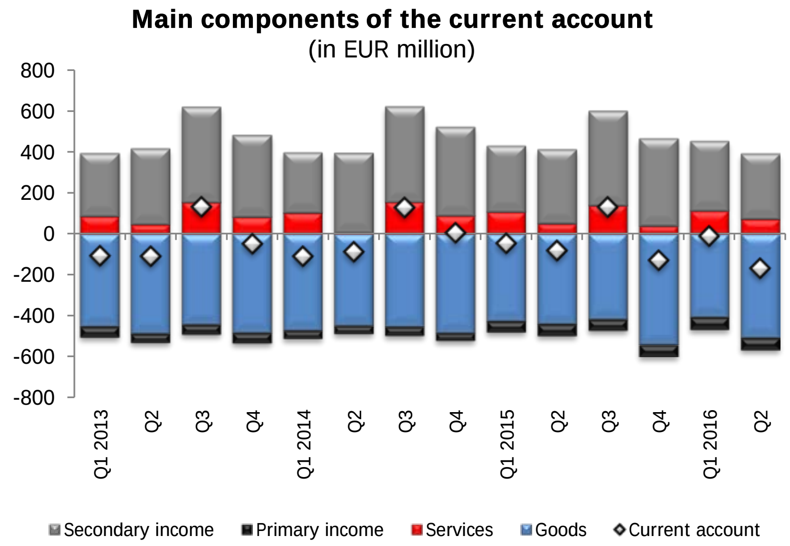
The analysis of REER indices, as measured using weights based on the foreign trade without primary commodities[13], indicates that they have appreciated. In July, the REER index deflated by consumer prices appreciated by 0.7%, while the REER deflated by producer prices appreciated by 4.6%.

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



Source: NBRM.

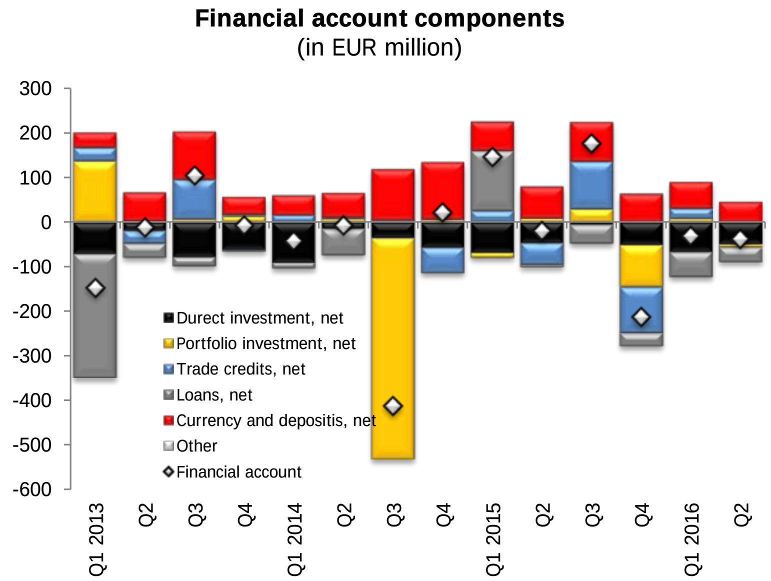
On an annual basis, relative consumer prices fell by 1%, while the relative prices of producer prices have increased by 2.8%. The NEER has appreciated by 1.7% on an annual basis.



Source: NBRM.

In the second quarter of 2016, the balance of payments' current account has registered a deficit of Euro 169.4 million (or 1.8% of GDP), which is higher than forecasted in April for the second quarter.

In terms of individual components, lower surplus in secondary income made the largest contribution to the deviation, and then, larger deficit in trade of goods and services, as well as somewhat larger deficit in primary income compared with the April projection.



Source: NBRM.

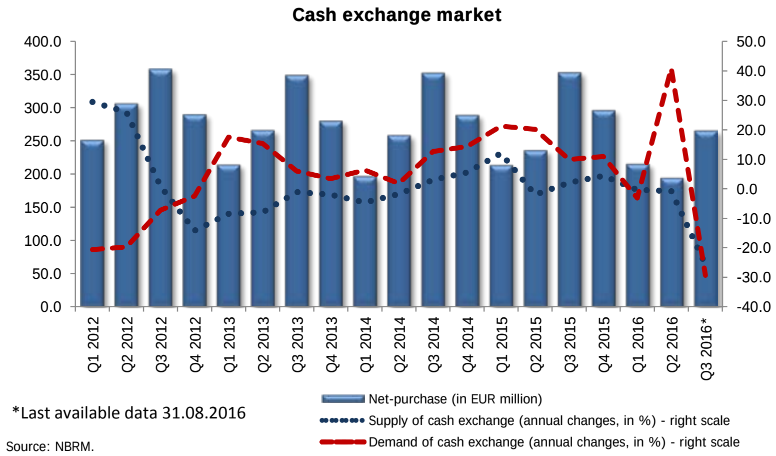
In the second quarter of 2016, the financial account registered net inflows of Euro 37.7 million (or 0.4% of GDP), which is a downward deviation from the April forecast[14].

The long-term loans category is the main factor for the downward deviation from the April forecast, where contrary to expectations of higher net withdrawals, almost neutral flows were realized in the second quarter. The realization regarding direct investments, in the currency and deposits category and in trade credits, was in line with the projected amounts. Moreover, within the currency and deposits category, the outflows in other sectors were higher, which were largely offset by the withdrawal of assets of banks from their accounts abroad. On the other

[14] According to the new methodology for compilation of the balance of payments (BPM6), the terms "net inflows" and "net outflows" denote net incurrence of liabilities and net acquisition of financial assets, respectively.

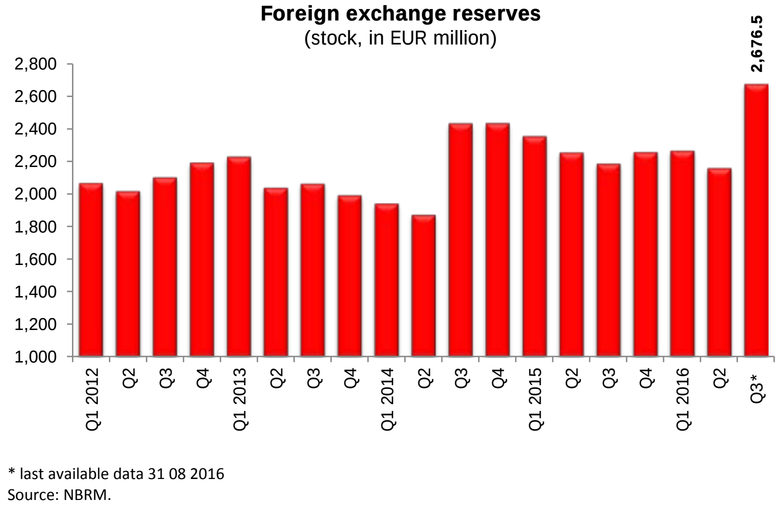
hand, net inflows recorded short-term borrowing abroad, despite the expected neutral position according to the April forecast.

Following last month's decline, as of August 2016, recent data on the currency exchange operations show growth of supply and demand for foreign currency, and thus further stabilization of the currency exchange market, after the pronounced pressures during April and May, caused by non-economic factors.



In the period 1 July – 31 August 2016, the net purchase in the currency exchange market totaled Euro 266 million, which is an annual increase of 6.9%.

The latest information from the currency exchange market indicate net inflows which are in line with the expected in private transfers in the third quarter of 2016, as projected in April.



As of 31 August 2016, the gross foreign reserves stood at Euro 2,676 million, which is an increase of Euro 517.8 million compared to the second quarter of 2016. The increase in foreign reserves mostly arises from transactions on behalf of the government, i.e. the issued Eurobond[15], as well as from the foreign currency deposits of domestic banks with the NBRM[16] and the NBRM interventions on the foreign exchange market. The other transactions have no significant influence on the amount of foreign reserves.

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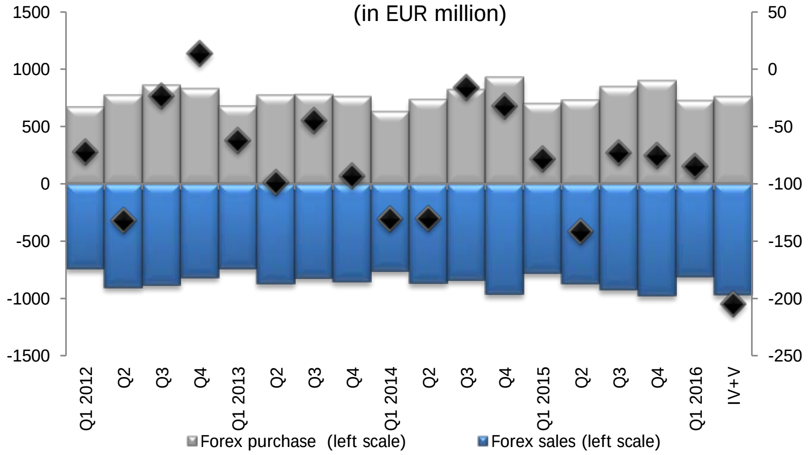
[15] On 26 July 2016 the government issued the fifth Euro bond in the amount of Euro 450 million, with maturity of seven years and interest rate of 5.625%.

[16] The growth of foreign currency deposits of domestic banks with the NBRM stems from the Decision on foreign currency deposit with the National Bank of the Republic of Macedonia, adopted on 6 May 2016, which allows interest rates to be determined at a level higher than the level of interest rates which domestic banks receive in placing funds in euros abroad.

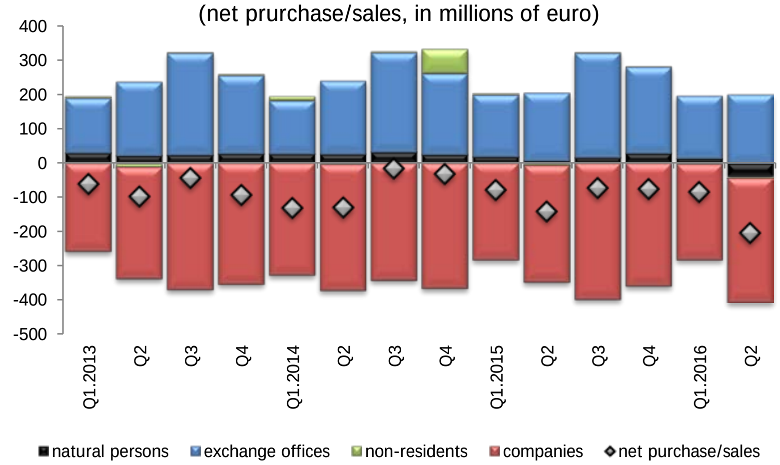
Foreign exchange market
(in EUR million)



Source: NBRM.

In the period July - August 2016, on the banks' foreign exchange market net purchase of Euro 41.9 million was realized, which is an increase of Euro 71 million on an annual basis (in the period July - August 2015 a net sale of Euro 29.2 million was realized). This annual change was due to increasing supply of foreign currency by 13.1% given the almost unchanged demand.

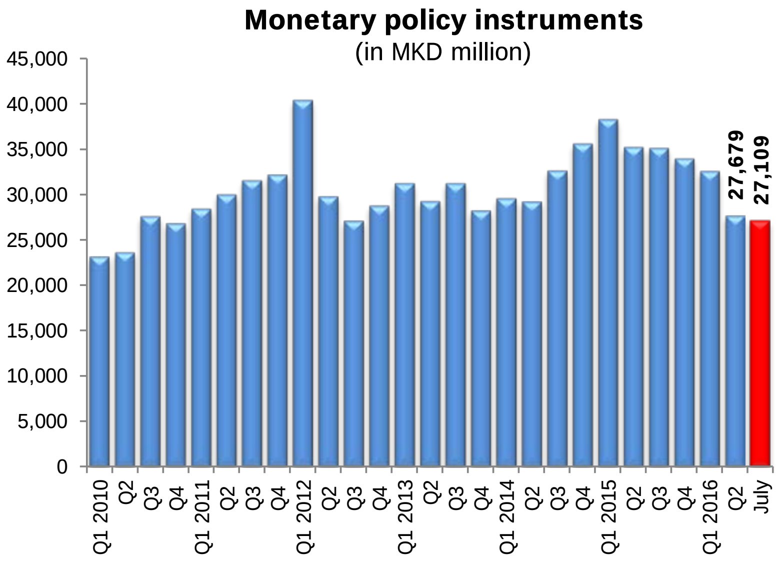
Structure of foreign exchange market,
(net prurchase/sales, in millions of euro)



Source: NBRM

Sector-by-sector analysis shows that these performances mostly arise from the lower net sales in companies, and then from the increased net purchase in exchange offices in this period.

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

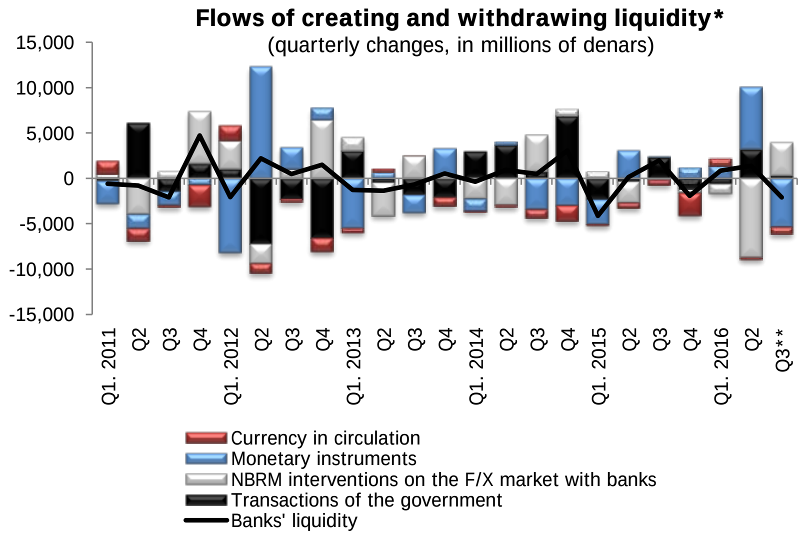


Source: NBRM.

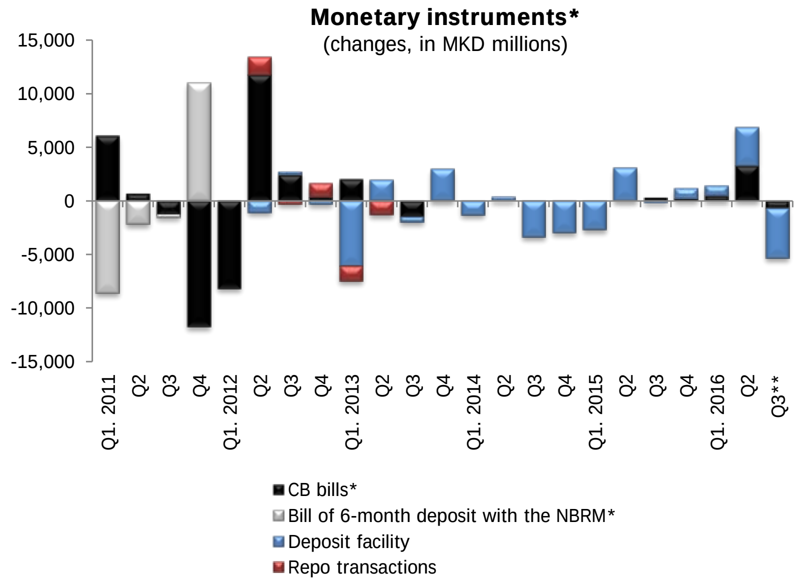
Regarding the flows of creating and withdrawing liquidity (in terms of balance sheet), in July, the NBRM net foreign assets significantly increased compared to the end of the second quarter, and the growth is also greater than expected for the third quarter. The increase mostly arises from the net government borrowing abroad which simultaneously contributed to the higher level of government deposits with the NBRM. Total government deposits were significantly higher than the envisaged increase in the third quarter, according to the April forecast.

In July, reserve money registered an increase compared to the end of the second quarter, which is higher compared to expectations for the third quarter of the year.

Taking into account the changes in some balance sheet components and their deviations from the forecast, the lower than expected level of monetary instruments is a consequence of deviations in the government position with the NBRM and reserve money.

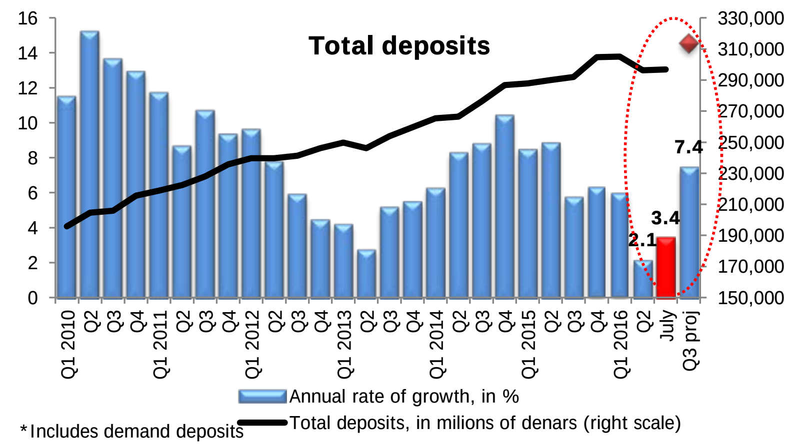


*Positive change- liquidity creation, negative change- liquidity withdrawal
** As of August. Source: NBRM.



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

According to operational data on liquidity flows, in August, the liquidity of the banks decreased on a monthly basis. Analyzing by individual factors, lower liquidity is entirely due to the higher amount of liquid assets placed in monetary instruments (mostly in short-term deposits with the NBRM), in terms of liquidity created by autonomous factors, mainly through the foreign currency transactions of the National Bank with the market makers.



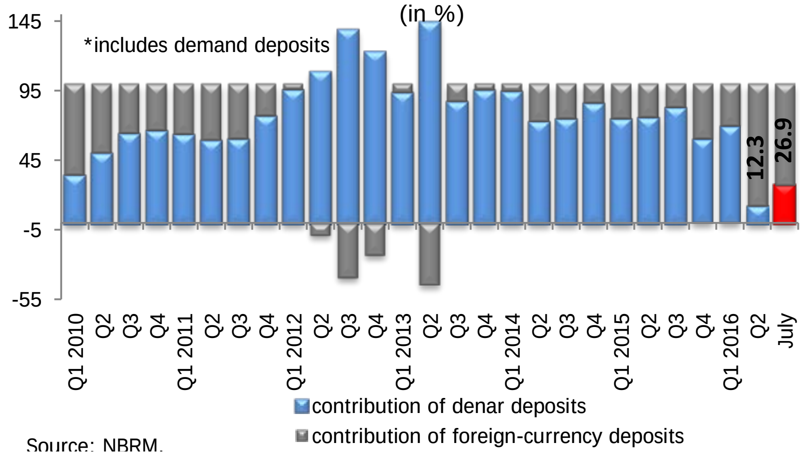
*Includes demand deposits
Source: NBRM.

After the fall in the previous three months, in July, total deposits increased. The higher level of banks' total deposit base is a signal of further evident stabilization of expectations of economic agents. Analyzed by sectors, the growth almost entirely arises from the increase in household deposits, amid small growth of corporate deposits, while deposits of other financial institutions[17] have registered a moderate decline.

In July, the annual growth rate of total deposits equaled 3.4%, which is below the projected growth of 7.4% for the third quarter of 2016.

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

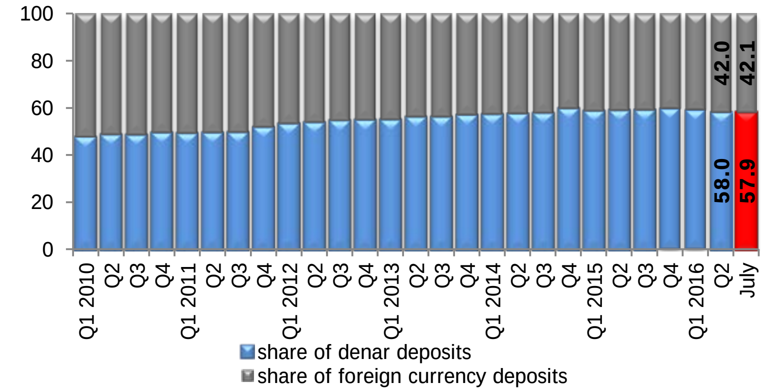
(in %)



Source: NBRM.
Includes demand deposits.

In terms of currency, in July, the contribution of Denar deposits to the annual growth of total deposits increased.

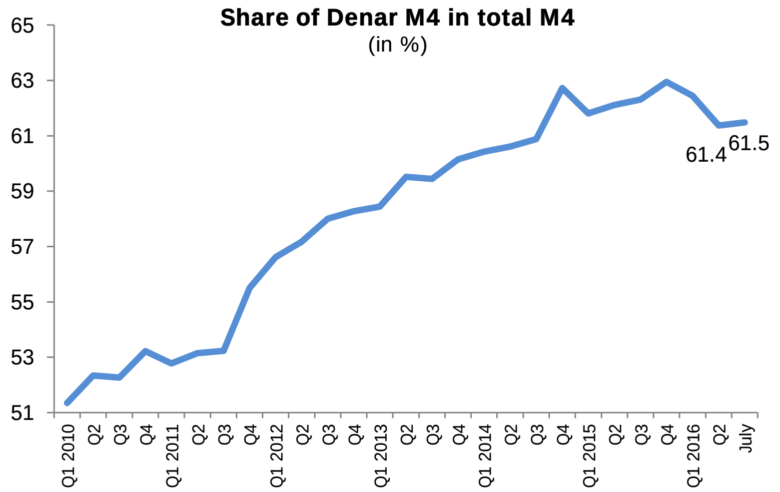
Share of denar and foreign currency deposits in total deposits



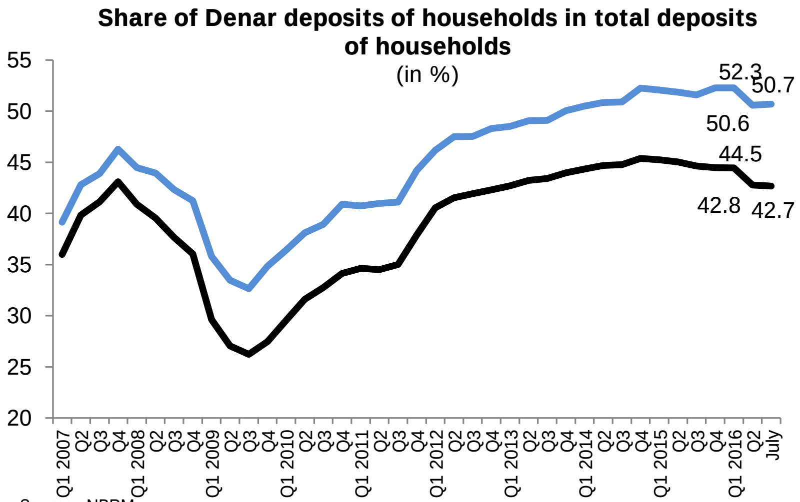
*includes denar deposits with FX clause. Source: NBRM.

The share of Denar deposits in total deposits in July remained relatively stable compared to the previous month, whereby Denar deposits dominated in banks' deposit base.

[17] Other financial institutions include investment funds, pension funds, insurance companies, investment funds management companies and pension funds management companies, financial companies and leasing companies.

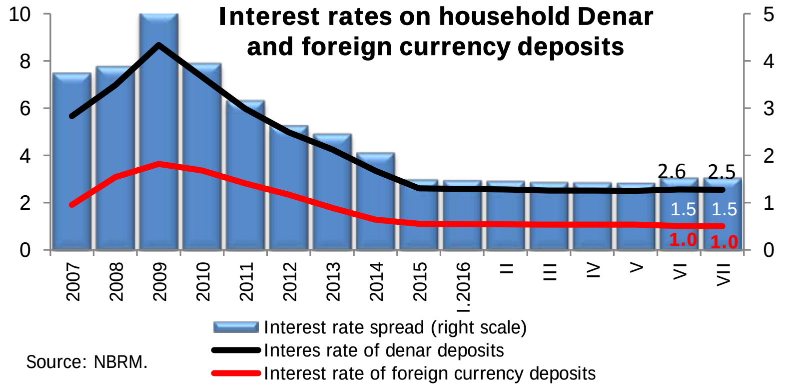


Source: NBRM.



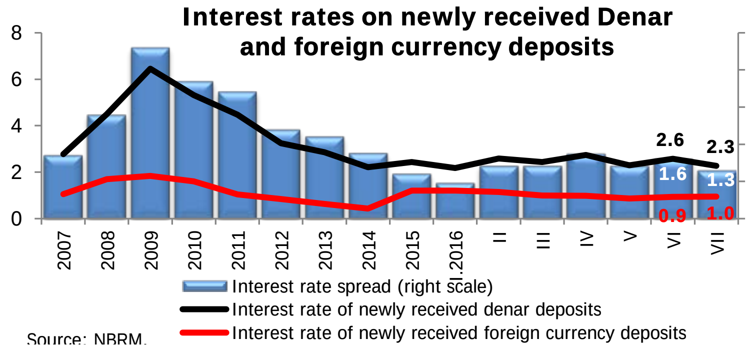
Source: NBRM.

In July, household deposits continued to increase, almost twice faster than in the previous month. In terms of currency, the increase in household deposits primarily derives from the increase in Denar deposits, indicating a significant improvement in entities' perceptions. Foreign currency deposits continued to increase, but at a moderately slower pace.



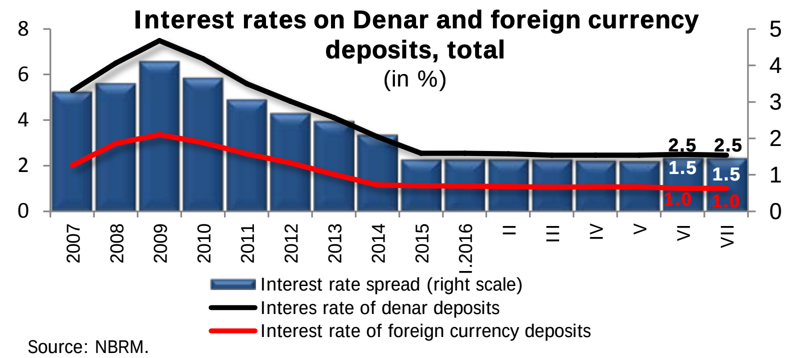
Source: NBRM.

In July, the interest rates on household Denar and foreign currency deposits remained at the same level as in the previous month. Consequently, the interest rate spread between the interest rates remained unchanged on a monthly basis. Interest



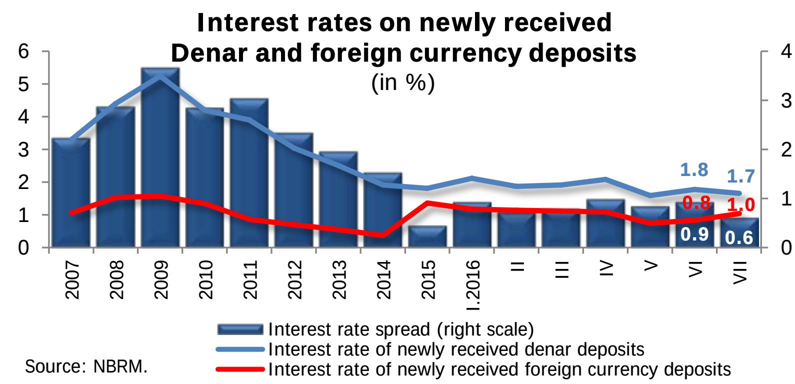
Source: NBRM.

spread of newly received deposits has narrowed as a result of the faster decrease in the interest rate on Denar deposits, amid small increase in the interest rate on foreign currency deposits.

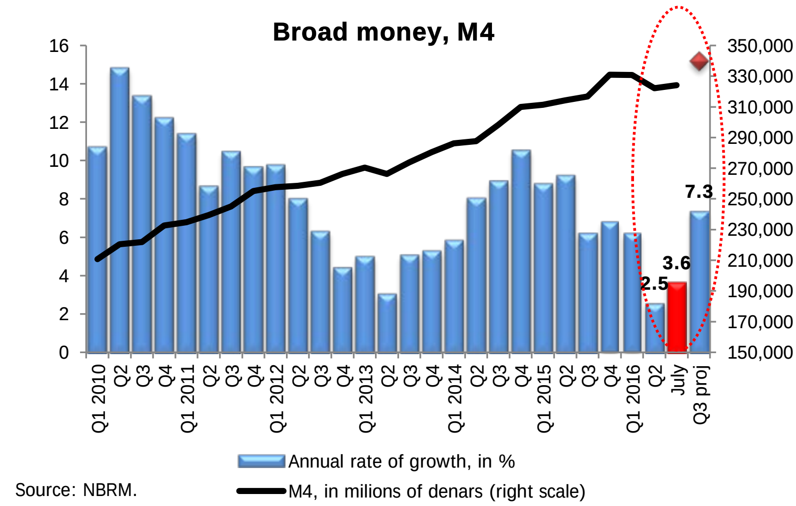


Source: NBRM.

Regarding the total interest rates, in July, there were no changes relative to the previous month. Regarding the newly accepted deposits, the interest rate on Denar deposits decreased, given the increase in the interest rate on foreign currency deposits. However, note that the interest rates on newly accepted deposits are volatile[18], possibly resulting in frequent and temporary adjustments of the interest spread.



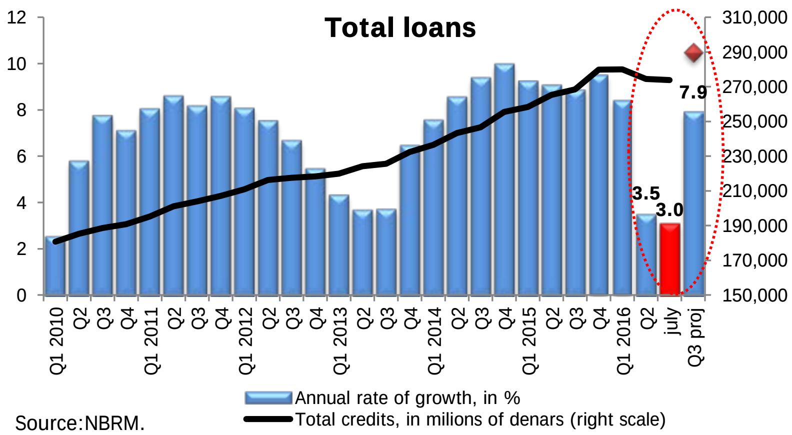
Source: NBRM.



Source: NBRM.

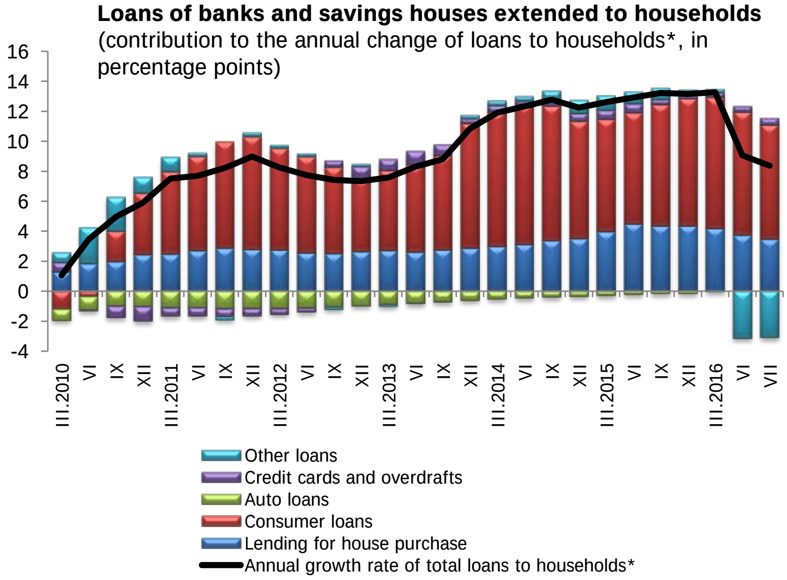
During July, broad money M4 increased on a monthly basis, contrary to the decrease registered in the previous three months. The increase in the money supply was mostly due to the increase in the currency in circulation, given the increase in the total deposits. **On annual basis, the broad money have increased by 3.6%, which is below the forecasted growth of 7.3% for the third quarter of 2016.**

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



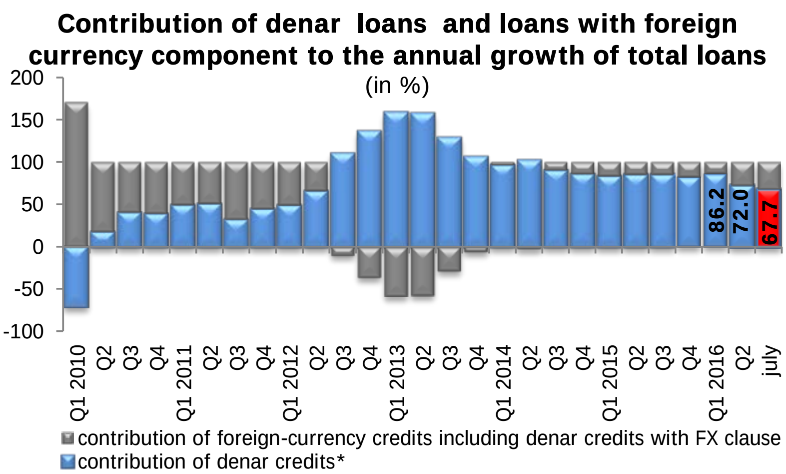
Source:NBRM.

Credit activity in July continued to decline on a monthly basis (by 0.3%), but at a significantly slower pace compared to the previous month. The fall in loans to the private sector is mainly a result of the regulatory changes.[19] Excluding the effect of the write-off, pursuant to the NBRM decision, loans to the private sector registered a smaller monthly decline of 0.1%. The results of the Lending Survey regarding the banks' expectations for the third quarter suggest a further easing of overall credit terms in both sectors, amid moderate net increase in demand in both sectors, at a slower pace in corporate loans.



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

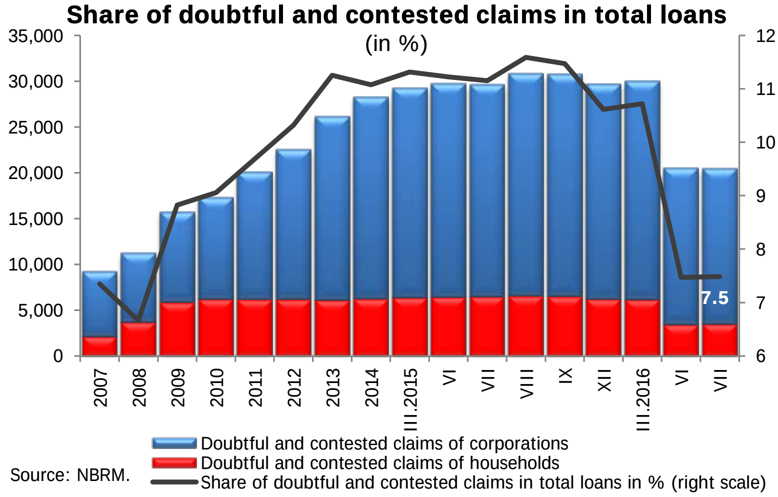
At the end of July, the annual growth rate of total loans equaled 3%, while if we exclude the effect of the regulatory changes, it equals 8.2% and is over the projected annual growth of 7.9% for the third quarter of 2016, as forecasted in April. In July, the level of total loans decreased by Denar 697 million, while if we exclude the effect of the write-off, the fall is lower, amounting to Denar 269 million.



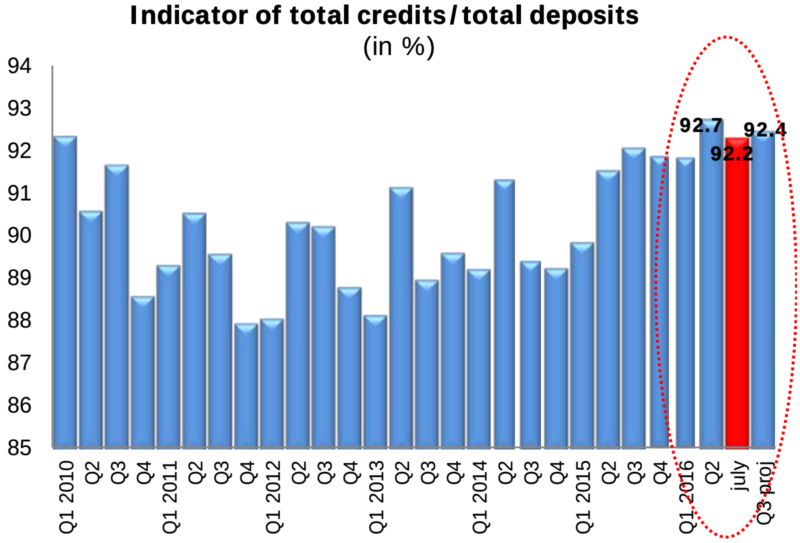
* does not include Denar credits with FX clause. Source:NBRM.

The annual rise in the total loans mostly arises from the growth of denar loans[20] and denar loans with FX clause, while the foreign currency loans registered a decrease.

[19] On 17 December 2015, the National Bank Council adopted the Decision amending the Decision on credit risk management, which requires from banks, for the period from 1 January 2016 through 30 June 2016, to write-off any claim that has been fully provisioned for more than two years, and where the bank identified and fully covered the credit risk of default at least two years before.
[20] Includes denar loans without FX clause, accrued interest and doubtful and contested claims.



Source: NBRM.

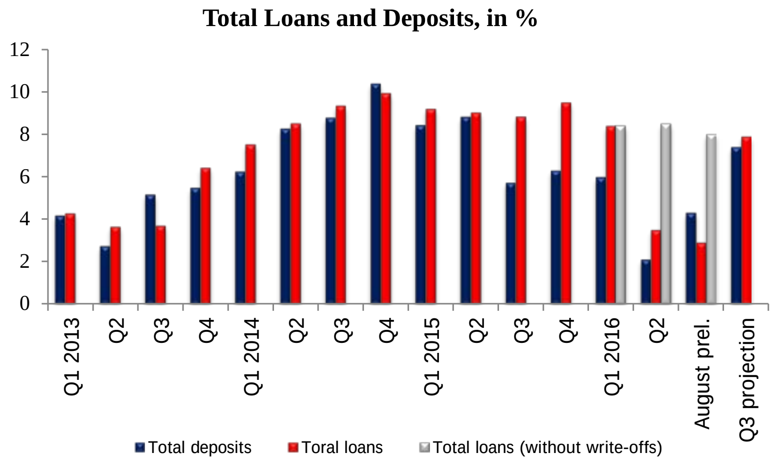


Source: NBRM.

The share of doubtful and contested claims in total loans equaled 7.5% in July, maintaining the same level as in the previous month. Analyzed by sector, there were minor changes in both sectors, a decrease in doubtful and contested claims on companies, and an increase in doubtful and contested claims on households.

On an annual basis, the total non-performing loans in July registered a significant decrease of 3.7 p.p. compared to the same month of the previous year, which is a result of changes in the regulations.

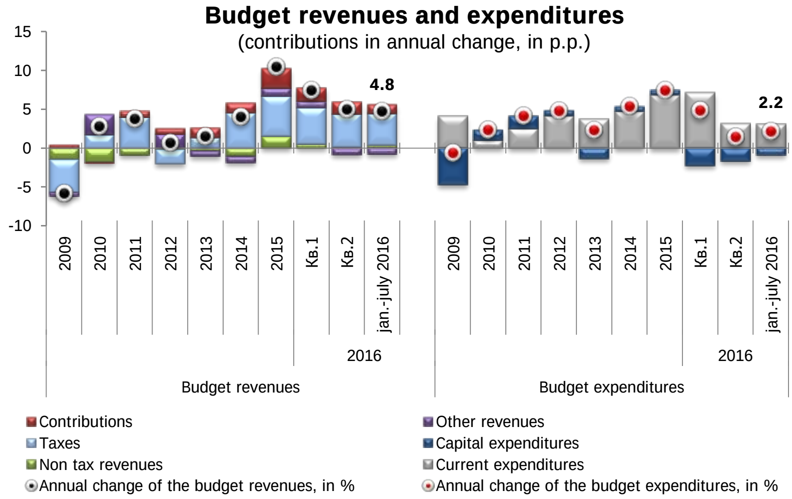
Utilization of the deposit potential for lending to the private sector as measured by the loan-to-deposit ratio amounted to 92.2% in July, which is lower performance compared to expectations with the April forecast. Compared to the previous month, the indicator decreased by 0.5 percentage points. Excluding the effect of the write-off, the loan-to-deposit indicator equaled 96.8%, which is by 4.4 percentage points above projections for the third quarter of the current year.



Source: NBRM.

Preliminary ten-day data as of August 2016 show a further increase in the total deposits of 2.5% on a monthly basis, i.e. at a significantly faster pace compared to the increase in the previous month (of 0.2%). The monthly increase in total deposits was mostly due to increased corporate deposits, amid moderate growth of household deposits. The currency structure of total savings shows further solid growth of denar deposits, which in August explain about 60% of the monthly growth of the total savings. Compared to the end of the second quarter, total deposits increased by Denar 7,977 million in August, exceeding the forecasted growth for the third quarter. **However, given the current downward deviations, total deposits increased by 4.3% on an annual basis, which is below the forecasted growth of 7.4% for the third quarter of 2016.** Analyzing the credit market, preliminary data as of August showed a minimal increase on a monthly basis, contrary to the decline of 0.3% registered in the previous month. The growth was entirely due to the higher indebtedness of households, amid further decline in corporate lending. **On an annual basis, total loans in August increased by 2.9%, while if we exclude the effect of the regulatory changes, they equal 8% and are over the projected annual growth of 7.9% for the third quarter of 2016, as forecasted in April[21].** Compared to the end of the second quarter, total loans in August decreased by Denar 614 million, while according to the April forecast for the third quarter, they are expected to grow.

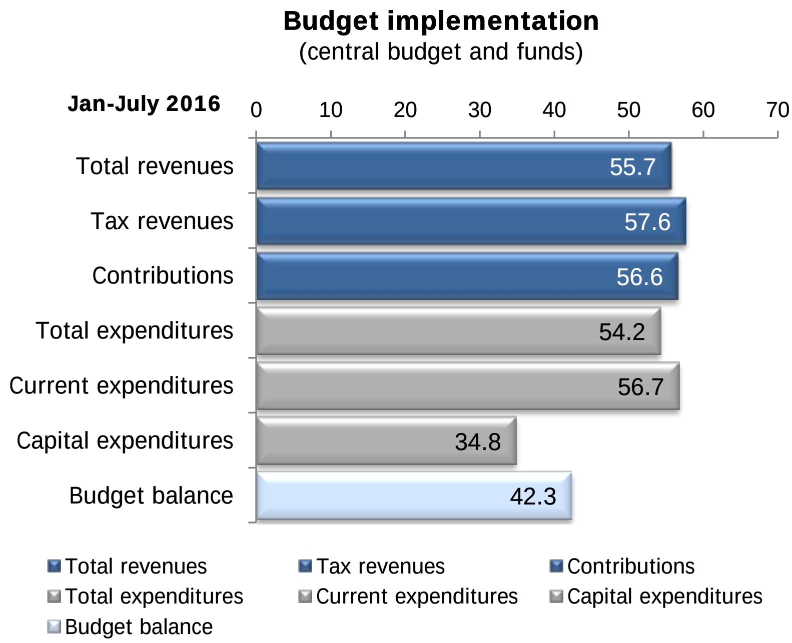
[21] During August, there was no correction for the write-off. It will be made after these data will be available.



*Other revenues include capital revenues, donations from abroad and revenues of recovered loans.

In the period January - July 2016, total revenues in the Budget of the Republic of Macedonia (central budget and budgets of funds) increased by 4.8%, on an annual basis. The higher annual increase in total revenues mostly arises from the higher realization in taxes and contributions. Analyzed by tax category, the increase in taxes is predominantly driven by inflows based on VAT and excise.

In the period January-July 2016, the budget expenditures increased by 2.2% on an annual basis, whereby the growth entirely arises from the higher current expenditures (within which transfers dominate), while capital expenses are lower on an annual basis.



Source: Ministry of Finance and NBRM's calculations.

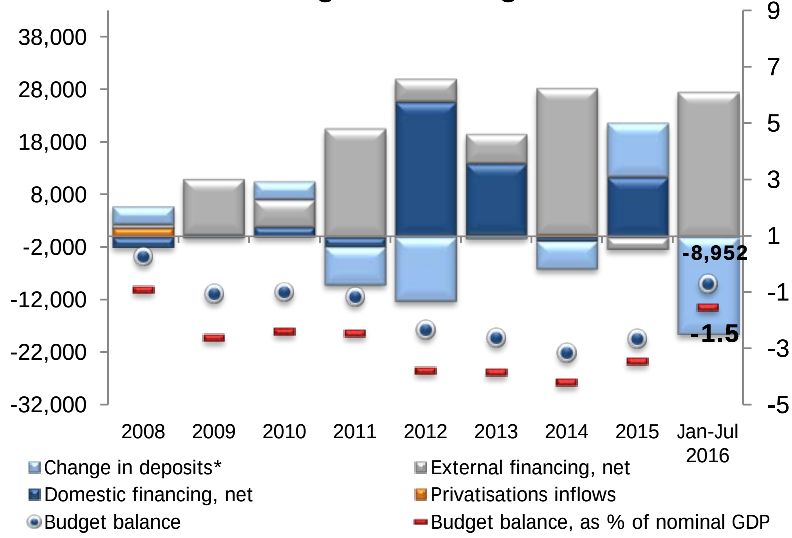
With respect to the Budget for 2016[22], in the period January-July, the realized budget revenues constituted 55.7% of the projected. Within the main categories of the budget revenues, the total taxes[23] and contributions registered realization of 57.6% and 56.6%, respectively.

As of July, the budget expenditures constituted 54.2% of the projected for 2016, whereby the realization of current expenditures amounted to 56.7% of the annual plan, while capital expenses are considerably lower (34.8% of the annual plan).

The realized budget deficit as of July constituted 42.3% of the planned for 2016.

[22] The comparison is made with the Budget Revision for 2016 of July 2016.
[23] It includes tax revenues (SSP)

Financing of the budget balance

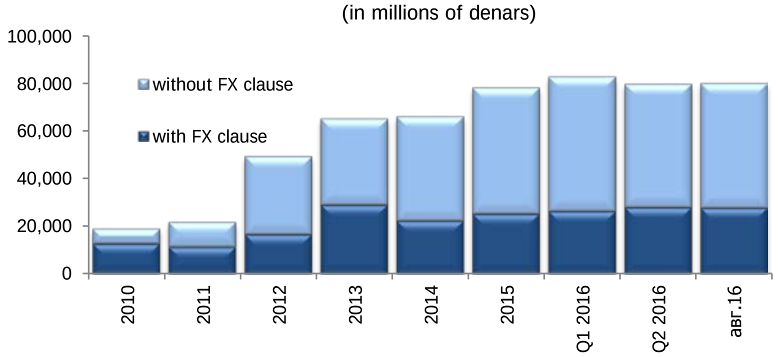


* Positive change- deposits withdrawal; negative change-deposits accumulation.
Source: MoF.

The period January-July 2016 registered a budget deficit of Denar 8,953 million or 1.5% of the nominal GDP[24].

The budget deficit in the analyzed period was mostly financed through external government borrowing, by issuing Eurobond on the international financial markets[25].

Stock of total government securities
(in millions of denars)

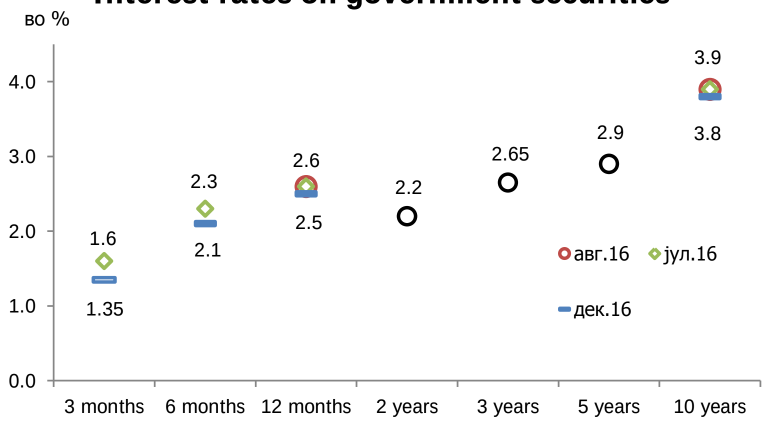


Извор: НБРМ.

At the end of August, the stock of government securities amounted to Denar 80,108.6 million, which is higher by Denar 315 million, compared to the end of the second quarter.

On a cumulative basis, the stock of government securities is higher by Denar 1,775 million since the beginning of 2016.

Interest rates on government securities*



* interest rates on 2 years, 3 years and 5 years government securities are from the last held auctions (in may 2015, sept. 2015 and nov. 2014, appropriately).

Source: Ministry of finance

In August, interest rates on government securities remained at the level of the previous month.

Compared to the end of the previous year, interest rates in August were moderately higher.

24 The analysis uses the NBRM April projections for the nominal GDP for 2016.
25 In Luly 2016, Eurobond was issued in the nominal amount of Euro 450 million, a maturity of 7 years and an interest rate of 5.625%.

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

January 2013

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

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

March 2013

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

July 2013

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

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

October 2013

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

November 2013

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

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

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

February 2014

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

April 2014

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

September 2014

- In order to further channel banks' excess liquidity to the non-financial sector, in September the NBRM revised the mechanism for transfer of the demand for CB bills, which is above the banks' potential into another instrument, i.e. seven-day standing deposit facility. According to these changes, for the seven-day standing deposit facility that banks are obliged to allocate if on the CB bills auctions they demand an amount higher than the potential[26], 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.

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

September 2014

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

October 2014

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

March 2015

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

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

April 2015

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

June 2015

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

August 2015

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

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

December 2015

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

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

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

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

May 2016

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

- The National Bank Council adopted the Decision on reserve requirement, which increased the reserve requirement rate for banks' liabilities in domestic currency with FX clause. The measure has been aimed at further encouraging the process of denarization of deposits in the domestic banking system. Given the negligible market share of these liabilities in the banks' balance sheets, the changes are exclusively for further maintenance of low propensity of the economic agents for placing this type of deposits in domestic commercial banks.

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