

National Bank of the Republic of Macedonia



Quarterly Report August 2015



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Introduction

During the second quarter of 2015, the NBRM kept its policy rate unchanged at the level of 3.25%. This decision was based on the latest macroeconomic projections made in April and the latest developments in the key macroeconomic and financial indicators, which did not point to any significant changes in the environment for conducting the monetary policy. In this period, inflation was within the April projections. **The rate of inflation** returned to the zone of moderate growth, which ended the year-long continuous decline in consumer prices. The rise in headline inflation was driven by the moderate increase in food prices and core inflation, which also grew after the downward movements registered in the previous two quarters. The growth of **economic activity** in the first quarter was within the expectations, and the latest short-term indicators pointed to further retention of positive trends also in the second quarter of 2015. Banks continued to support the economy through further growth of **credit activity**, which at the end of June was above the expectations of the April projection. The survey findings indicate positive developments in both the credit supply and credit demand, whereby both factors that drive the credit market tend to stimulate credit growth. The NBRM intervened in the foreign exchange market with net sales of foreign currency, which was in part expected, considering the payment of dividends to foreign shareholders, typical for this time of year. The fall in **foreign reserves** was expected in the April projection, and according to adequacy ratios, they still remain at the appropriate level, sufficient to cope with possible shocks. Regarding the **risks**, in this period they were related mainly to **non-economic factors** associated with domestic political developments and escalating economic and political developments in Greece (especially in June), the effects of which were estimated as limited, mainly materialized through the expectations channel. In the context of Greek developments and uncertainty about the future course of events, in late June the National Bank took preventive measures¹ to manage capital flows. Those are protective measures of a temporary character, introduced to prevent the threat of any significant outflows of capital from the domestic economy to Greece and thereby prevent significant disturbance to the equilibrium in the balance of payments and the stability of the financial system. In such conditions, **it was assessed that the current monetary policy stance is appropriate. Leaving the zone of accommodative monetary policy in the next period will depend on the materialization of identified risks and the effects on the external position of the economy and on foreign reserves.**

The key macroeconomic parameters in the domestic economy were generally moving within the projections in the April forecasting round. In the first quarter, gross domestic product registered an annual growth of 3.2%, which was in line with the expectations. The export sector continues to be the key single growth driver, mainly due to the increased activity of the new production facilities, and partly traditional sectors, amid a gradually improving external economic environment. From the components of domestic demand, private consumption made the largest positive contribution to growth, amid continued positive trends in the labor market and strengthening of banks' lending to households. In addition, growth in gross investments continued, while public consumption had minimal positive impact on GDP growth. As a result of the growth of export and domestic demand, in the first quarter growth in imports was registered. However, given the faster growth of exports than imports, the contribution of net exports to GDP growth in the first quarter was positive, which is the first such outturn since the end of 2013. Performances in the first quarter, as well as most of the available high-frequency data for the second quarter of 2015 point to keeping the economy in the zone of solid growth. However with some of the indicators, primarily activity in industry, which declined in the period from April to May, the movements are less favorable. The projected GDP growth for 2015 and 2016 amounted to 4.1% and 4.5%, respectively, when it is expected the export sector and investments to be the main generator of growth, producing positive spillover effects on the labor market and further encouraging household consumption. Unlike the April projections, now **downward risks have increased, mainly due to non-economic factors of domestic and external nature.** In fact, despite the agreement to stabilize the domestic political environment and the expectations for the conclusion of a new program for financing of Greece,

¹ For details on the preventive measures of the NBRM see the Decision on introducing special protective measures ("Official Gazette of RM" no. 107/15) at: http://nbrm.mk/WBStorage/Files/Regulativa_Odluka_voveduvanje_posebni_zastitni_merki_ang.pdf



certain delayed effects are possible that could have an adverse effect on the growth of the domestic economy in the second half of 2015.

During the second quarter, domestic prices increased on average by 0.3% annually. Such performances marked the one-year continuous steady decline in consumer prices and are generally within the expectations. Price movements reflect the growth in food prices and core inflation, which stood at 0.7% in the second quarter, as opposed to the decline in the previous two quarters. On the other hand, although with a reduced intensity the negative contribution of energy prices on overall inflation continued, mainly reflecting the continued annual decline in oil prices. **The risks to the inflation projection of around 0.5% for 2015 are assessed as balanced.** Upward risks arise from the latest expectations of higher world food prices compared with the assumptions included in the latest projections, while the downward risks are related to the possible slower growth of the domestic economy than projected.

Within the external sector, in the first quarter of 2015, the current and capital account showed a deficit of Euro 35.3 million or 0.4% of GDP, which is a slightly lower deficit than expected for the first quarter, mainly due to the improved performances in the trade account. At the same time, the financial account registered net outflows of Euro 155 million or 1.7% of GDP, which primarily reflects the early repayment of the loan from the IMF, used under the Precautionary Credit Line. The net financial outflows realized in the first quarter were slightly higher than planned and were in line with the expectations for this period that part of the balance of payments transactions will be financed through foreign reserves. In the second quarter, **gross foreign reserves** declined with somewhat greater intensity than expected for this period. The NBRM intervened in the foreign exchange market with net sale of foreign currency, which was in part expected, considering the payment of dividends to foreign shareholders, typical for this time of year. The presence of certain non-economic factors in this period, related to the developments on the domestic political scene and developments in the debt crisis in Greece has created uncertainty and influenced the expectations of economic agents, which also had a moderate effect on the developments in the foreign exchange market. Despite the decline in foreign reserves, foreign reserves adequacy indicators are still within the safe zone. The available external sector indicators for the second quarter are still insufficient to create an accurate picture of the position of the balance of payments compared with the projection. Recent data on foreign trade as of May point to achieving a trade deficit in line with that planned for the second quarter, while data on currency exchange operations point to the realization of slightly lower net inflows of private transfers relative to the projections. Pursuant to the April projection for the period 2015-2016, a slight decline in foreign reserves on a cumulative basis is expected. However, foreign reserves adequacy indicators show that they will further be maintained at an appropriate level, sufficient to cope with unforeseen shocks in the future. Downward risks in the external sector of the economy are still present and are associated with the present uncertainty in the global and domestic environment and their effects on the expectations of households and the corporate sector, although they are somewhat mitigated by the achievement of agreements on resolving the situation in the country and in Greece. Additional risk factors are changes in the prices of primary products in world markets.

In the second quarter, banks continued to support the economic recovery by increasing the lending to the private sector. New lending in this period was largely directed to households, with further credit support also for the corporate sector, which increased significantly relative to the first quarter. The annual growth rate of total loans in June was 9%, which is above the projection for the second quarter (8.8%), amid weaker deposit performance than expected in April (8.8% instead of 10% as projected). Weaker performances in the deposit base are partly explained by the changes in household deposits, which after a long period of time show moderate decrease on a quarterly basis due to the decline registered in May and June. Probably, such changes are in part reflecting the domestic political developments and escalating economic and political developments in Greece (especially in June) as factors that affect households' expectations. However, the decrease in total deposits is relatively small and in June it was with a reduced intensity compared to May, suggesting possible temporary trends and expectations for stabilization of the deposit base in the next period. Amid such expectations and generally favorable perceptions of risk by banks (as confirmed by the latest Lending Survey), one can expect the growth of credit activity to continue in



the next period, and according to the April projection it is expected to be between 9-10% in the period 2015 -2016. Risks common for the flows in the real and external sector are certainly present also on the credit market and create some uncertainty about future movements.

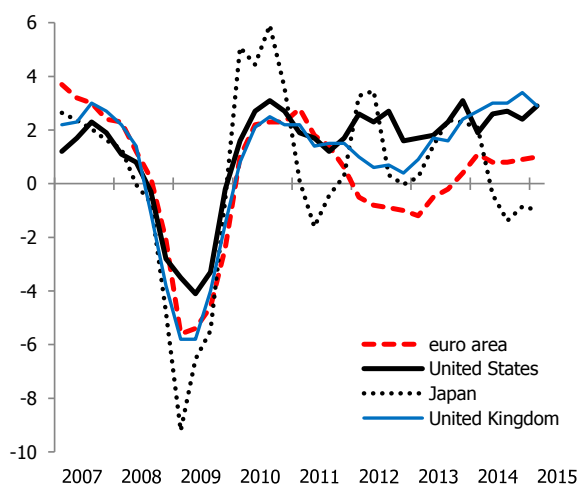
In summary, recent developments show that despite the increased risks in this period, related to factors of external and domestic nature, the fundamentals of the domestic economy remain solid. The economy has still been recovering at a solid pace, in part supported by the lending of the domestic banks. Economy recovers without price pressures and with adequate level of foreign reserves. Some indicators show changes pointing to possible effects from recent political developments whose impact is mainly materialized through the expectations channel. However, so far the effects are limited, indicating probably temporary trends, which in the coming period are expected to stabilize. The NBRM will continue to closely monitor the developments and if necessary, will make appropriate changes in the monetary policy for successful achieving of the monetary objectives.

I. Macroeconomic developments

1.1. International economic surrounding²

In the first quarter of 2015, the global economy continued to recover, however more slowly than expected, registering annual growth of 2.2%. Within the advanced economies, growth in the Euro area and Japan gradually strengthened, and the USA and the UK economies are expected to maintain the solid pace, despite the temporary drawbacks. In contrast, economic growth in emerging and developing countries continued the trend of moderate slowdown. According to the July projections of the IMF, the world economy in 2015 will grow at an annual rate of 3.3% and the growth will be driven by the developed countries. Positive developments in advanced economies come as a combined effect of the progress in deleveraging of the private sector, mitigated fiscal consolidation, improvement in the labor markets and expected investment growth. The negative risks still prevail, which in the short term is related to the increased volatility of financial markets, while the lower potential output in developed and in emerging countries is a major threat to medium-term growth. In terms of global inflation, it remained at a low level, influenced by movements in the price of energy, and together with the improvement in global conditions it is expected to accelerate in the coming period.

Real GDP growth in advanced economies
(year-on-year percentage changes; quarterly data)

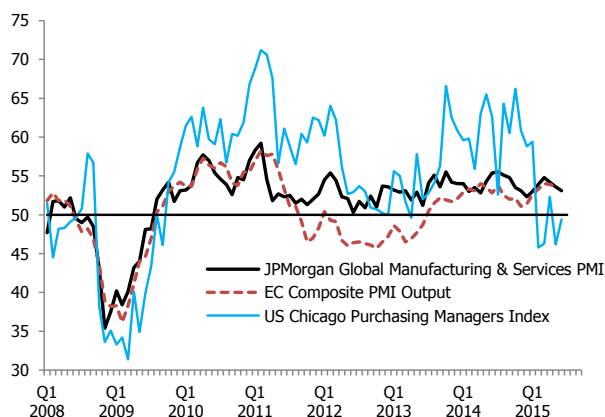


Source: Eurostat.

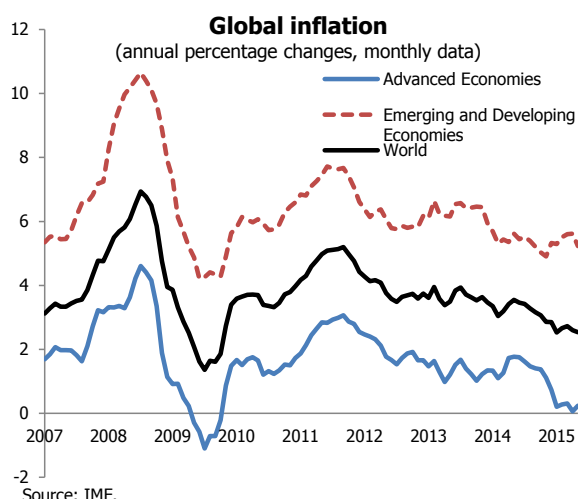
In the first quarter of 2015, the world economy grew by 2.2% annually, which is by 0.8 percentage points lower than expected. The weaker than expected economic activity of the USA was one of the main factors for such performances, reflecting the negative effects of some temporary factors³, which resulted in quarterly growth stagnation. However, on an annual basis the US economy retains the solid performance, achieving annual GDP growth in the first quarter of 2.9% (versus 2.4% in the previous quarter). According to recent estimates, the favorable conditions in the labor market, real estate market and low market prices of energy will support private consumption and investment in the United States also in the forthcoming period. The British economy continued to grow, albeit at a relatively slow pace, thus registering an annual growth of 2.9%, driven by private consumption, despite the lower net exports. In circumstances of stimulating monetary and fiscal policies, the economy of Japan has exceeded last year's poor

² The analysis is based on the IMF's "World Economic Outlook" of July 2015; the ECB's Economic Bulletin; the announcements of "Markit Economics"; "Global Economic Prospects" of the World Bank; Bloomberg; "Roubini Global Economics" and "Capital Economics" reports, the monthly reports of the International Energy Agency and the weekly reports of the Bank of Greece.

³ United States' GDP growth was limited because of the economic damage from the unusually cold winter, the stalled unloading of goods at ports on the west coast all the way to the resolving of the conflict over workers' rights, the sharp cut in capital costs of the oil industry and so on.



*The PMI index reflects the percentage of respondents that reported better business conditions compared to the previous month and it can take values between 0 and 100. PMI=50 is considered as a reference value, indicating unchanged economic conditions. A PMI value over 50 is taken to indicate that the economy is expanding, while a PMI value below 50 suggests that the economy is contracting.
Source: Markit, ISM-Chicago.



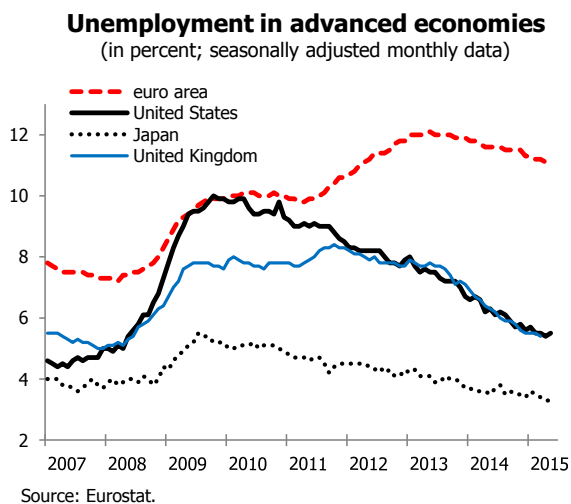
Source: IMF.

results and continued to recover at a fast pace. At the same time, economic activity in emerging countries registered sharp slowdown. The weaker investment activity, particularly in the construction sector, limited the growth of China, while the high uncertainty, reduced market confidence and high inflation adversely affected the economies of Russia and Brazil. The high-frequency survey indicators of economic activity - PMI pointed to further growth of the world economy, but with some slowdown also during the second quarter. Global composite PMI was lower than in the previous quarter (by 0.3 pp) and reached a value of 53.6 index points, amid weaker performances in the manufacturing industry. **In terms of expectations, the IMF forecasted an annual growth of the world economy in 2015 of 3.3%, which is a downward revision of 0.2 pp relative to the April projections⁴.** According to recent estimates, also in the forthcoming period negative risks to global growth will prevail. From the perspective of developing countries and emerging economies, there is still a risk of financial instability in the wake of the expected normalization of the monetary policy of the Fed, which builds on the threat of fiscal, financial and external pressures caused by lower oil prices to which exporting countries are exposed. Further appreciation of the US dollar poses a risk to the balance sheets and financing of countries whose debt is denominated in this currency, especially for some of the emerging economies. Regarding the Euro area, although the risk of spillover of the economic and political crisis in Greece is limited so far, there is a need of a timely response in case of its materialization.

In the period April-May 2015, global inflation remained at the level of the previous quarter (2.6%). Moreover, during this period it continues to be influenced by movements in global energy prices. Observed by groups of countries, low global inflation is a result of the movements in inflation in the developed economies and in the emerging and developing economies. The inflation in these two groups in this period gradually began to stabilize at levels of 0.2% and 5.4%, respectively, which is slightly lower than the performances in the previous quarter. According to the latest expectations, global inflation will gradually begin to move upwards in the coming period as a result of the exhaustion of the effects of recent cuts in the prices of primary products, their expected gradual transition in the growth zone and projected

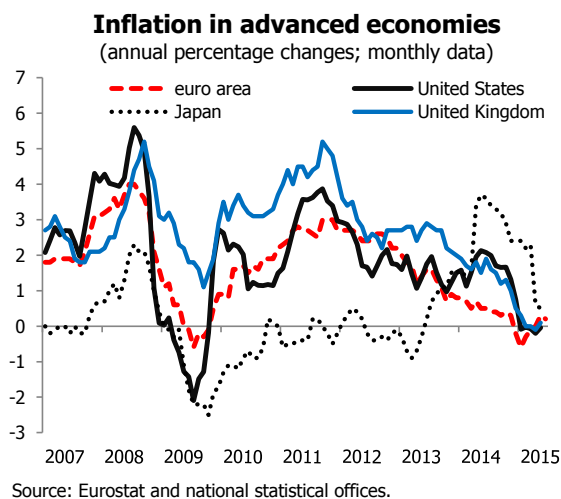
⁴ World Economic Outlook, IMF, July 2015.

acceleration of global economic activity. According to the latest IMF projections for 2015, the rate of inflation in the developed economies will be reduced to 0% (a downward revision of 0.4 pp compared to the April projection), while in emerging economies and developing countries it will be 5.5% (minimum upward revision of 0.1 pp).



The economy of the Euro area continued to recover during the first quarter of 2015. While on a quarterly basis real GDP growth has maintained the same pace of the previous quarter (0.4%), the annual rate of growth accelerated and reached 1%. The cyclical recovery of the Euro area is stimulated by the temporary effect of several factors, such as low stock prices of the fuels, the more favorable terms of financing provided by the accommodative monetary policy of the ECB and the improved price competitiveness amid the depreciation of the euro. They are reflected in the further recovery of private consumption, as the main driver of economic activity, which was accompanied by growth in investment and public consumption. On the other hand, in the absence of significant positive impulse from global demand on exports, and amid simultaneous intensification of imports, foreign trade had a negative net impact on overall economic performance. Regarding the largest countries in the Euro area, Spain recorded the best results (0.9%), while slightly lower quarterly growth was registered in France, Germany and Italy (0.6%, 0.3% and 0.3%, respectively). However, there is a significant divergence in the economic growth among other member states⁵. The growth of the real economy in the Euro area was accompanied by improved conditions in the labor market where the unemployment rate in the period from April to May was reduced to 11.1% on average. **Towards the end of the second quarter, increased adverse risks to the cyclical recovery of the Euro area and the medium-term prospects of the European capital market were registered, as a result of the deteriorating economic and political situation in Greece.** The Greek crisis escalated on June 30, when the agreement for financial assistance from international creditors under the

⁵ Under the influence of cyclical factors, the highest quarterly growth (of 3.1%) was registered in the Czech Republic, while the political uncertainty and worsening economic conditions led to a quarterly decline of the Greek economy (of 0.2%).



Second Economic Adjustment Programme⁶ formally expired and when Greece⁷ failed to repay the due debt to the IMF⁸. On the other hand, the ECB took a decision to retain the current level of Emergency Liquidity Assistance - ELA amounting to Euro 89 billion, which provides short-term financial support to the Greek banking system⁹. In these circumstances, Greece introduced a series of measures to prevent further excessive outflow of deposits, in the form of capital controls and temporary closure of the Greek banks. **However, the measures taken in July aimed at resolution of the Greek crisis, have contributed to avoiding the major risks associated with the economic and political outlook in Greece.** Despite the outcome of the referendum¹⁰, in the following days the Greek government agreed with the creditors to start negotiations for the Third Economic Adjustment Program¹¹. Meanwhile, Greece was granted temporary financial assistance from the European Commission¹², which enabled the repayment of outstanding liabilities to the ECB and the outstanding debt to the IMF¹³. Also, after a three-week period, Greek banks reopened, although capital controls remained in force¹⁴. According to estimates, the recent measures reduced the uncertainty and assisted in avoiding major shocks in the European and world markets.

⁶ On 14 March 2012, Greece was approved financing through the Second Economic Adjustment Program with joint resources of the European Financial Stability Facility (EFSF) and the IMF, totaling Euro 164.5 billion in order to restore fiscal sustainability and implement structural reforms.

⁷ These events were preceded by a sudden interruption of the negotiations of the Greek government with the Eurogroup and the IMF and its decision to hold a referendum in early July over the new austerity measures which were the precondition for the extension of the Second Economic Adjustment Program.

⁸ Thus Greece has officially become the first developed country with arrears to the IMF in the amount of Euro 1.5 billion, which prevents additional financial assistance from this institution until its repayment.

⁹ From February onwards, after the ECB had banned the use of Greek government and publicly guaranteed bonds in their standard operations, the Greek banking system has been relying on funding through the ELA, being unable to join the interbank and bond markets.

¹⁰ At the referendum held on 06 July 2015, the majority of the Greek population pleaded against the austerity measures proposed by international lenders.

¹¹ It is planned this three-year program of financial assistance to be in the amount of Euro 86 billion and it is accompanied with a new package of reforms of the tax and pension systems.

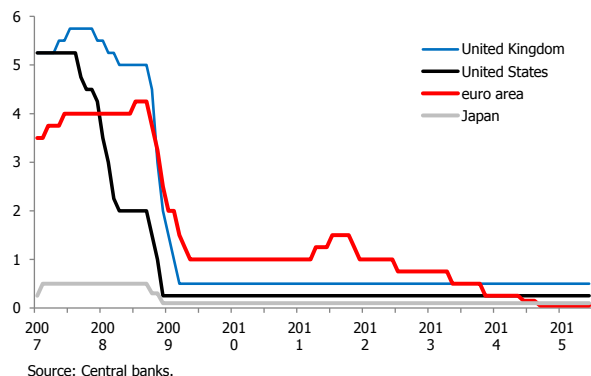
¹² Through the EFSF, funds had been transferred to Greece (the so-called bridging loan) in the amount of Euro 7.16 billion to overcome financing needs in July.

¹³ Repayment of Euro 4.2 billion to the ECB and Euro 2 billion to the IMF.

¹⁴ The threat of a lack of funding for the Greek banking system was alleviated after the ECB increased the level of ELA for additional Euro 900 million, without making change in terms of the collateral.



Policy rates in advanced economies
(in %)



In the second quarter, inflation in the Euro area exited the zone of negative annual growth, reaching 0.2%.

These achievements are a result of the upward trends in all inflation components. More specifically, in this quarter there was a significant acceleration of food inflation, a moderate rise in core inflation, and a reduction in the deflationary pressures from the energy component. In the coming months inflation is expected to continue to be low due to base effects, whereafter it would start to gradually approach the target of 2%, in line with the recovery of the domestic economic activity and more pronounced transmission effects through the exchange rate channel.

Central banks of developed countries continued to conduct accommodative monetary policy in the second quarter.

The policy rates of the Fed, the ECB and the Bank of England remained unchanged at levels near zero (0-0.25%, 0.05% and 0.5% respectively). Contrary to the expectations for starting the normalization of the monetary policy, in the past quarter the Fed did not make an upward adjustment in the reference interest rate. At its June session, the Federal Open Market Operations Committee (FOMC) reaffirmed its view that it expects the increase in the policy rate to be appropriate at the point when further improvement in the labor market and convergence of inflation towards the medium-term target of 2% are registered. Fed maintained its existing policy of reinvesting the maturing debt in new assets in order to maintain the accommodative financial conditions. Regarding the Euro area, the ECB continued to implement the expanded asset purchase program, in a monthly amount of Euro 60 billion. This measure is envisaged to be implemented until the end of September 2016, i.e. until it is assessed that convergence of inflation to the target level of about 2% over the medium term is sustainable. In the previous period, the Bank of England did not make significant changes in the monetary policy.

USD/EUR Exchange rate
(monthly data, average)

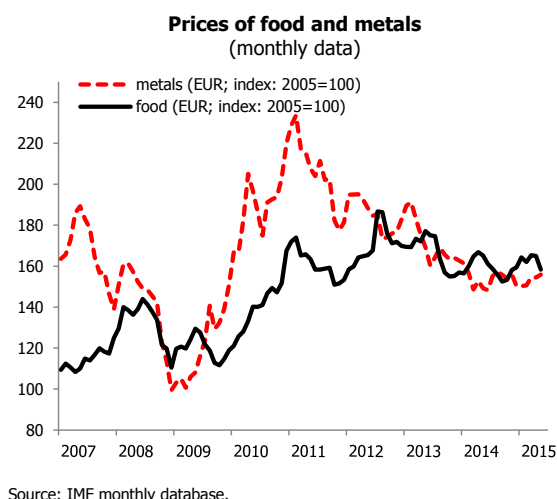
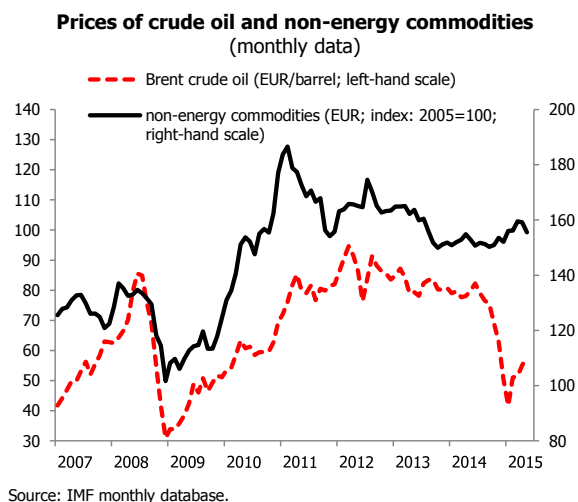


Source: Eurostat.

During the second quarter, the nominal exchange rate of the US dollar against the euro appreciated, but at a slower pace.

In fact, during this period the US dollar recorded a moderate quarterly appreciation of 2% (as opposed to the appreciation of 10.9% in the first quarter). It reflects the changing monthly movements, meaning that after the realized appreciation of 0.5% in April, in the next two months the US dollar depreciated by 3.3% and

0.6% on a monthly basis. The strengthening of the US dollar which is mainly associated with the measures of quantitative easing of the ECB and the Bank of Japan, is partly mitigated by the possibility of prolonging the normalization of the monetary policy of the Fed. As of June, the US dollar appreciated by 21.2% on an annual basis, with one US dollar being exchanged for 0.89 euros.



Oil price, expressed in euros, remained low also during the first two months of the second quarter. However, compared to the previous quarter, the oil price increased, achieving the first quarterly growth after three quarters of negative growth rates. Such price movements were to some extent prompted by the increased demand for oil, in response to the favorable price conjuncture, and due to the overall recovery of the global economy. Also, upward pressures were caused by the military conflicts in the Middle East, together with the medium-term implications for the supply of oil from the expected cut in the capital costs of US unconventional production. Despite recent developments, the oil price remains at extremely low levels, reflecting the high supply and the inventories of this fuel, supported by the latest OPEC decision to continue with the strategy to retain the market share. In the April-May period, the crude oil "Brent" was sold at an average price of 56.5 euros per barrel, which is a quarterly increase of 17.6%. Although this movement has slowed the annual decline in prices, it remained substantial and amounted to 29.5%. **Prices of non-energy primary products¹⁵ denominated in euros had a small quarterly growth (0.1%) in the first two months of the second quarter¹⁶.** Moreover, there was a quarterly increase in the price of metals (by 2.2%), which is explained by the appreciation of the US dollar against the euro in this period¹⁷. On the other hand, food prices reduced on a quarterly basis (by 1.4%), amid improved harvest and rising global inventories of cereals.

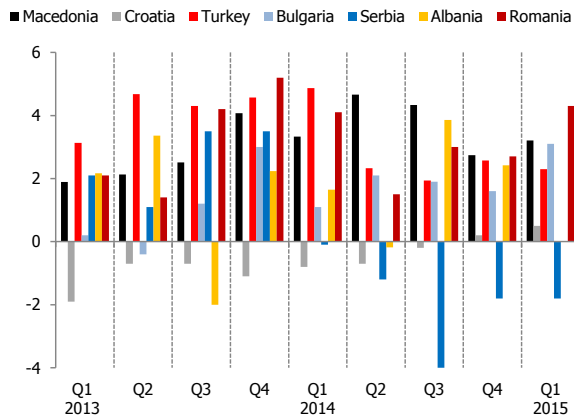
In the first quarter of 2015, most countries of the region had a more dynamic economic growth. An exception to this was Serbia, which continued to register a declining economic activity, which was largely a

¹⁵ The price index of non-energy primary products includes: prices of food, beverages, agricultural raw materials and metals.

¹⁶ Expressed in dollars, the prices of non-energy primary products registered a quarterly decline of 2.7%.

¹⁷ Expressed in US dollars, food prices registered a quarterly decline.

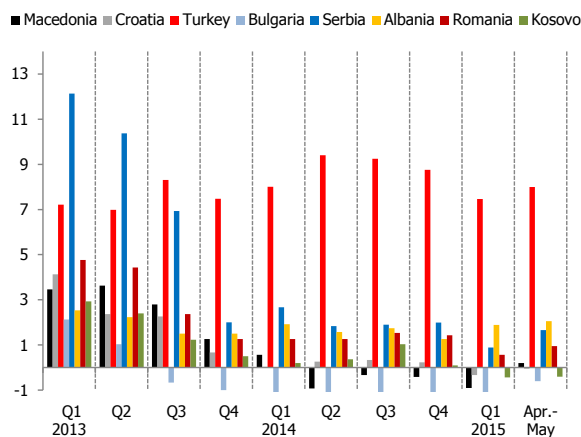
Real GDP growth in countries from the region (annual percentage changes, quarterly data)



Source: Eurostat and national statistical offices.

consequence of the implementation of fiscal consolidation measures by the government. On the other hand, Romania's economy registered a remarkable growth, which can be attributed to the strengthening of private consumption and gross investment. Bulgaria also recorded a solid growth, despite the restrictive fiscal measures, which was entirely due to the positive contribution of net exports, in conditions of improved external environment. Within this group of countries, Turkey also noted an economic growth, but due to reduced public investment and higher imports, the growth was lower compared to the previous quarter. Economic activity in Croatia continued to recover for the second consecutive quarter, although the process is still very slow.

Inflation in countries from the region (annual percentage changes)



Source: Eurostat and national statistical offices.

In April-May 2015 almost all countries of the region registered upward price pressures, although in some of them those pressures are not yet strong enough to allow exit from the zone of deflation. Moreover, compared with the previous quarter, the inflation rate increased in Turkey, Romania, Serbia and Albania. Inflation developments in Turkey and Romania, point to the upward trends in the food and energy component as the main factors for this rise, Serbia's inflation increase was influenced by the higher core inflation, while in Albania this was due to the effects on food prices due to the flooding in the beginning of the year. On the other hand, Croatia, Bulgaria and Kosovo continued to register negative price changes, although there is an evident trend of a gradual slowdown of such movements in the months of the second quarter.

1.2. Domestic supply

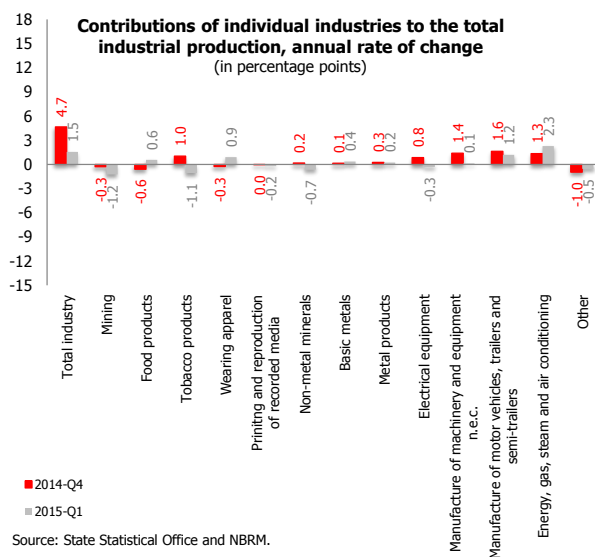
The Macedonian economy continued to grow in the first quarter of 2015, thus registering a quarterly growth of 1.1%. In times of such positive quarterly developments, GDP registered an accelerated annual growth of 3.2%. Improved economic performances were registered in most sectors, with the highest contribution coming from the growth in "trade, transport and communications," while solid performances were observed in the industrial activity, partly due to the activity of the new export-oriented capacities, which led to an improved assessment of the economic situation and the level of utilization of industrial capacities. Growth of value added was recorded in construction, but at a significantly slower pace compared to the previous quarter.

In the first quarter of 2015, quarterly growth of gross domestic product amounted to 1.1% (seasonally adjusted). Such growth accelerated the annual growth of the economic activity, with the real GDP being

higher by 3.2%. The quarterly growth of GDP is largely explained by the growth of value added of the activities "trade, transport and communications", industry, agriculture, as well as "financial activities and insurance activities". In terms of the annual dynamics, "trade, transport and communications" and "hotels and restaurants" are major drivers of the growth in the first quarter¹⁸. Higher added value, compared to the same period last year was registered in most sectors, with the exception of the "administrative and support service activities", agriculture and activities related to real estate. The value added in industry remains as one of the most important factors for the growth, with a slight intensification of the annual dynamics. However, in its framework, manufacturing industry registered a decline in added value for the first time in the first quarter, after the continuous growth present since the third quarter of 2012.

	annual growth rates, in %											contributions to GDP growth (in p.p.)										
	Q1 2013	Q2 2013	Q3 2013	Q4 2013	2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014	2014	Q1 2015	Q1 2013	Q2 2013	Q3 2013	Q4 2013	2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014	2014	Q1 2015
Agriculture	16.0	7.3	1.7	14.3	9.0	3.8	8.7	0.9	-3.1	2.0	-0.4	0.9	0.5	0.2	1.2	0.7	0.2	0.6	0.1	-0.3	0.2	0.0
Industry	6.7	5.8	4.5	6.2	5.8	2.6	5.7	5.9	2.8	4.3	3.1	0.8	0.7	0.5	0.8	0.7	0.3	0.7	0.7	0.4	0.5	0.4
Manufacturing	10.8	7.8	7.8	10.4	9.2	8.2	11.3	16.6	4.5	10.0	-1.8	0.8	0.7	0.7	1.0	0.8	0.7	1.0	1.5	0.5	0.9	-0.2
Construction	5.8	4.0	8.9	5.7	6.0	9.5	0.3	3.2	11.1	6.1	3.1	0.7	0.4	0.8	0.5	0.6	1.1	0.0	0.3	0.9	0.6	0.4
Trade and transport	10.6	5.7	3.4	-0.2	4.5	3.5	5.8	3.9	-0.9	3.1	6.3	1.5	0.9	0.6	0.0	0.7	0.5	1.0	0.6	-0.1	0.5	1.0
Information and communication	10.4	10.7	9.2	10.0	10.1	2.3	4.7	4.0	2.0	3.3	3.5	0.5	0.5	0.5	0.5	0.5	0.1	0.3	0.2	0.1	0.2	0.2
Financial and insurance activities	2.6	1.1	0.5	3.6	1.9	4.2	3.5	7.5	3.8	4.7	6.2	0.1	0.0	0.0	0.1	0.1	0.2	0.1	0.3	0.1	0.2	0.2
Real estate activities	-10.4	-2.5	3.5	5.8	-1.3	4.8	4.1	2.8	0.9	3.2	-0.2	-1.4	-0.3	0.4	0.6	-0.2	0.6	0.5	0.3	0.1	0.4	0.0
Professional, scientific and technical activities	-3.0	7.8	11.7	17.4	7.6	2.0	6.9	8.2	12.4	7.2	9.9	-0.1	0.3	0.4	0.5	0.3	0.1	0.2	0.3	0.4	0.2	0.4
Public administration	2.0	1.5	1.0	0.4	1.2	0.6	0.6	0.8	0.0	0.5	-1.9	0.3	0.2	0.1	0.0	0.2	0.1	0.1	0.1	0.0	0.1	-0.2
Other service activities	-19.6	-7.5	10.5	22.0	-1.0	12.2	11.3	11.6	11.7	11.7	6.6	-0.6	-0.2	0.2	0.4	0.0	0.3	0.3	0.3	0.3	0.3	0.2
Gross Domestic Product	1.9	2.1	2.5	4.1	2.7	3.3	4.7	4.3	2.7	3.8	3.2	1.9	2.1	2.5	4.1	2.7	3.3	4.7	4.3	2.7	3.8	3.2

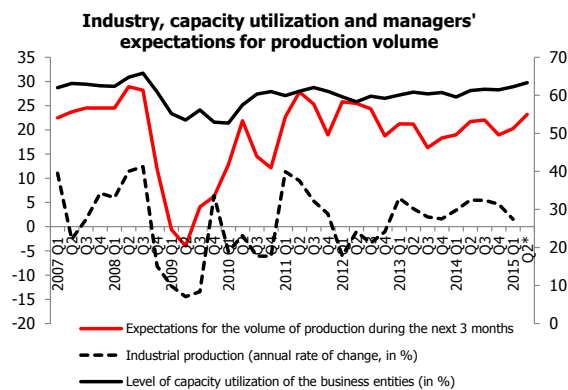
Source: State Statistical Office and NBRM calculations.



During the first quarter of 2015, the favorable developments in the industry continued. In circumstances of quarterly growth of value added, intensification of annual growth was registered. The new export oriented facilities are still the main generators of the annual growth in the industrial activity¹⁹, and growth was observed also in part of the other facilities. Analyzed by individual activities, the annual industry growth is mostly explained by the growth in the production of motor vehicles and devices, clothing, as well as higher food production. At the same time, in the first quarter, the sector "electricity, gas, steam and air conditioning supply" increased for the second consecutive quarter, contrary to the negative developments in this sector in the first three quarters of 2014. On the other hand, mining

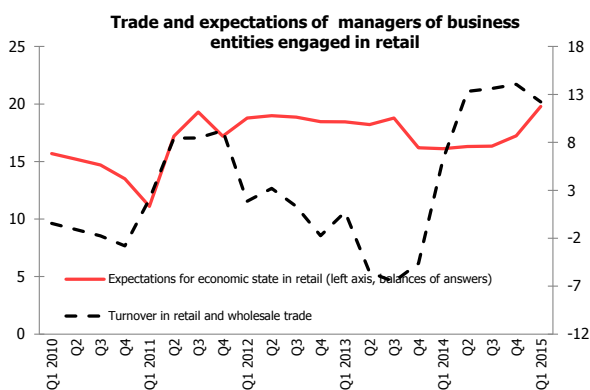
¹⁸ Since the third quarter of 2014, the three activities: trade, transport and communications, and hotels and restaurants have been published aggregately, i.e. it is impossible to present their growth individually.

¹⁹ The analysis is based on data on industrial production.

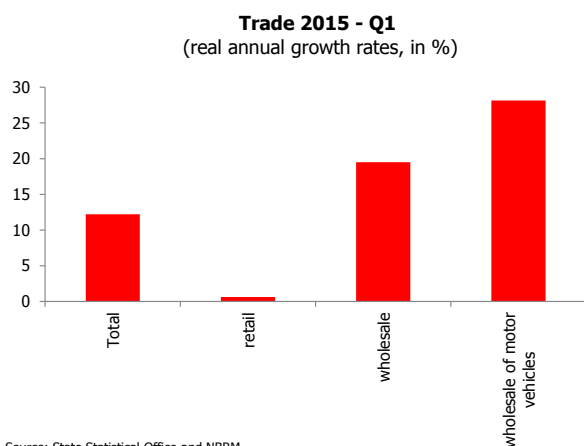


Source: State Statistical Office.

* average of expectations for 4 and 5 month of 2015.



Source: State Statistical Office and NBRM.



Source: State Statistical Office and NBRM.

sector again made negative contribution to the growth. In support of the improved performances in part of the manufacturing industry are the results of the **Business Tendency Survey in the manufacturing industry**²⁰ that point to a rise in the average capacity utilization in the first quarter of the year. Observing the limiting factors, corporate managers stress the lack of skilled labor as a factor with highly negative impact in the first quarter (compared to the same period last year).

Contrary to the more favorable developments in the industrial sector in the first quarter, the available data for this sector for the April-May period indicate less favorable movements in the second quarter.

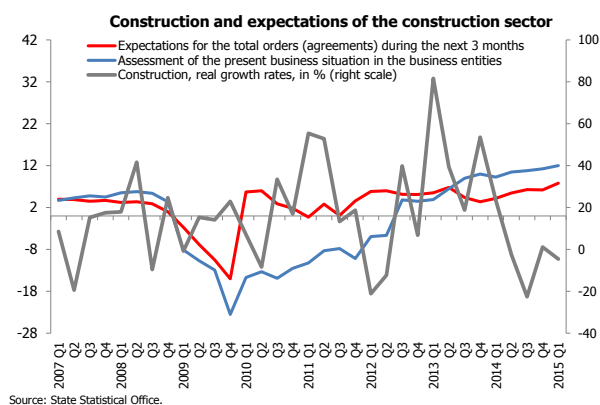
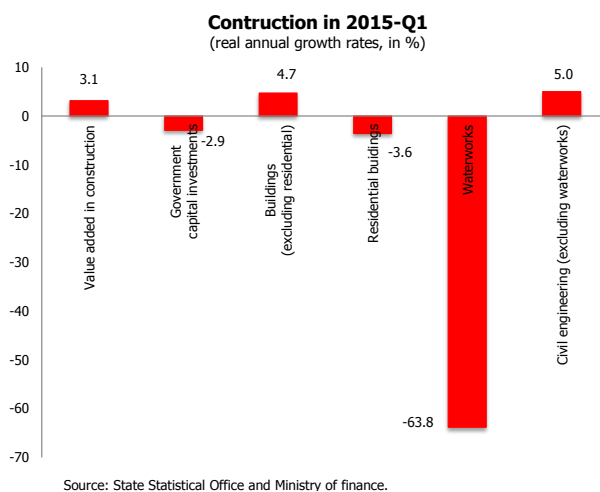
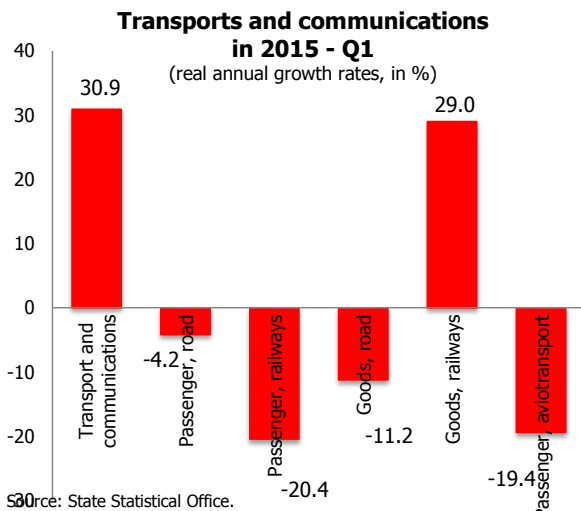
Namely, in the first two months of the second quarter, industrial production recorded an annual decline of about 3%. On the other hand, most of the decline was concentrated in only a few sectors (manufacturing of tobacco products, clothing, fabricated metal products and rubber products) which hampers the precise estimation of the duration and intensity of this movement, and hence the overall effect on economic growth. In support of this conclusion are the surveys conducted in April and May indicating continued growth of the degree of capacity utilization, as well as more optimistic perceptions of the managers of the manufacturing sector about the output volume in the next three months.

In the trade sector, the trends from the last quarter of 2014 continued in the first quarter²¹. Namely, also in this quarter, the increase in the turnover in the wholesale trade and the trade in motor vehicles continued, and the turnover in retail trade recorded growth after seven quarters of annual decline. Improved performances in retail trade are confirmed also by the results of the **Survey of Managers in Retail Trade**²² conducted in the first quarter. Thus, in the first quarter managers assess the current business situation of companies as more favorable. In terms of the factors that limited the activity of companies in trade, the managers indicated a significant improvement in the factors "lack of trained personnel" and "increased competition"

²⁰ Refers to the surveys conducted in the first quarter of 2015.

²¹ The analysis of trends in trade is based on data on the trade turnover.

²² SSO's Business Tendency Survey in retail trade for the first quarter of 2015. The balance of responses is the difference between weighted positive and negative responses of corporate managers. The balance is designed to show the movement of the observed economic indicator rather than its true size, i.e. it provides qualitative rather than quantitative (numerical) data from the corporate managers.



(compared to the same period last year). On the other hand, there was a less favorable influence of the low demand from buyers and increased demand in the market. Favorable movements in trade are expected to continue in the second quarter amid registered double-digit growth in the value of total trade turnover in the April-May period. Additionally, the results of the Survey of managers in retail trade for the first quarter point to more favorable expectations about the business situation in companies in the next six months.

In view of the developments in the sector "transport and communication" with the exception of passenger air traffic, whose growth has accelerated for two consecutive quarters, the other categories register less favorable developments in the first quarter of the year. Namely, passenger road transport points to slower annual growth, while passenger rail and freight transport decreased on an annual basis, contrary to the growth registered in the previous quarter. **The small number of high frequency indicators prevents the precise assessment regarding the developments in the sector "transport and communications" in the second quarter,** although the currently available data suggest activity growth (annual growth of passenger rail traffic during April).

In the first quarter of the year, construction activity declined on a quarterly basis²³, thus slowing down the annual growth. In terms of the types of buildings, the annual growth is explained by the growth of construction in the area of high-rise buildings and civil engineering. On the other hand, the construction activities in the field of hydro construction reduced rapidly due to the high base effect, while housing construction has registered a moderate decline compared to the same period last year. The favorable annual developments in this sector in the first quarter of the year are in line with the results of the **Business Tendency Survey in construction²⁴** according to which the current business and financial standing of the corporate sector is regarded as more favorable compared to the same period last year. However, also in this quarter the managers highlighted several factors that limited the growth in construction activity, such as the rising costs for materials, increased financial costs and shortage of trained staff. **For the second quarter the managers of companies in the construction sector had more favorable expectations**

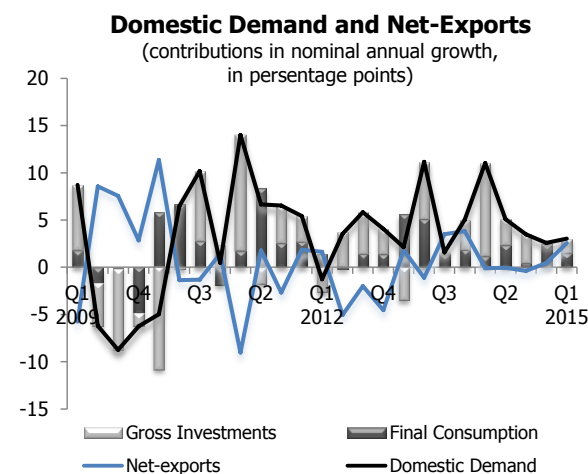
²³ Seasonally-adjusted.

²⁴ Refers to surveys conducted in the first quarter of 2015.

regarding the volume of orders, the period of providing work and in terms of the number of employees. Such expectations of managers are in line with the latest data on the developments in this sector in April when annual growth in the value of completed construction works was recorded.

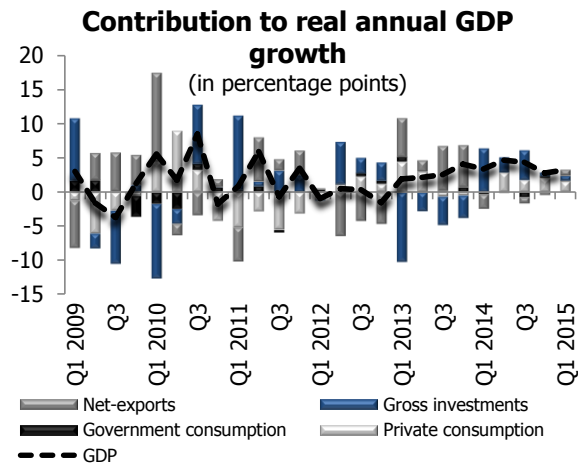
1.3. Aggregate demand

Analyzing demand, the annual growth in gross domestic product of 3.2% in the first quarter is explained by the concurrent positive contribution of domestic demand and net exports, unlike the previous four quarters, when the contribution of net exports was negative. Regarding individual components, as in previous quarters, exports of goods and services recorded the highest annual growth and made the largest individual contribution to GDP growth. However, the pace of growth in export activity is slower compared to the previous few quarters. The export growth was largely attributable to the activity of the new production facilities and the gradual improvement of the external economic environment. All domestic demand components grew with the biggest positive contribution of household consumption, amid continuous favorable developments in the labor market and enhanced credit support to the households through domestic banks. Gross investments remained in the positive zone with minimal acceleration of the growth rate, where public consumption also made minimal contribution to overall GDP growth. Imports of goods and services increased, but at a slower pace than exports, so that net exports made a positive contribution to GDP growth.



Source: State Statistical Office and NBRM calculations.

In the first quarter of 2015, gross domestic product (GDP) grew by 1.1% compared to the previous quarter (seasonally adjusted) and by 3.2% compared to the same period last year, which is slightly faster compared with the growth rate recorded in the previous quarter. The analysis shows that economic growth is generated by both domestic factors and net exports. Such a structure of growth is registered after a temporary halt of four quarters, given that in the meantime only domestic demand made a positive contribution to growth. Analyzing individual components, exports, same as in the previous two quarters, made the greatest individual positive contribution to growth. Such continuing favorable developments in the export sector are mainly due to the activity of the new production facilities, and the gradual improvement of the external economic environment, in part related to recent changes in the monetary policy of the ECB and low oil prices. In the first quarter of the year, all domestic demand components reported growth. Namely, the continuing favorable labor market developments, the growth of real wages and lending by domestic banks provided



Source: State Statistical Office and NBRM calculations.

further support for the annual and quarterly growth of household consumption. Gross investments increased at a minimal accelerating pace, reflecting possibly increased investment in machinery and equipment, amid less favorable trends in the construction sector and a minimal decline in inventories. Similarly to the previous quarter, public consumption made minimal contribution to overall GDP growth. Increased domestic and export demand intensified imports, but at a slower pace compared to the increase of exports.

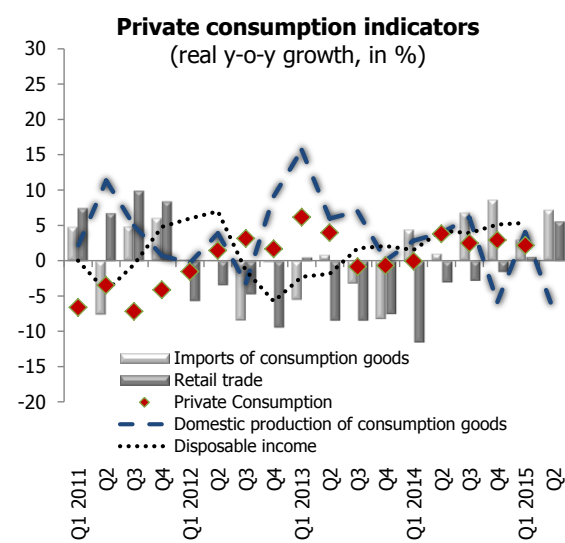
Real annual growth rates (%)

	2012-Q1	2012-Q2	2012-Q3	2012-Q4	2012	2013-Q1	2013-Q2	2013-Q3	2013-Q4	2013	2014-Q1	2014-Q2	2014-Q3	2014-Q4	2014	2015-Q1
Private consumption	-1.5	1.4	3.1	1.7	1.2	6.1	4.0	-0.9	-0.7	2.1	-0.1	3.8	2.5	2.9	2.3	2.2
Government consumption	2.2	0.8	3.7	3.1	2.4	4.4	-0.1	1.2	4.4	2.5	-1.7	0.0	-5.2	1.9	-1.2	0.9
Exports of goods and services	-1.5	-0.1	3.7	5.2	2.0	-5.0	-0.7	-3.3	-1.9	-2.7	14.2	15.9	15.2	22.4	17.0	8.0
Imports of goods and services	-1.3	12.1	10.4	11.8	8.2	-13.1	-3.4	-12.9	-10.7	-10.0	14.8	11.5	14.3	17.4	14.5	4.3
Gross capital formation	-0.4	27.7	8.9	8.7	10.2	-32.6	-9.8	-15.2	-9.6	-16.6	31.0	8.9	19.1	1.8	13.5	2.4
Domestic demand	-0.7	6.6	4.5	3.7	3.5	-4.3	0.1	-4.0	-2.5	-2.6	5.4	4.4	4.9	2.5	4.2	2.0
Net exports*	-1.0	54.6	36.8	28.6	26.3	-30.2	-9.4	-41.6	-28.8	-27.0	16.3	0.8	9.8	3.2	6.6	-6.3
GDP	-1.0	0.5	0.3	-1.6	-0.5	1.9	2.1	2.5	4.1	2.7	3.3	4.7	4.3	2.7	3.8	3.2

*decrease represents lower deficit

Source: SSO and NBRM calculations.

1.3.1. Private consumption

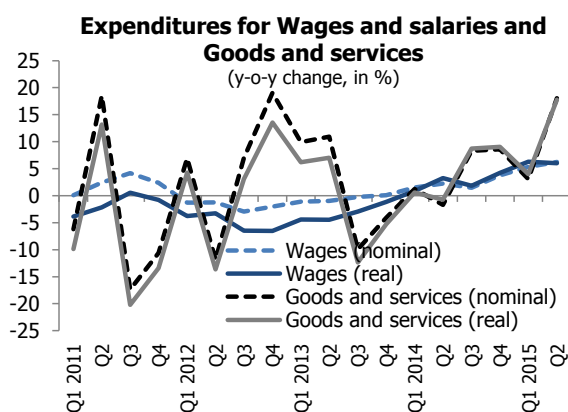


Source: State Statistical Office, Ministry of Finance and NBRM calculations.

In the first quarter of 2015, household consumption recorded a quarterly increase of 1.5% (seasonally adjusted) and a moderate acceleration of the annual growth of 2.2%. Moreover, same as in the previous quarter, the solid annual growth of private consumption was supported by the growth of the available funds, amid growth registered in the most significant components of disposable income. Thus, the real growth in average wages paid, coupled with the higher employment growth, increased the wage bill in the economy, although at a somewhat slower pace compared with the previous quarter. Moreover, the growth of pensions paid continued in the first quarter, although at a slower pace compared with the previous quarters, with the higher inflows based on private transfers from abroad making additional positive contribution to the growth of household income. Beside the growth of the main components of households' disposable income, higher consumption in the first quarter of the year

was supported by lending to households, mainly in the form of consumer loans. The movement of short-term indicators of private consumption, largely corresponds with the growth registered in the first quarter. Thus, an annual growth was observed in the domestic production and the import of private consumption goods, but also in the retail trade turnover, after seven quarters of continuous fall.

The annual growth in the private consumption is expected to continue in the second quarter of 2015 according to the latest available data²⁵. Namely, the increase in real wages, pensions (although minimal) and transfers leads to further growth of the total funds available to households in the second quarter. According to the lending data for the period April-May, the relatively fast growth of consumer loans to households is expected to continue in the second quarter of 2015, which according to the Lending Survey²⁶, corresponds to the banks' announcements for easing the terms of lending and the expectations for accelerated demand for loans in this period. As for the remaining short-term indicators of private consumption, real annual growth was recorded in the retail trade, as well as in the import of consumer goods that also underpins the expectations for higher private consumption in the second quarter.



Source: Ministry of Finance and NBRM calculations.
The calculations include expenditures of Consolidated Budget of Central Government and Funds, deflated by CPI.

1.3.2. Public consumption

In the first quarter of 2015, public consumption dropped by 4.1% on a quarterly basis (seasonally adjusted), while on an annual basis a small increase of 0.9% was registered. The moderate annual growth stems from the costs for wages, goods and services as well as the higher transfers for health care²⁷. Available data for April and May 2015 point to an annual increase in the public consumption **in the second quarter of 2015**, given the real growth in the cost of goods and services, wages and higher transfers for health care.

1.3.3. Investment consumption

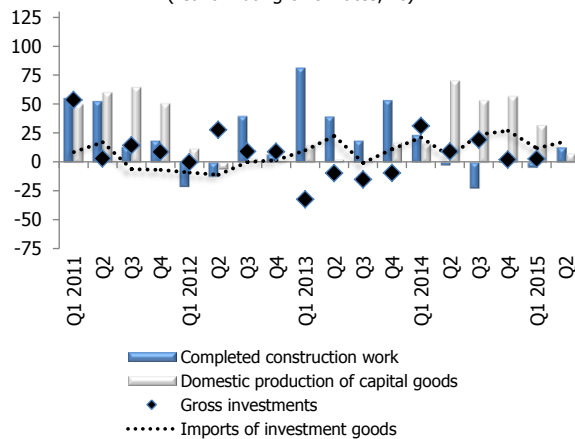
Gross investments in the first quarter of 2015 registered a quarterly increase of 3.2% (seasonally adjusted) and a moderate

²⁵ Data on wages, private transfers and import of consumer goods are as of April, while other data are as of May.

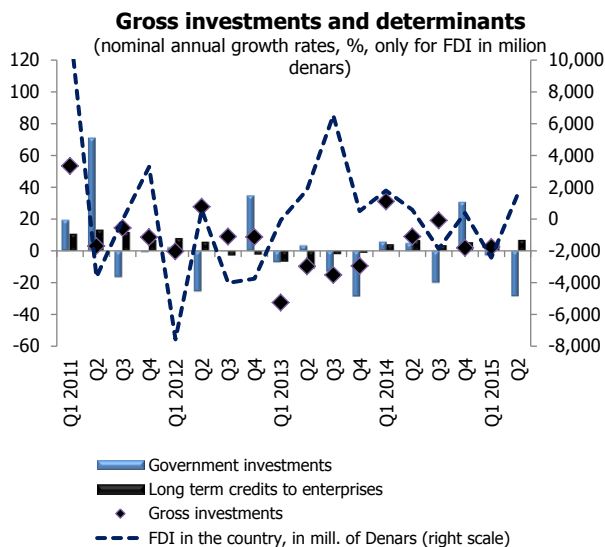
²⁶ NBRM's Lending Survey conducted in March 2015.

²⁷ Most of these assets relate to expenditures for goods and services.

Gross investment and indicative series
(real annual growth rates, %)



Source: State Statistical Office, Ministry of Finance and NBRM calculations.



Source: State Statistical Office, Ministry of Finance and NBRM calculations.

acceleration in the annual growth of 2.4% (1.8% in the previous quarter). Thus, investments remain in the zone of positive growth rates for five consecutive quarters, although in the recent period their pace was slower. According to the short-term indicators of investment activity, the growth of gross investments probably reflects the increase of the investments in fixed assets amid minimal decline in inventories. In circumstances of reduction of completed construction works, the growth of investments in fixed assets arises from the investments in machinery and equipment. Namely, import of capital goods, which is an indicator of investment in machinery and equipment continued to grow in the fourth quarter, although at a slower pace. Some of the remaining short-term investment indicators also support the growth of investments in the first quarter. Thus, in the first quarter, growth was registered in the domestic production of capital products, as well as in the corporate loans. Moreover, according to the results of the Lending Survey²⁸, amid mainly unchanged terms of lending of most of the banks (common for the third quarter of 2013), the demand for loans increased, and a significant portion of loans to the corporate sector were still earmarked for investments in inventory and working capital. With the remaining short-term indicators, movements are unfavorable and in the first quarter an annual decline in foreign direct investment and government investment was registered, contrary to the growth of these indicators in the previous quarter.

Regarding the movement of investments in the second quarter of 2015, most of the available short-term indicators of investment activity point to continuing growth²⁹. Thus, annual growth was registered in the import of investment goods and in the domestic production of capital goods. Meanwhile, in the period April-May the annual growth of long-term bank lending to companies accelerated, while growth was registered also in capital budget expenditures, despite their fall in the previous quarter. Increase was registered also in the value of completed construction works, after the decline registered in the previous quarter. This is in line with the expectations of the managers in the construction sector for the second quarter, which are more favorable than in the previous one, in terms of the possible periods of providing work,

²⁸ NBRM's Lending Survey conducted in March 2015.

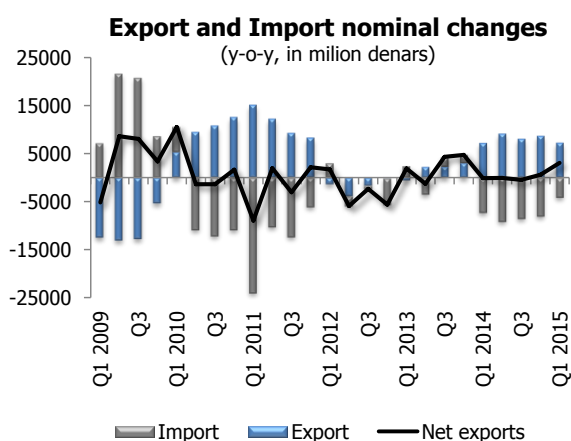
²⁹ Data on completed construction works, foreign direct investments and import of working capital are as of April, while other data are as of May.

the orders and the number of employees³⁰. These achievements point to favorable developments, i.e. probably positive support of the construction sector for the total investment demand in the second quarter. **Contrary to these favorable developments**, in the period April-May government expenditures for capital investments declined, pointing to weaker support of the public sector for the investment activity in the second quarter. An additional indicator that points to a potential slowdown in the investment activity in part of the enterprises is the decline in the industrial production in the April-May period.

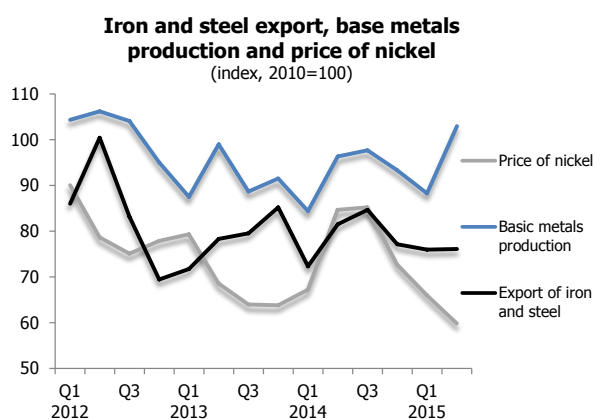
1.3.4. Net external demand

Developments in the external sector during the first quarter are more favorable compared to the shifts that characterized the previous quarters. Namely, amid faster growth of exports than imports, the deficit in foreign trade declined, so that net exports in the first quarter of 2015 made a positive contribution to GDP growth after four consecutive quarters of negative impact. Real exports of goods and services registered an annual growth of 8% (slowdown in the annual pace of growth), and compared with the previous quarter a decline was registered (quarterly decline of 3.1%, seasonally adjusted). The annual growth is mainly a result of the increased exports of new production facilities. The largest export from these facilities was registered among manufacturers of machines, electrical equipment and chemical products. Solid performances were registered in part of other exports, i.e. exports of manufacturers of furniture, tobacco and metals. Despite the growth in the exports of metals, the situation in the domestic metal industry remains unfavorable, given the still weak global demand for metals and low metal prices on the world market. Imports of goods and services in the first quarter of 2015 increased by 4.3% on an annual basis, which given the dependence of the domestic production on imports is explained by higher imports of intermediate products. As in exports, a quarterly decline was registered also in the imports, of 3.5% (seasonally adjusted).

The data for the third quarter point to favorable developments on the exports side. Thus, in April-May 2015, nominal annual growth in the export of goods was realized. Generators of growth are the new export capacities (higher export of machinery, electrical



Source: State Statistical Office .



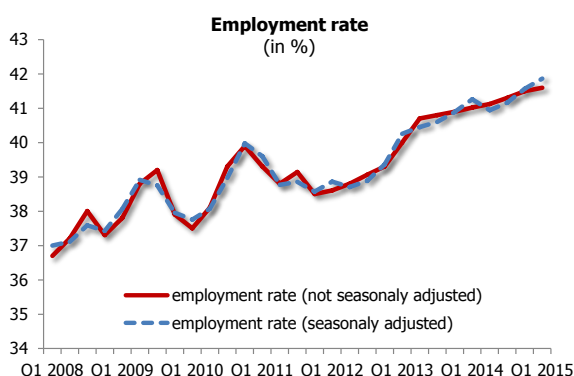
Source: State Statistical Office, IMF monthly database and NBRM calculations.

³⁰ Refers to the surveys conducted in the first quarter of 2015.

equipment and chemical products), with positive contribution to growth also being made by the facilities of other export sectors (moderate growth of export of furniture and electricity). **Nominal annual growth in the first two months of the second quarter was also registered in the imports**, primarily due to increased import of raw materials. **Regarding the movement of net export**, based on nominal data for April and May, certain narrowing of the trade deficit is expected for the second quarter, given the faster growth in exports compared to the growth in imports.

1.4. Employment and wages

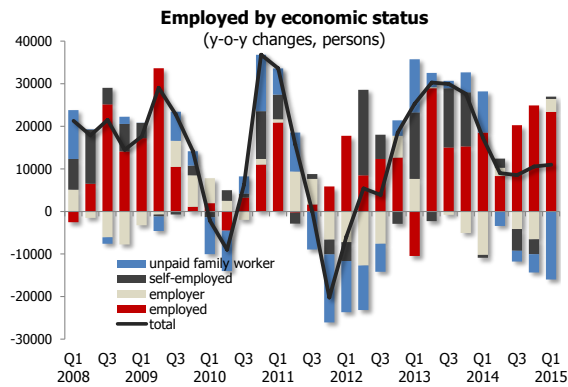
In the first quarter, the number of employees on the labor market continued to increase on an annual basis, at a pace similar to the previous three quarters. Thus, for three years in a row, this indicator remained in the zone of positive annual growth signaling a continuous increase in the capacity of the economy to absorb labor. These developments correspond with the real sector performances, which are also favorable. The improvement in some of the key labor market indicators for several years can be related to the operation of the new facilities in the technological-industrial development zones. Moreover, for a longer period, the labor market has been showing solid responsiveness to the fiscal policies aimed at acceleration of economic activity and employment, such as the active employment measures, the delivery of public infrastructure projects, as well as policies for subsidizing agricultural production. The aggregated signals from business tendency surveys point to a strengthening of employment prospects in the coming three months. In the first quarter, despite the increase in productivity, the faster annual wage growth resulted in a small increase in the unit labor costs.



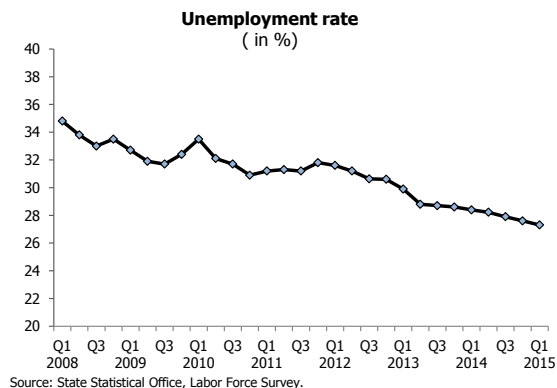
Source: State Statistical Office, Labour Force Survey.

In the first quarter, the number of employees registered an annual growth of 1.6%, a pace similar to that present in the past three quarters. In this quarter the continuity of the quarterly increase in employment was retained, with a quarterly growth rate of 0.7%³¹. In terms of individual sectors, the annual growth in the number of employees was created by the industry and the services sector, while the employment in agriculture declined for the third consecutive quarter. Observed by sectors of activity, the annual employment growth is characterized by a relatively high dispersion, whereby however, the largest contribution is that of the activities: hotels and restaurants, manufacturing, financial intermediation and construction. In terms of the

³¹The analysis of quarterly dynamics of employment, unemployment and total active population was made using seasonally adjusted data.



Source: State Statistical Office, Labor Force Survey.



Source: State Statistical Office, Labor Force Survey.

economic status³², the growth is completely a result of the category of employees. These developments increased the employment rate by 0.6 percentage points annually, to 41.6%. The results of the Job Vacancy Survey confirm the positive developments in the employment³³. Namely, the number of vacancies, as another indicator of the movement of labor demand, increased annually by 3.8% in the first quarter, while the rate of vacancies³⁴ remained at the level registered in the same period of the previous year (1.49%).

For the next quarter, employment prospects are stronger. Beside the continuation of the active government measures³⁵, aggregate signals from Surveys on business tendencies³⁶ indicate an increased optimism among managers of the business entities in terms of employment for the next three months.

Similarly, in the first quarter, there are no significant changes in labor supply. Namely, compared to the same period last year, the total active population has increased by only 0.1%, which amid simultaneous faster growth of the inactive population has led to stagnant activity rate, which remained positioned at the last year's average level of 57.3%.

In the first quarter, the reduction of unemployment continued, amid further more intensive growth of labor demand versus the growth of labor supply. Namely, the number of unemployed in the first quarter

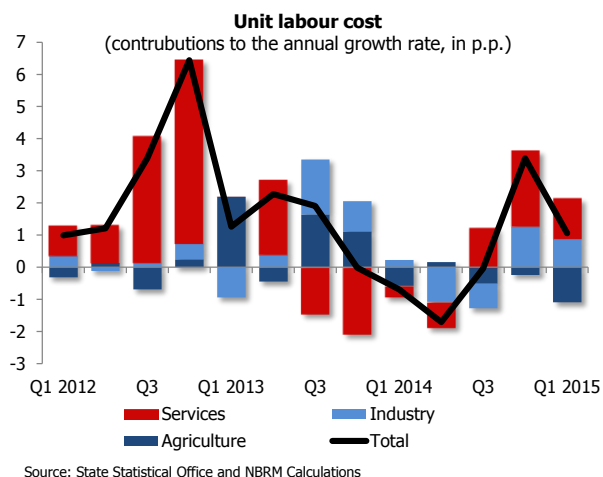
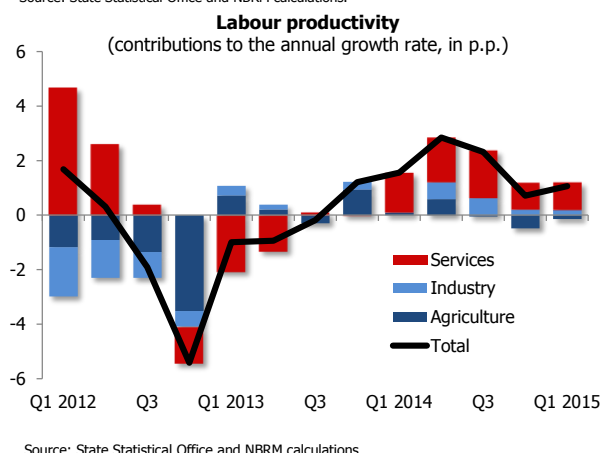
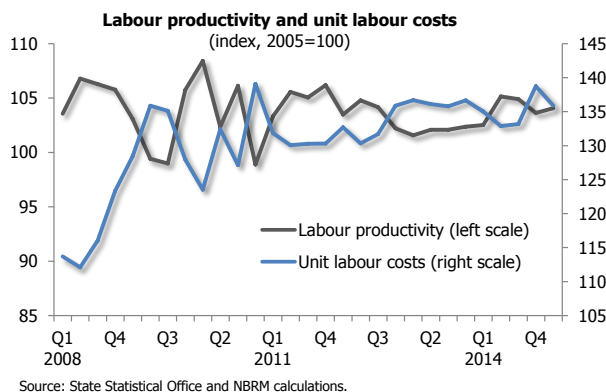
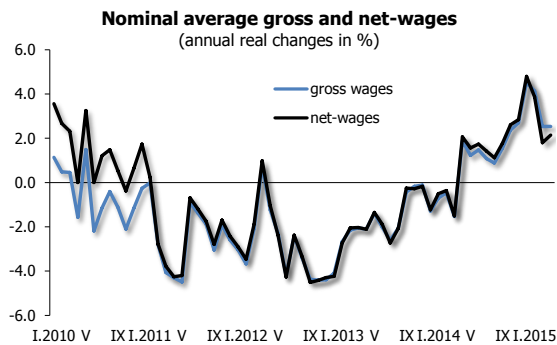
³² The classification by economic status applies to the following groups: **employers** - persons who operate their own business entity or engages independently in their own shop, or farm owners who hire other employees; **employees** - persons who work in government institutions, business entities in public, mixed, cooperative and undefined ownership or for private employer; **own-account workers** - persons who operate their own business entity, company, engage independently in their own business and work on a farm in order to generate income, while not hiring other employees; **unpaid family workers** - persons who work without pay in a business entity, shop or farm (owned by a family member).

³³ For the first time in 2012, the State Statistical Office began to conduct a Vacancy Survey as part of the labor market research. The purpose of this Survey is quarterly reporting on vacancies in companies in the Republic of Macedonia, as an important indicator for the macroeconomic developments and policies in the labor market.

³⁴ The rate of vacancies is defined as the ratio between the number of job vacancies and the total number of jobs, i.e. both vacant and occupied jobs.

³⁵ Start of the project "Macedonia provides employment" during the second quarter of the year.

³⁶ Source: State Statistical Office, business tendency surveys in manufacturing industry (April 2015), construction (first quarter of 2015) and trade (first quarter of 2015).



decreased by 3.7% on an annual basis. Consequently, the unemployment rate fell by 1.1 percentage point annually and reduced to 27.3%.

The average wages paid in the first quarter increased on an annual basis, but at a slower pace. Thus, in the first quarter, the nominal net and gross wages increased annually by 1.7% and 2.1%, respectively. With the exception of agriculture which registered a downward adjustment, wages in industry and services sector continued to be in the zone of positive annual change. Regarding the wages in the individual sectors, most remarkable according to the intensity of the positive change are "other services" and "arts, entertainment and recreation." They are followed by the wages in public administration³⁷, whose growth largely reflects the low base effect, i.e. the spillover effect of the increase realized at the end of the previous year. On a quarterly basis, nominal net and gross wages recorded a downward movement, which is the common feature of the three main sectors. **In the first quarter, real net and gross wages recorded a slowdown in their positive annual dynamics, i.e. growth of 2.6% and 3.1%, respectively, which in terms of further deepening of the fall in the general price level is entirely determined by the slower nominal growth.** Also, for the first time in three quarters, real wages declined on a quarterly basis (by 1.5%), which comes amid a nominal decline and simultaneous reduction in the general price level.

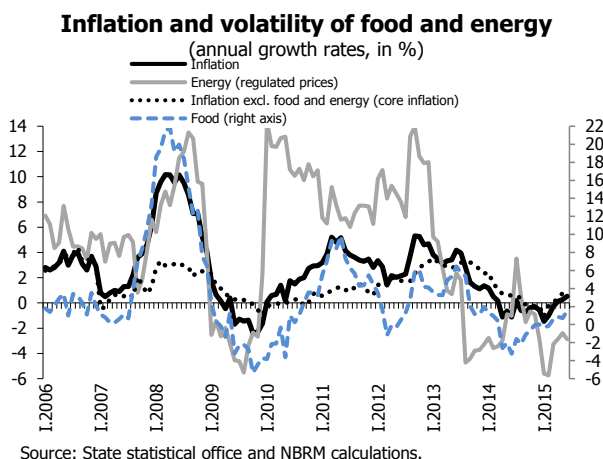
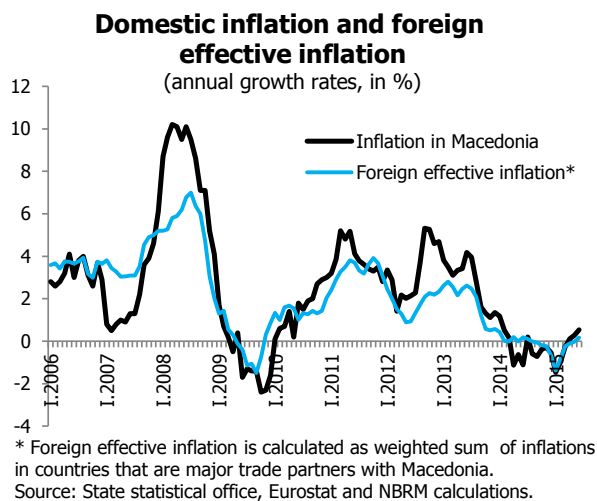
Labor productivity in the first quarter registered an annual growth of 1.5%, which is a small acceleration compared to the previous quarter. The above results from the more intense annual growth of economic activity compared to the employment growth. Analyzed by sector, the annual productivity growth in the first quarter is mostly associated with the services sector. After the fall registered in the previous quarter, productivity has surged on a quarterly basis. Factors that drive the annual dynamics, simultaneously explain the quarterly dynamics of productivity. **Unit labor costs registered an annual increase of 0.6%, which is a slightly slower pace than that registered in the previous quarter.** This adjustment is due to the faster growth of gross wages compared to the productivity growth. At the

³⁷ In September 2014, the Assembly of the Republic of Macedonia passed legislative amendments that allowed an increase of wages of the public administration of 4%. The increase relates to the October wage paid in November.

same time, the annual growth in unit labor costs is driven by the services sector and industry. On a quarterly basis, however, labor costs registered a downward movement, amid a simultaneous decline in gross wages and productivity growth.

1.5. Inflation

In the second quarter of 2015, a moderate annual price increase of 0.3% was registered, which ended a year-long continuous decrease in consumer prices. The growth was mainly a result of the positive contribution of food prices, influenced by the higher prices of vegetables, accompanied by the contribution of the core inflation. On the other hand, energy prices were still in the negative zone, due to lower prices of oil derivatives. Lower prices of oil derivatives also affected the producer prices, which continued to decline also in the second quarter. In terms of the expectations for the future period, inflation expectations survey conducted in June pointed to unchanged inflation expectations relative to the previous quarter, i.e. the expected rate of inflation for the next 12-month period is again around 0%.



In the second quarter of 2015 consumer prices increased by 0.3% on an annual basis, which is the first growth registered after four quarters of continuous decline. Analyzed by components, the highest contribution to the rise in prices in the second quarter was that of the higher food prices, primarily due to higher prices of vegetables. In the second quarter, a small growth also in core inflation was registered (price component excluding food and energy), mainly influenced by the increase in the prices of tobacco, products for home maintenance and catering services. At the same time, the energy component continues to have a negative contribution to the growth of consumer prices, in conditions of lower prices of liquid fuels and lubricants, reflecting the still low world oil prices on an annual basis³⁸.

Similarly, an upward trend is registered in the foreign effective inflation³⁹, i.e. it is 0%, contrary to the decline of 0.8% in the previous quarter.

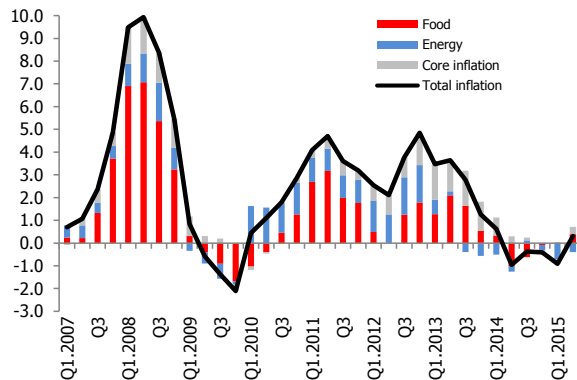
³⁸ In the second quarter, certain signals of stabilization of the downward trend in oil prices were noticed. Namely, although the annual decline continued, quarterly growth in the price of oil on the world market was registered.

³⁹ The calculation of foreign effective inflation derives from the weighted sum of consumer price indices of countries that are most important partners of the Republic of Macedonia in the field of import of consumer goods. The weight structure is based on the normalized shares of nominal imports from each country in the total nominal imports in the period 2010-2012. The calculation of this indicator includes Bulgaria, Germany, Greece, France, Italy, Austria, Slovenia, Croatia and Serbia.

	2014							2015						
	Q1	Q2	Q3	Q4	2014	2015		Q1	Q2	Q3	Q4	2014	2015	
Consumer price index - all items	0.6	-1.0	-0.4	-0.4	-0.3	-0.9	0.3	0.6	-1.0	-0.4	-0.4	-0.3	-0.9	0.3
Food	0.9	-2.6	-1.6	-0.2	-0.9	0.1	1.0	0.3	-1.0	-0.6	-0.1	-0.3	0.0	0.4
Energy	-3.3	-1.6	0.8	-1.5	-1.4	-4.9	-2.7	-0.5	-0.2	0.1	-0.2	-0.2	-0.7	-0.4
Electricity	-3.2	-3.2	4.5	3.6	0.4	3.6	3.6	-0.2	-0.2	0.3	0.3	0.0	0.3	0.3
Heat energy	-12.3	-2.9	-8.2	-11.0	-8.7	-11.0	-11.0	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Fuels and lubricants	-4.3	-0.8	-2.2	-8.2	-3.9	-20.1	-13.3	-0.2	0.0	-0.1	-0.4	-0.2	-0.9	-0.6
Food and energy (volatile prices)	-0.3	-2.4	-0.9	-0.6	-1.1	-1.3	0.0	-0.2	-1.3	-0.5	-0.3	-0.6	-0.7	0.0
Core inflation (inflation excl. food and energy)	1.7	0.6	0.3	-0.2	0.6	-0.4	0.7	0.8	0.3	0.1	-0.1	0.3	-0.2	0.3

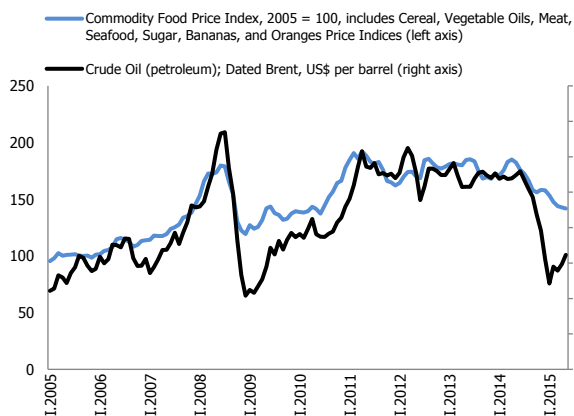
Source: State Statistical Office and NBRM calculations.

Volatile (food and energy) and core inflation (contribution to inflation, in percentage points)



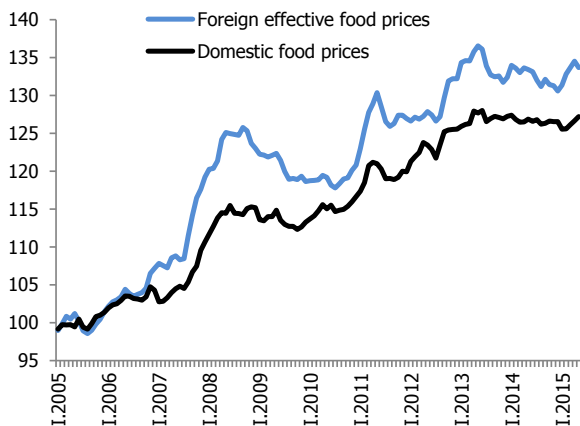
Source: State statistical office and NBRM calculations.

Crude oil and food prices



Source: IMF Primary Commodity Prices.

Foreign effective food prices* and domestic food 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.

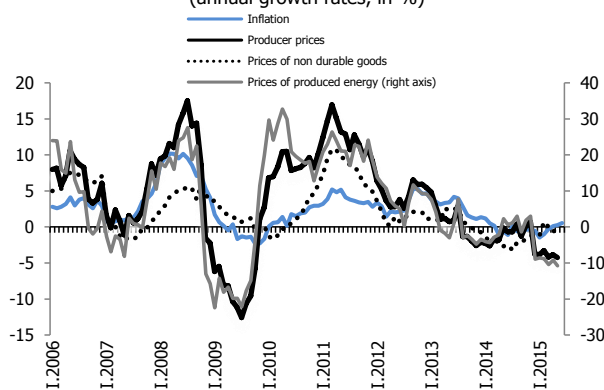
Analyzing the dynamics, the annual growth of consumer prices, contrary to its decline in the previous quarter, reflects the growth in food prices and core inflation, amid mitigated negative effect of the reduction in energy prices. **The annual rate of core inflation increased from -0.4% in the first quarter of 2015 to 0.7% in the second quarter of 2015.** This change in the dynamics of core inflation can mostly be explained by the growth in the prices of products for home maintenance and pharmaceuticals - two groups of products whose prices declined in the previous quarter.

On a quarterly basis, consumer prices in the second quarter of 2015 increased by 1%, which is explained by the upward movements in all three components of inflation. The largest contribution is that of the food component (quarterly growth of 1.1%) mainly due to the usual seasonal rise in the prices of fresh vegetables and fruits at this time of year. In addition, in the second quarter growth was registered also in the energy prices (quarterly growth of 2.1%) and in core inflation (quarterly growth of 0.7%), as opposed to their decline in the previous quarter. **On the other hand, seasonally adjusted data indicated a quarterly decrease in consumer prices of 0.2%,** reflecting the movement in food prices.

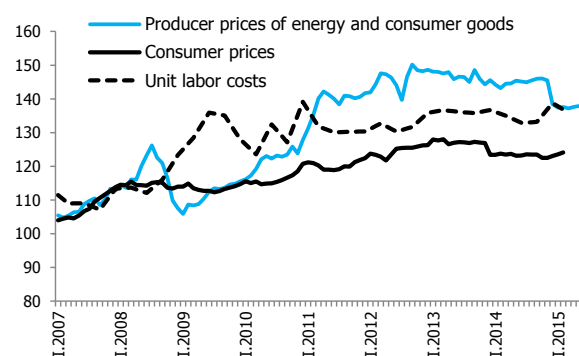
In the second quarter of 2015, the change in producer prices in the domestic market remained in the negative zone for seventh consecutive quarter. The annual decline in producer prices in the first two months of the second quarter averaged 4.1%, which compared to the previous quarter is an acceleration of the decline (-3.8% in the previous quarter). The largest contribution to the annual decline was made by the lower energy production prices, mainly oil derivatives, with higher prices of electricity acting in the opposite direction. **On a quarterly basis, producer prices increased by 0.3%** (while on a seasonally adjusted basis they dropped by 0.2%), which mainly reflects the higher producer prices in the manufacturing industry and electricity prices. **The movement of producer prices which affect domestic**



Inflation and industrial producer prices (annual growth rates, in %)



Factors affecting consumer prices (indices, 2005=100)



inflation component⁴⁰ indicates downward pressures. The annual decline in these prices accelerated to 5% (despite the fall of 4.5% in the previous quarter), amid simultaneous quarterly fall of 4.9% versus the fall of 4.4% in the previous quarter (seasonally adjusted data). Keeping these prices in the negative zone indicates lower inflationary pressures in the coming period.

In the first quarter of 2015, unit labor costs registered a decline of 2.1% on a quarterly basis and growth of 0.6% on an annual basis, which amid still negative output gap⁴¹ indicates the absence of pressures on the prices of final products through this channel.

Box 1: Inflation Expectations Survey⁴²

Inflation Expectations Survey includes three groups of respondents: economic analysts, companies and financial institutions. The questionnaire contains two questions to measure inflation expectations, one qualitative and one quantitative in nature. For the first question on inflation expectations, the respondents indicate the direction and extent of price changes compared with the change in the previous 12 months⁴³. Carlson and Parkin (1975) probability approach has been used for quantification of qualitative answers, which assumes that amid sufficiently large number of respondents, the expected change in prices is normally distributed among the population. The second

⁴⁰ Consumer goods (durable and non-durable) and energy.

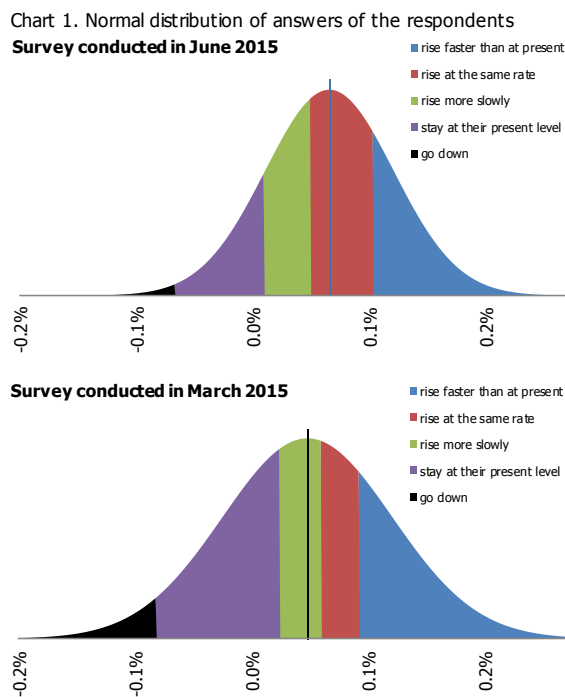
⁴¹ The NBRM's estimates show that domestic output is still below the potential level (negative output gap).

⁴² In order to improve the survey measure of inflation expectations, in 2013, the Monetary Policy and Research Department of the National Bank of the Republic of Macedonia started an in-depth analysis of the experiences of other central banks associated with conducting surveys. On that basis, the existing survey was redesigned and starting from October 2013, data were collected for the new survey, thus ensuring greater approximation to the European practice.

⁴³ The qualitative question of expectations reads as follows: "Compared with the past 12 months, how do you expect consumer prices to change in the next 12 months? a) will have a faster growth; b) will grow at the current pace; c) will grow at a slower pace; d) will remain almost unchanged; e) will decrease; f) it is difficult to determine"

question requires from the respondent to quantify precisely the expected average rate of change of prices in the next two years⁴⁴. The overall expected rate is calculated as a simple average of the responses of all participants. The resulting indicator is useful for obtaining indications for the direction of the respondents' expectations.

The Inflation Expectations Survey was conducted in June 2015⁴⁵. As in the previous survey round, also in June **the negative average inflation rate for the previous 12-month period remained⁴⁶ and the results of the June survey suggest unchanged inflation expectations compared to the March survey.** Thus, in the next 12-month period, respondents expect inflation to be around 0%, and the same are the expectations analyzed in terms of individual groups of respondents (economic analysts, companies and financial institutions) who expect the inflation rate in the next 12-month period (until May 2016) to average around 0%.



In terms of the quantitative question on the expected rate of inflation for 2015 and 2016, minor changes compared to the expectations in the previous survey round are registered.

Namely, in the period between the two surveys, the respondents' expectations for inflation in 2015 decreased by 0.1 percentage points, on average, while for 2016 they increased by 0.1 percentage points, on average. According to respondents, **factors with which they explain the inflation expectations in June** include the movement of domestic consumer prices in the past period and the exhaustion of the downward pressures in the energy component, amid still unstable geopolitical environment.

⁴⁴ The quantitative question reads as follows: "What are your expectations/forecasts for the average inflation rate for 2015 and 2016?"

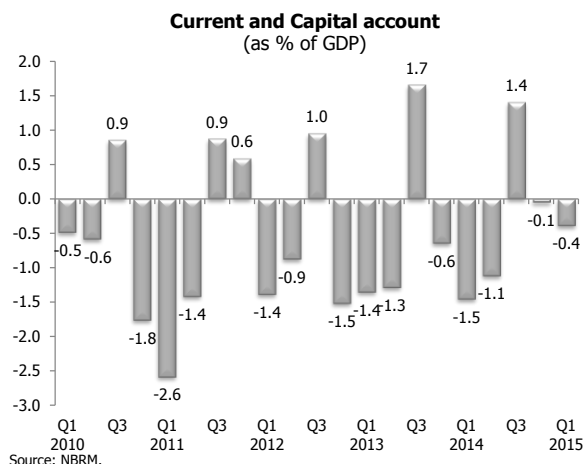
⁴⁵ Refers to the period June 2014 to May 2015. The percentage of responsiveness to the Survey conducted in June was 26.3%, which compared to the previous quarter, represents a decrease of responsiveness. Analyzed by groups of respondents, the financial institutions' responsiveness is 44.4%, followed by economic analysts with 29.0% and companies with 21.4%.

⁴⁶ In circumstances of a negative price growth, the interpretation of the results of the survey can be blurred, and therefore, it is necessary to change the method of calculation of the indicator for inflation expectations. Thus, in the procedure for quantification, the negative rate is replaced with the last positive growth rate. This is the way to avoid the contradictory responses from the survey that assume a positive price growth. Taking into account that changes in the method are of a purely technical nature, the quantification of qualitative answers for the expected rate of inflation in periods of negative inflation should be taken with caution, while the indicator for inflation expectations as approximate.

1.6. Balance of payments⁴⁷

In the first quarter of 2015, the deficit in the current and capital account of the balance of payments recorded a slight increase on a quarterly basis, fully driven by the seasonal decline in the inflows in secondary income. On the other hand, the trade deficit in goods and services decreased significantly compared to the previous quarter as a result of the sharper decline in import relative to the actual decline in the export of goods. The increased trade balance is the driving factor of the achieved annual contraction in the current and capital account, given the good export performance of the new facilities in the economy and the pronounced fall in the price of crude oil on world markets. Additionally, higher net inflows in secondary income contributed toward improving the deficit in the current and capital transactions on an annual basis. In the first quarter of 2015, the financial account recorded net outflows, largely due to government early repayments and changes in currency and deposits, amid realized solid inflows of direct investments. The overall performance of the individual components of the balance of payments in the first quarter of the year led to a decrease in the foreign reserves.

1.6.1. Current account

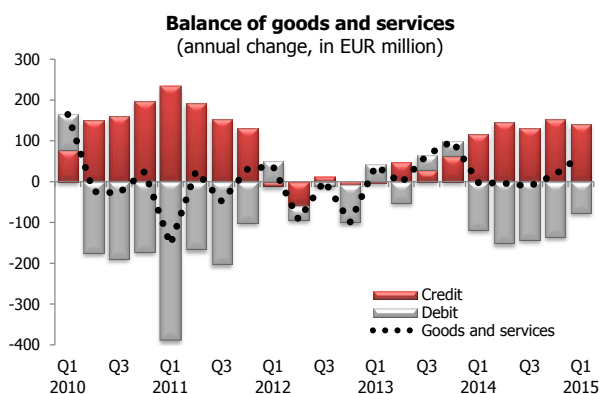
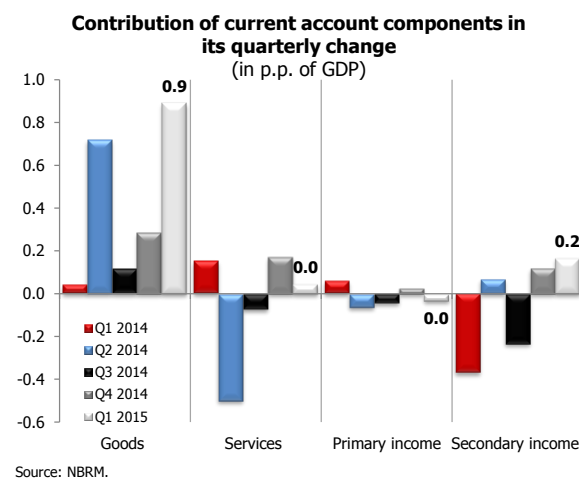
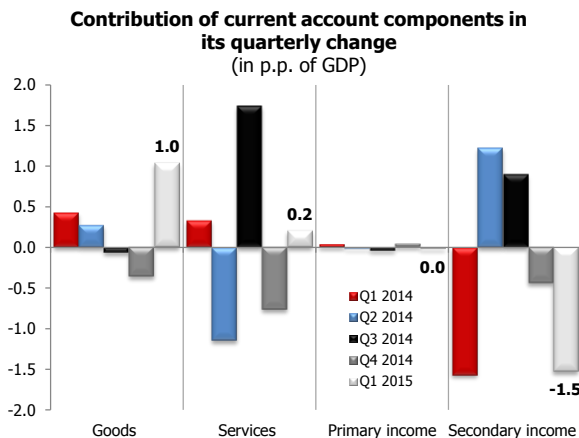


In the first quarter of 2015, the deficit in the current and capital account of the balance of payments was Euro 35.3 million or 0.4% of GDP⁴⁸. The seasonal decline in inflows with secondary income led to a quarterly deterioration of the current balance by 0.3 pp of GDP despite the positive developments in the balance of goods and services. The achievement of lower net inflows in the secondary income compared to the previous quarter is a typical movement of this component, caused by the fall of purchased cash foreign exchange on the currency exchange market⁴⁹, coupled with reduced official transfers. In fact, during the last quarter of 2014, an intensive utilization of IPA funds for the support of rural and institutional development was registered, which contributed to achieving high official transfers within secondary income. On the other hand, the trade deficit in goods and services recorded positive changes compared to the previous quarter. Against the backdrop of minor

⁴⁷ Starting from the Quarterly Report, October 2014, the analysis of the movements in the balance of payments is based on data compiled under the Manual on the Balance of Payments and International Investment Position, sixth edition (IMF, 2009) (IMF, 1993). For more detailed information on the methodological changes, visit the NBRM website (http://nbrm.mk/WBStorage/Files/Statistika_Informacija_za_omenite_vo_platniot_bilans_megunarodnata_investiciska_pozicija_i_nadvoresniot_dolg_koisto_proizleguvaat_od_primenata_na_novite_megunarodni_statisticki_standardi.pdf).

⁴⁸ The calculations use the projected amount for the nominal GDP.

⁴⁹ Foreign cash purchased on the currency exchange market is used to estimate private transfers in cash.



* Positive change in the import of goods mean it's decrease.
Source: NBRM.

changes in the surplus of services, the improvement is predominantly driven by the trade balance, i.e. the faster decline in import demand relative to the decline in the export activity.

The analysis of the changes in the current and capital account on an annual basis indicates a significant improvement of 1.1 pp of GDP, due to the improved trade balance of goods and secondary income. The intensification of the export activity of the new facilities in foreign ownership, coupled with the moderate recovery of part of the traditional export sectors has driven the dynamic annual growth of exports. On the other hand, import pressures recorded moderate growth. Despite the high import demand for raw materials for the domestic industry, the fall in the international prices of crude oil caused an annual reduction of energy imports and respectively slower growth in the overall import component. The cumulative effect of these developments resulted in a significant narrowing of the trade deficit in goods. Additional positive factor for the favorable changes in the current account are the increased net inflows in the secondary income, driven by higher transfers of other sectors⁵⁰ of the economy⁵¹. In the other two categories, primary income and services, there are no significant shifts in the annual aggregate level. Thus within the trade balance of services, positive developments relative to the first quarter of the previous year were realized in the services for processing and transportation, amid moderate widening of the deficit in other services.

The recent balance of payments data show that in April 2015, the current and capital account recorded a deficit of Euro 60.1 million. Compared to the same month last year, there was a narrowing of the deficit as a result of significantly improved performances in the balance of services, in particular the favorable changes in construction services⁵². Additionally,

⁵⁰ Secondary income of other sectors of the economy includes the secondary income of financial companies, non-financial companies, households and non-profit institutions serving households classified as private transfers (current transfers between resident and non-resident households), net cash on the currency exchange market and other current transfers of the private sector.

⁵¹ Leaving the exchange rate target by the central bank of Switzerland led to a strong appreciation of the Franc in mid-January. Accordingly, such change brought about higher purchase of francs on the currency exchange market and appropriate growth of net inflows in secondary income during January.

⁵² In April 2014, the services category registered high deficit, which was due to the high outflows in construction services based on advances for construction works related to highway construction projects.

the annual increase in net inflows in secondary income, driven by transfers of other sectors of the economy contributed to the improved current account position. On the other hand, higher realized import in April, amid stagnation in the export component, caused an expansion of the balance in the trade of goods on an annual basis.

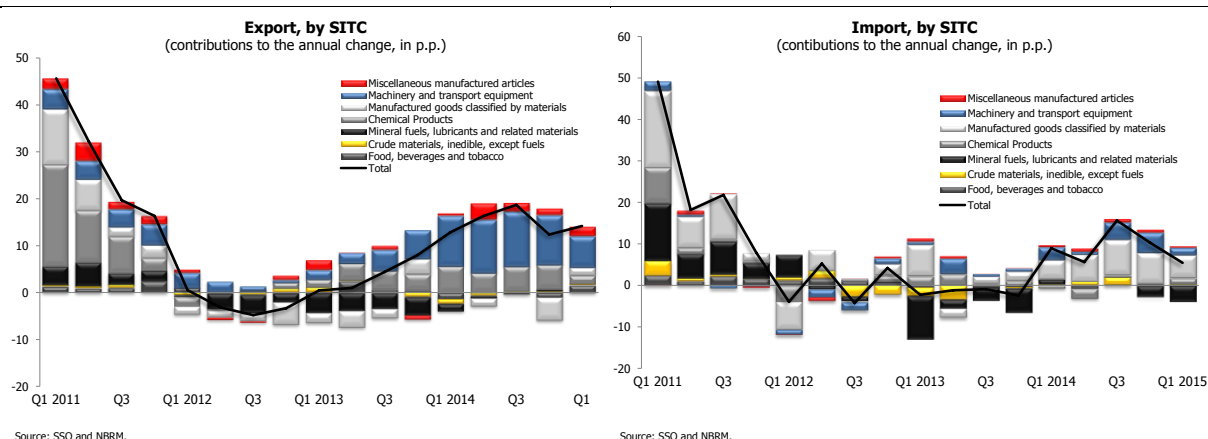
Box 2: Foreign trade of goods and movement of the Nominal and the Real Effective Exchange Rate (NEER and REER)⁵³



In the first quarter of 2015, the total foreign trade of goods amounted to Euro 2,237.8 million (24.8% of GDP), which is a decline of 9.2% compared to the previous quarter. Both of its components registered a quarterly decline, which is a typical seasonal pattern at this time of year. The quarterly decline in exports of 5.8% largely reflects the lower export of fruits and vegetables and the reduced export of chemical products and machinery and equipment. At the same time, the import of goods decreased by 11.4% on a quarterly basis, due to the lower import of raw materials for the new facilities in

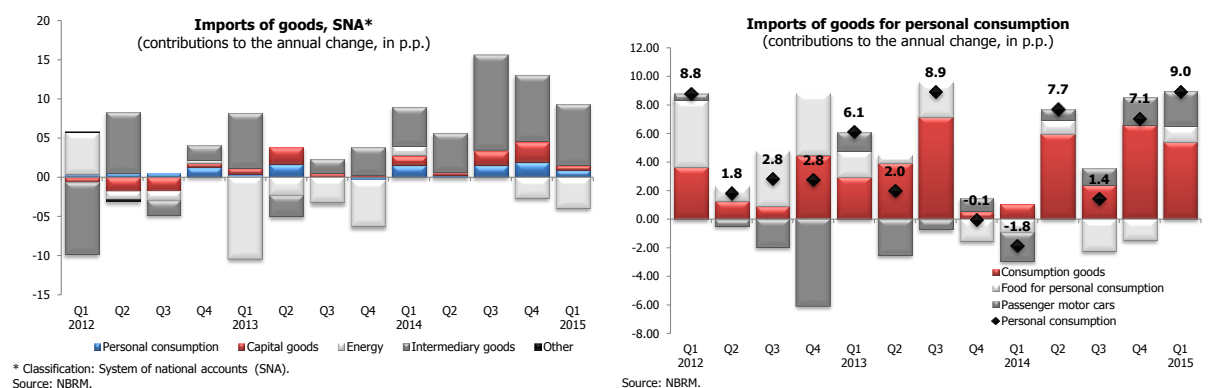
the economy, coupled with the decline in the import of raw materials for the textile industry, imports of petroleum products and food. In such circumstances, the negative trade balance narrowed by 22.8% compared to the previous quarter, almost entirely due to the reduction of the non-energy deficit, amid almost unchanged energy component. The analysis on an annual basis indicates **further improvement in the export performances, with the export of goods reaching a growth rate of 14.2% in the first quarter** (12.4% in the previous quarter). Again, new foreign facilities were the main generator of growth, but mild signs of recovery were noted also among some traditional export sectors. Upward movements were registered in the export of tobacco (mainly due to the low base effect) and the export of the metal processing facilities, after the negative growth rates achieved during the last year. At the same time, **imports continued to grow in the first quarter of the year, but at a slower pace, with their annual rate being reduced to 5.4% (versus 10.3% in the previous quarter)**. Amid high import dependence of the domestic economy on raw materials, such performances primarily reflect the further increase in the needs of the new industrial facilities. The non-ferrous metals, machinery and transport equipment and chemical products are the categories that contribute most to the annual increase. Imports of iron and steel made a small positive contribution to the annual growth. On the other hand, reduced energy imports caused significant downward pressures, which is primarily due to the lower imports of oil products, reflecting the price effect of the fall in world oil prices, and to a lesser extent, the lower import of electricity. **Intensified export activity, amid more moderate growth in imports, led to a narrowing of the trade deficit of 11.3% on an annual basis.** The favorable performances of the trade balance mainly resulted from the lower energy deficit, while the non-energy balance was neutral.

⁵³ According to the Foreign Trade Methodology, data on the export of goods are published on a f.o.b. basis, and on the import of goods, on a c.i.f. basis.



The analysis of the import of goods under the System of National Accounts (SNA) indicates that also in the first quarter, the intermediate products make the dominant contribution to the annual growth of total imports. The increased import of goods for private consumption and the import of capital goods also made a positive contribution to import growth, although to a considerably lesser extent, while the lower import of energy acted in the opposite direction. In terms of imports for private consumption, the annual growth of this component reflects the higher imports of consumer goods, while the contribution of the import of food for private consumption and import of passenger vehicles was insignificant. Overall, the annual growth in imports for private consumption remains moderate and it decelerates compared with the previous quarter, indicating absence of significant pressures on private consumption.

The latest available data on foreign trade indicate continuation of trends in the trade components during April and May. Export of goods continues to grow annually, but at a slower pace (at a rate of 5.7%), which was mostly a result of the higher exports of the new facilities in the economy. Annual growth (of 3.3%) was registered also in imports, as a result of the increased export of raw materials for the new facilities, as opposed to lower energy imports.

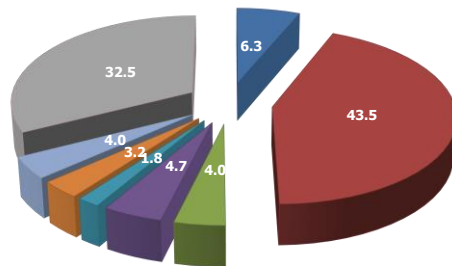


The analysis of foreign trade by trading partners in the first quarter of 2015 confirms that the European Union remains our largest trading partner (accounting for 69% of total trade). Analyzing the exports, the higher exports to Germany, as a market to which the export activity of the new industrial facilities is largely targeted, remain the main driver of the annual growth. EU Member States contributing to the export growth include Spain, Finland and Belgium. As for other countries, some positive movements came as a result of the increased exports to China⁵⁴ and the

⁵⁴ In the first quarter, the increased export to China and Finland was due to the higher exports of products from the metal industry, which partially offset the lower placement of metals to Italy.

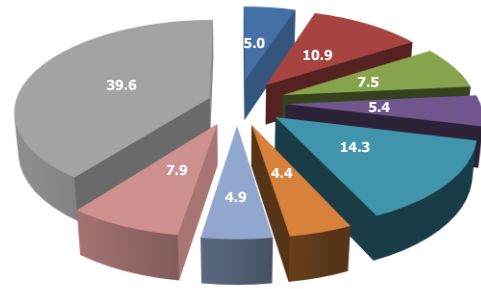
United States⁵⁵. The annual growth in imports reflects the higher imports from Russia (increased import of precious metals and natural gas) and the UK (higher import of platinum). On the other hand, there were downward import pressures from Greece due to the reduced import of oil derivatives. Analyzing the balances, the further reduction in the trade deficit with the European Union made the largest contribution to the narrowing of the trade deficit, due to the increased surplus with Germany and the reduced deficit with Greece, which is coupled with the reduction of negative trade balance with China. The deepening of the negative trade balance with Russia and Great Britain mainly acts in the opposite direction.

Export of goods, by countries in the first quarter of 2015 (share, in %)



Source: NBRM.

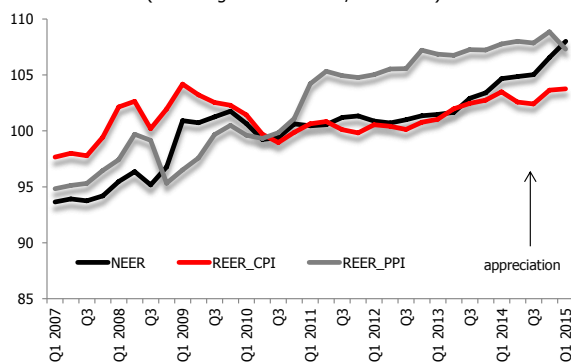
Import of goods, by countries in the first quarter of 2015 (share, in %)



Source: NBRM.

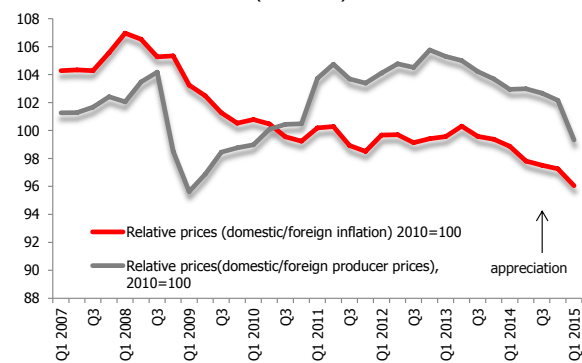
In the first quarter of 2015, the indicators of price competitiveness of the Macedonian economy give different indications of the competitiveness on a quarterly basis. Namely, REER deflated by consumer prices had minimal appreciation of 0.2%, while REER deflated by producer prices depreciated by 1.3% compared to the previous three months. The nominal effective exchange rate appreciated on a quarterly basis by 1.4%, due to the depreciation of the Russian ruble and the Ukrainian hryvnia against the denar. On the other hand, relative prices had a positive influence on competitiveness, amid a quarterly decline in the relative consumer prices of 1.2% and a decline in the relative producer prices of 2.6%.

NEER and REER
(according to CPI and PPI, 2010=100)



Source: NBRM.

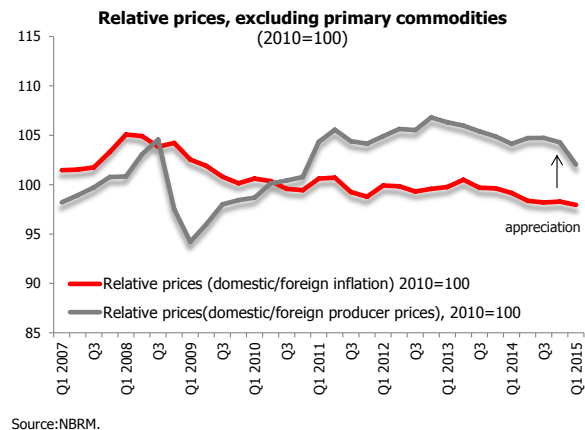
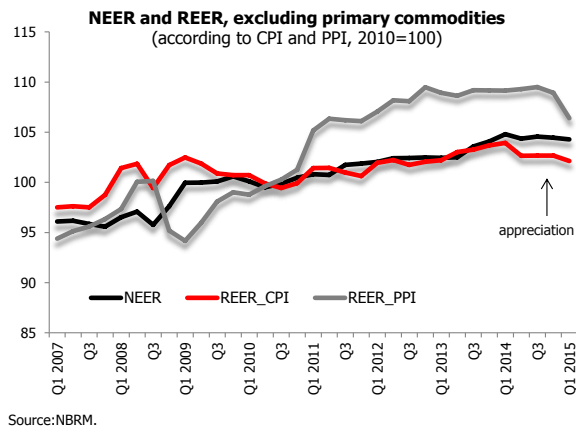
Relative prices
(2006=100)



Source: NBRM.

⁵⁵ Increased exports to the United States reflect the growth in the export of tobacco, in circumstances of larger production of one facility in the tobacco processing industry.

The analysis of the alternative REER⁵⁶ calculated with weights based on foreign trade excluding primary products⁵⁷ indicates an improvement in the price competitiveness of the domestic economy compared to the previous quarter⁵⁸. Namely, REER based on producer prices depreciated by 2.2% on a quarterly basis, while REER deflated by consumer prices depreciated by 0.5%. Such changes are in circumstances of depreciation of NEER thus calculated (by 0.2%) and the changes in domestic relative to foreign prices act in the same direction.



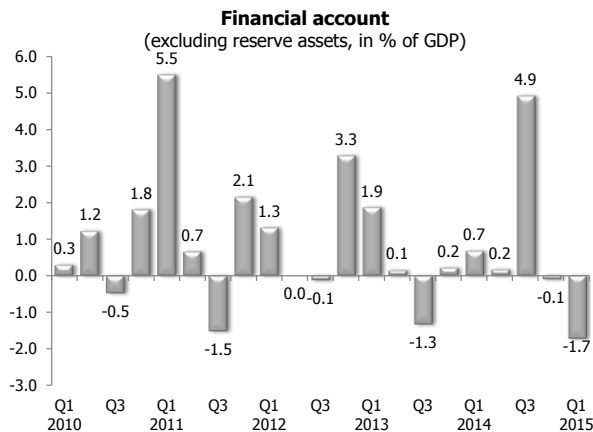
According to the latest data on price competitiveness, in the period from April to May, the REER calculated according to the two separate methodologies had depreciated compared to the first quarter of 2015. The increasing competitiveness of the domestic economy as measured by these indicators arises from the favorable movements in the nominal effective exchange rate and the relative prices. Within the REER calculated with weights based on the total foreign trade, the index deflated by consumer prices depreciated by 2.4% and the index calculated by the producer prices depreciated by 3%. Similar trends were registered in the REER calculated with weights based on foreign trade excluding primary products, when the index based on the CPI and the index deflated by producer prices depreciated by 0.2% and 0.7%, respectively.

1.6.2. Financial account

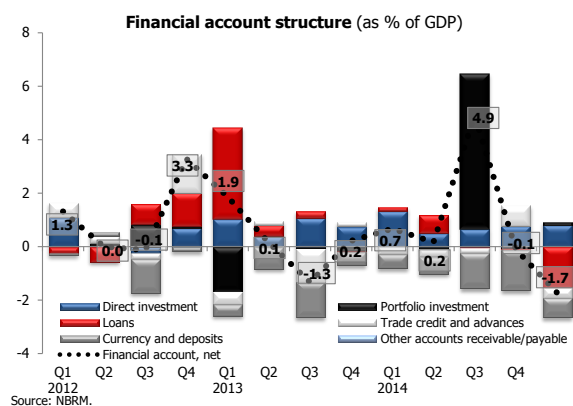
In the first quarter of 2015, the financial account recorded net outflows amounting to Euro 155 million or 1.7% of GDP. Compared to the previous quarter, increased net outflows were registered in the financial flows,

⁵⁶ Significant depreciation of the Russian ruble in 2014, driven by factors which are not purely economic, highlights some concerns when analyzing indicators of price competitiveness of the domestic economy by including volatile currencies such as the ruble. Consequently, price competitiveness indicators are more appropriate to be analyzed through the real effective exchange rate indices calculated using weights based on the foreign trade without primary products. This is the way to eliminate some volatilities related to changes in currencies sensitive to trends in world stock prices and appropriate focus is put on structural factors that drive competitiveness of the economy.

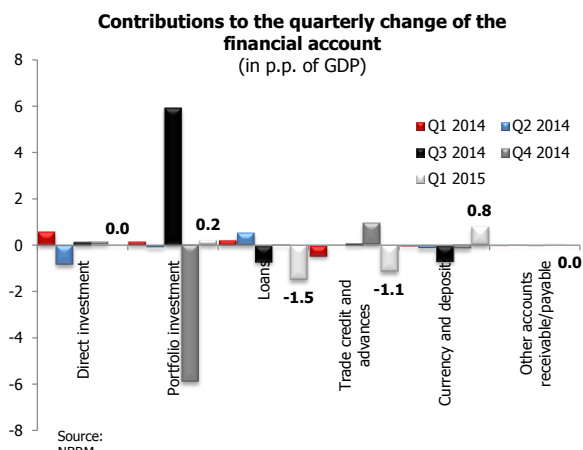
⁵⁷ Primary products that are not included in the calculation are: oil and oil derivatives, iron and steel, ores and imported raw materials for the new industrial facilities in the free economic zones. For more detailed information on the methodology for calculating the real effective exchange rate visit: http://nbrm.mk/WBStorage/Files/Statistika_REDK_Informacija_za_promenite_na_metodologijata_za_presmetuvanje_na_realni_ot_efektiven_devizen_kurs_na_denarot_mak.pdf



Source: NBRM.



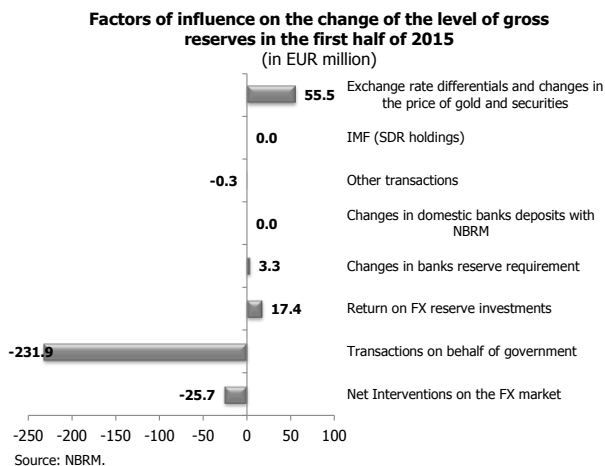
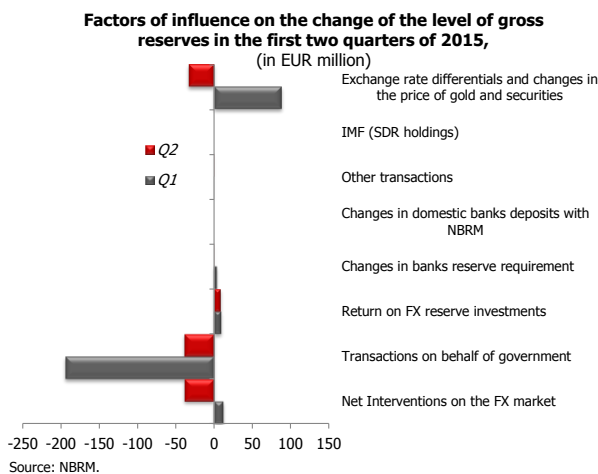
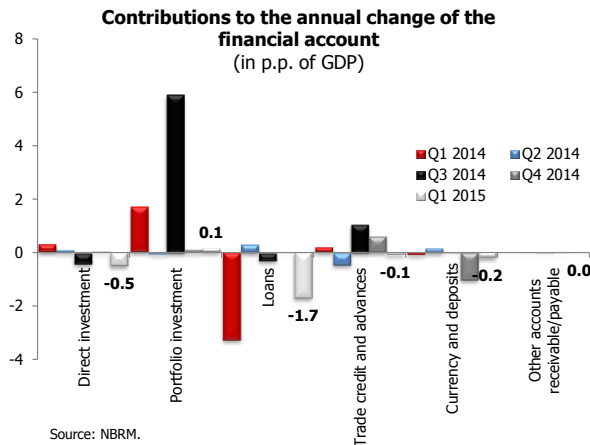
Source: NBRM.



Source: NBRM.

as a result of the intensified government deleveraging, with the early repayment of the remaining part of the PCL to the IMF and of the private sector on the basis of trade credits, when net-outflows were registered, versus the inflows in this category in the fourth quarter of 2014. The analysis of the movement of individual components suggests that direct and portfolio investments were sources of financial net inflows, as opposed to other categories that registered net outflows. Contrary to the government deleveraging on the basis of long-term financial loans, the remaining sectors of the economy registered a moderate long-term net borrowing abroad, driven by further borrowing by public enterprises and depository institutions. Negative trends in the category currency and deposits continued in the first quarter of the year, although at a significantly reduced pace. Namely, despite the high net outflows registered in the other sectors, depository institutions made withdrawal of deposits from foreign banks in the domestic economy, which created inflows in this category and mitigated the negative trends created by other sectors. Additionally, deleveraging of the private sector through the repayment of accumulated trade credits had a negative impact on the position of the financial account in the first quarter of the year. Despite these achievements in financial and commercial loans and currency and deposits, foreign direct investments continued to support the balance of payments position of the economy through the creation of net inflows. The structure of foreign direct investments again dominated the debt component, amid a significantly lower share of non-debt flows. Further reduction of loans approved by domestic entities in favor of the parent companies, with simultaneous new investments of foreign investors in domestic companies, resulted in significant inflows on the basis of intercompany debt.

The annual analysis of the financial account indicates significant annual deterioration of 2.4 percentage points of GDP compared to the first quarter of 2014, when positive financial flows on a net basis were realized. Almost all individual components contribute to this change, with the exception of portfolio investments. A major factor for this annual change in financial flows are the high net outflows in financial loans, entirely caused by the government sector, due to the early repayment of the loan to the IMF. In addition, inflows on the basis of foreign direct investments decelerated in the first quarter of 2014, caused by lower reinvested profit. Namely, the higher amount of repatriation of earned income in the

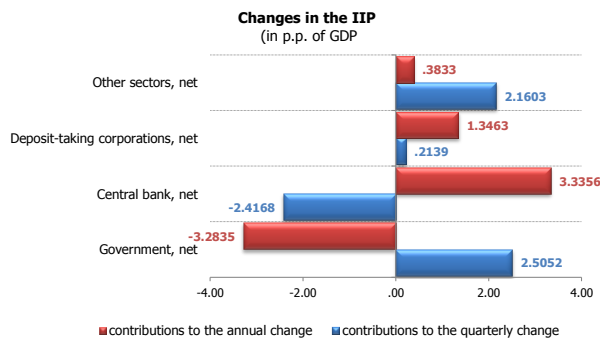
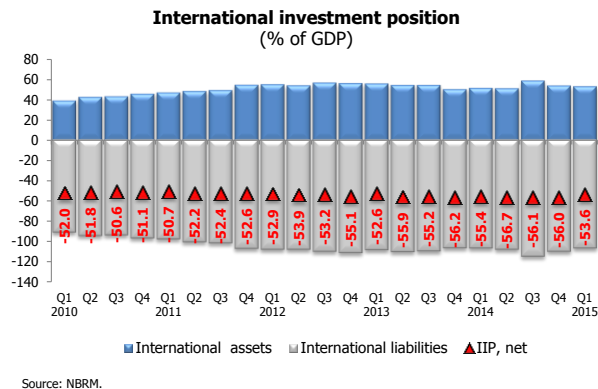


form of dividend paid to the foreign investor in the first quarter, acted toward a reduction of the net reinvested profit. On the other hand, the debt component of direct investments continued to grow. Further growth in net outflows realized in currency and deposits of other sectors also contributed to the less favorable position in the financial account on an annual basis. On the other hand, portfolio investments registered a slight improvement, driven by the withdrawal of foreign funds registered in investment funds. Namely, the low yields on securities in foreign markets caused the withdrawal of funds back into the economy with the aim of their investing in financial instruments with higher yields. **In April 2015, the financial account of the balance of payments registered inflows of Euro 54.8 million on a net basis.** Net inflows are due to the favorable developments in trade credits and foreign direct investments, in circumstances of further negative financial flows in the category currency and deposits, and realized net repayments based on financial loans abroad.

The gross foreign reserves at the end of the first quarter of 2015 amounted to Euro 2,354.8 million, which was a quarterly decline of Euro 81.6 million. The change compared to the end of 2014 was caused by the net outflows of funds on the basis of transactions on behalf of the government⁵⁹, as opposed to the high positive price changes and exchange rate differences and the moderate net purchase by the NBRM in the foreign exchange market realized in the first quarter. ***According to the latest available data, at the end of June, the foreign reserves amounted to Euro 2,254.8 million, which is by Euro 100 million less than at the end of the first quarter of 2015.*** The decline in foreign reserves was due to the transactions on behalf of the government, registered net sales by the NBRM in the foreign exchange market and the negative price changes and exchange rate differences during the second quarter.

⁵⁹ In February 2015, early repayment was made of the outstanding portion of the IMF Precautionary Credit Line, in the amount of Euro 153.4 million.

1.6.3. International investment position⁶⁰ and gross external debt



At the end of the first quarter of 2015, the **negative international investment position⁶¹ of the Republic of Macedonia amounted to Euro 4,824.9 million or 53.6% of GDP.** The comparison on a quarterly basis points to improved debt position of the country amid a more dynamic decline in international liabilities relative to the decline in international assets⁶². *Sector-by-sector analysis shows that the largest quarterly decline is registered in the government net liabilities* mainly as a result of the reduced liabilities based on long-term loans i.e. the early full repayment of the precautionary credit line (PCL) from the IMF. Smaller downward movements were registered in the net liabilities in "other sectors in the economy" and the net liabilities of depository institutions. On the other hand, deterioration was registered in the position of the net assets of the central bank as a result of lower foreign reserves.

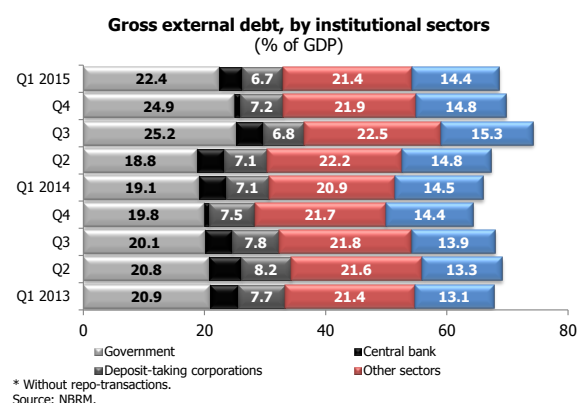
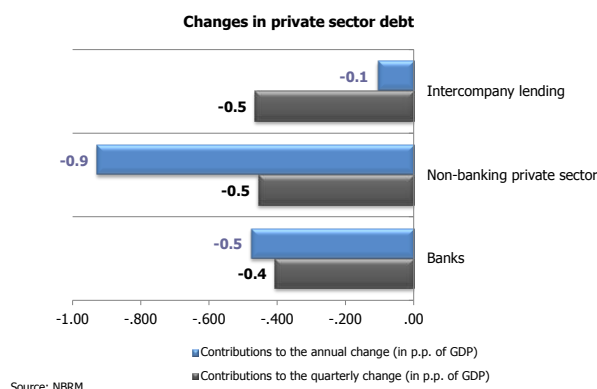
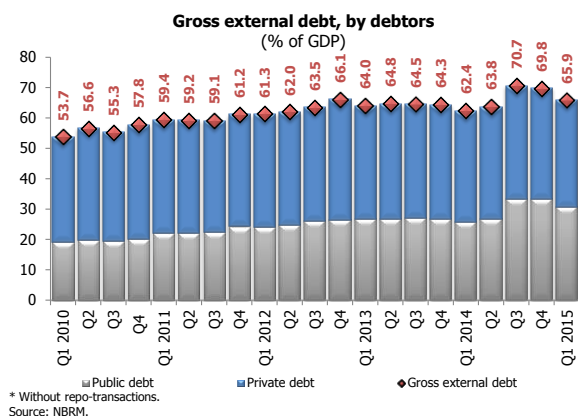
On an annual basis, net liabilities to the rest of the world declined by 1.8 pp of GDP, due to the growth of international assets, amid unchanged international liabilities⁶³. Sector-by-sector analysis of the international investment position of the economy indicates improvement

⁶⁰ The analysis in this section is entirely based on data on the international investment position compiled under a new methodology. Namely, in July 2014, the NBRM started disseminating data on the international investment position (IIP) and gross external debt of the Republic of Macedonia, according to the new international statistical standards defined by the Balance of Payments and International Investment Position Manual (BPM6) and the External Debt Statistics (2013). For more detailed information on the methodological changes, visit the NBRM website (http://nbrm.mk/WBStorage/Files/Statistika_Informacija_zapr_omenite_vo_platnot_bilans_megunarodnata_investiciska_pozicija_i_nadvoresnot_dolg_koisto_proizleguvaat_od_primenata_na_novite_megunarodni_statisticki_standardi.pdf).

⁶¹ In the second quarter of 2011, the NBRM began concluding repo and reverse repo transactions. These transactions represent an investment opportunity to use portfolio securities to provide additional income. Conclusion of repo transactions incurs liabilities. At the same time, the claims created from entering into reverse repo agreements increase gross claims. The NBRM simultaneously carries out matched conclusion of repo and reverse repo agreements in nearly identical amounts. In general, as they are concluded concurrently, these transactions have a neutral net effect on net basis, i.e. they appear in almost identical amount on both liabilities and assets side, and therefore do not affect the total net IIP nor the total net external debt.

⁶² Analysis of MIP in absolute terms, indicates a slight quarterly deterioration of 0.9% of the negative IIP which stems from the faster growth of international liabilities relative to the growth of international assets.

⁶³ The analysis of negative debt investment position in nominal terms indicates moderate annual growth of 2.1%.



mainly in the central bank and depository institutions, and then to a lesser extent in "other sectors in the economy", while changes in the government sector suggested deterioration. The favorable change with the central bank is due to the high annual growth of net assets, driven by higher foreign reserves, and by the positive change in depository institutions, where lower net liabilities were mostly driven by the growth of assets in the form of currency and deposits. In the government sector, the registered annual deterioration is entirely caused by the growth of liabilities based on debt portfolio investments⁶⁴.

As of 31 March 2014, the gross external debt stood at Euro 5,932 million, or 68.7% of GDP, which is a decrease of 1.1 percentage points of GDP, on a quarterly basis. If the effect of the repo transactions of the monetary authority is excluded, the decline would be somewhat larger and would amount to 3.9 percentage points of GDP⁶⁵. The quarterly decline in gross external debt is mainly due to the lower public debt, with an additional contribution from the fall of the private sector debt. The decline in public sector debt results from the lower debt of the central government i.e. the full early repayment of the PCL of the IMF. Lower private debt is almost equally due to the lower liabilities to foreign direct investors, reduced short-term liabilities based on trade credits and advances and lower long-term loans with the non-banking private sector, as well as the fall in the liabilities based on long-term loans with banks.

Compared with the first quarter of 2014, gross external debt increased by 11.4% or 3.5 pp of GDP. The annual growth in gross debt is due solely to the higher public debt (by 5 percentage points of GDP), with a simultaneous annual decline in the private sector debt (of 1.5 percentage points of GDP). Fast growth in public debt is primarily due to the intensive growth of long-term liabilities of the central government in the form of debt securities as a result of the issued Eurobond, with additional contribution of the growth of the debt based on long-term financial loans to public

⁶⁴ During the third quarter of 2014, the government borrowed on the international financial markets through the issuance of the third Eurobond in the amount of Euro 500 million, resulting in an increase of government liabilities on portfolio investments. At the same time, beside the increase in liabilities, there was also high accumulation of foreign reserves, and accordingly, higher net assets.

⁶⁵ The overall analysis below relates to gross external debt without the central bank liabilities based on repo transactions.

companies⁶⁶. Observing the private sector debt, decline was registered in both the banking and non-banking sector.

Generally, the external indebtedness indicators of the national economy still show that the gross external debt is in the safe zone. The only indicator that classifies the economy in the group of highly indebted countries is the share of the gross external debt in GDP. Observing the dynamics, the external debt of the country⁶⁷ indicates deterioration in almost all solvency indicators for the first quarter of 2015, compared with the same period last year, excluding the ratio between interest repayment and exports of goods and services, which has improved. On the other hand, liquidity indicators suggest a more favorable external position, given the improvement in the provided indicators and full coverage of short-term debt liabilities with residual maturity with the foreign reserves.

As of 31 March 2015, net external debt, as an additional indicator of the external position of the economy, amounted to Euro 1,887.5 million or 21% of GDP, which is a slight annual growth of 1.7 percentage points of GDP. Slower growth of net external debt relative to the growth of gross debt is due to the higher level of gross external claims (by 1.8 percentage points of GDP).

⁶⁶ Higher liabilities on long-term foreign loans are mainly due to the borrowing of public enterprises for financing the construction of road infrastructure.

⁶⁷ The analysis of external indebtedness indicators uses balance of payments data in accordance with the Balance of Payments and International Investment Position Manual (BPM6) and data on gross external debt according to the External Debt Statistics (2013). The methodological changes caused no changes in the overall level of external debt, but only affected the maturity and sector structure of the debt. Accordingly, under the new methodology, the level of short-term debt is lower at the expense of the increase in long-term debt component, which caused changes in the liquidity indicators, i.e. their improvement relative to the analyses based on data from the previous methodological framework. On the other hand, the methodological changes in the export of goods and services and other inflows caused deterioration of the indicators for the share of export of goods and services and other inflows in the gross external debt and debt service in relation to export of goods and services and other inflows, compared with the indicators relevant prior to the methodological changes.



Indicators for external indebtedness

	<i>Solvency</i>				<i>Liquidity</i>		
	Interest payments/ Export of goods and services and other inflows	Gross debt/ Export of goods and services and other inflows	Gross debt/ GDP	Debt servicing/ Export of goods and services and other inflows	Foreign reserves/ Short- term debt	Foreign reserves/ Short-term debt, with residual maturity	Short-term debt/ Overall debt
	in %				ratio	ratio	in %
31.12.2004	2.41	129.3	47.3	12.4	1.14	0.89	30.3
31.12.2005	2.66	147.0	54.2	11.06	1.67	1.04	26.7
31.12.2006	3.44	131.3	49.8	21.7	1.95	1.34	29.0
31.12.2007	2.78	119.3	51.3	19.4	1.35	1.08	39.8
31.12.2008	2.66	116.9	54.1	10.2	1.29	0.95	35.2
31.12.2009	2.43	131.0	57.8	11.8	1.29	0.94	32.9
31.12.2010	3.22	140.4	59.7	13.9	1.49	0.99	27.9
31.12.2011	3.12	148.4	64.6	16.8	1.78	1.18	25.2
31.12.2012	2.92	141.9	67.6	13.1	1.64	1.03	26.7
31.12.2013	2.51	137.5	67.4	15.8	1.64	1.08	23.3
31.03.2014	3.00	133.3	65.9	17.1	1.41	0.95	25.8
30.06.2014	3.00	136.3	67.4	17.1	1.33	0.90	25.8
30.09.2014	3.00	151.1	74.7	17.1	1.75	1.16	23.1
31.12.2014	3.00	149.1	73.7	17.1	1.88	1.15	21.7
31.03.2015	2.09	137.9	69.4	19.6	1.86	1.24	21.4
<i>Moderate indebtedness criterion</i>	<i>12 - 20%</i>	<i>165 - 275%</i>	<i>30 - 50%</i>	<i>18 - 30%</i>	<i>1.00</i>		

*The moderate indebtedness criterion is according to the World bank's methodology of calculating indebtedness indicators, which implies 3-year moving averages of GDP and exports of goods and services in the calculation of the indicators.

*According to the "Greenspan-Guidotti rule", a country should maintain full coverage of short-term debt at remaining maturity with gross foreign reserves.

*According to the "Greenspan-Guidotti rule", a country should maintain full coverage of short-term debt at remaining maturity with gross Source: NBRM.

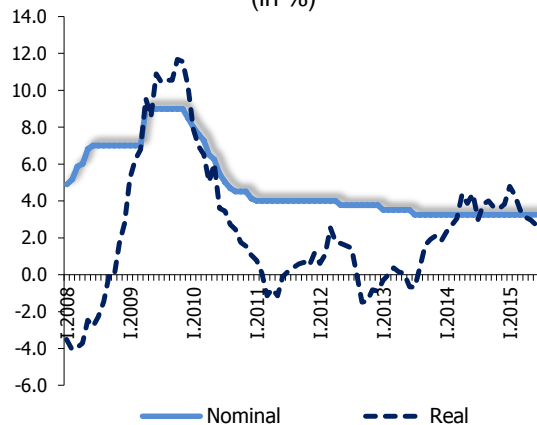
II. Monetary policy

During the second quarter of 2015, the NBRM kept its policy rate unchanged at 3.25%. This decision was based on the latest macroeconomic projections of April and the recent performances of the key macroeconomic and financial indicators. Analyses have shown that the economy continues to recover at a solid pace, in part supported by the credit activity of the domestic banks. Economy recovers without price pressures and with adequate level of foreign reserves. Such trends indicated existence of appropriate environment for sustained recovery of private sector, and it was again assessed that the domestic economy is sufficiently supported through the monetary policy measures. In this period, risks were a combination of external risks and domestic risks caused by the current political developments. Observing external risks, concerns about Greece's debt crisis were again brought to the fore in this period, which stresses the present uncertainty in the environment. In the context of Greek developments and uncertainty about the future course of events, in late June, the National Bank took preventive measures to manage capital flows. Analyzing domestic risks, although the effects of political developments on the economy remained limited in this period, certain indicators signaled potential initial unfavorable effects, suggesting a need for greater vigilance and close monitoring of all developments. The NBRM will continue to monitor closely the situation in order to make timely and adequate accommodation of monetary policy.

Based on the regular assessment of the recent macroeconomic and financial

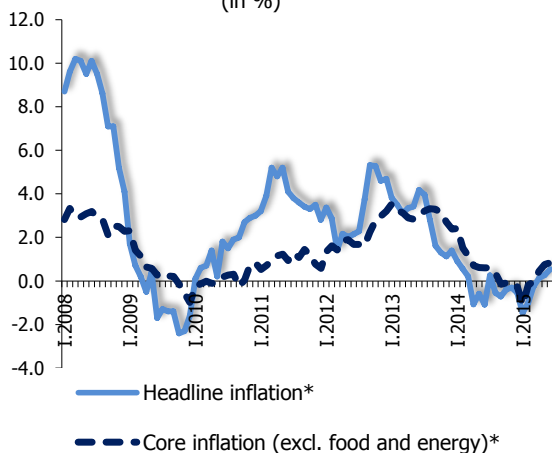


Nominal interest rate on CB bills and inflation
(in %)



Source: NBRM.

Inflation
(in %)



*Current month/same month of the previous year.

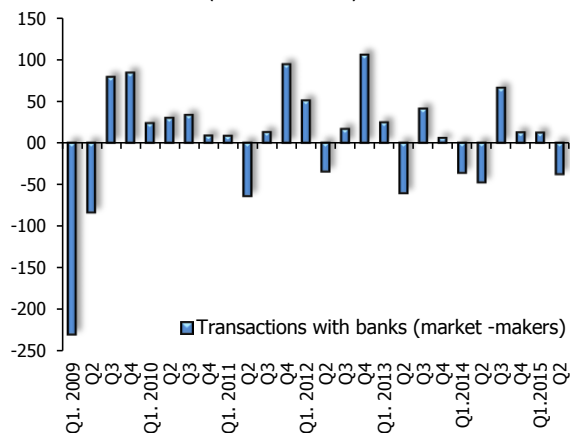
Source: SSO

developments, at the meeting held during the second quarter⁶⁸ of 2015, the NBRM Operational Monetary Policy Committee decided to keep CB bill interest rate at 3.25%. The latest reassessment of the NBRM's macroeconomic projections in April indicated no significant changes in the environment for conducting monetary policy compared to the previous estimates. Observing performances, in the second quarter, the movements of key macroeconomic indicators generally do not deviate much from the expected dynamics. In the second quarter, the foreign reserves declined. The NBRM intervened on the foreign exchange market with sales of foreign currency, as expected, considering the payment of dividends to foreign shareholders, typical for this time of year. The fall in foreign reserves was expected with the April projection, and according to adequacy ratios, they remained at an appropriate level, enough to cope with any shocks. After eight consecutive months of continuous decline, inflation in the second quarter recorded a small growth and averaged 0.3% annually. Growth of annual inflation in the second quarter was driven by the moderate increase in food prices and core inflation which averaged 0.7% annually. In this period, the inflation moved as projected in April. Real sector performance remains favorable. Available high frequency data during the quarter showed continuation of economic growth in the first quarter, as confirmed by the GDP official data. The rise in GDP in the first quarter was as projected, and recent short-term data pointed to continuing positive performance in the second quarter. Observing credit market, in the second quarter of 2015, total loans recorded solid growth compared to the first quarter, mainly due to the increase of loans to households, amid simultaneous growth of loans to corporate sector. The annual rate of growth of total loans in June exceeds the projection for the second quarter, pointing to further support of banks for the private sector. Also in this period, risks were a combination of external risks and risks caused by the domestic political developments. The global environment has not undergone significant changes compared to the last assessments, amid continuous uncertainty about the pace of global growth and changes in the prices of primary commodities. However, the latest information on the international environment showed some risk reduction. This primarily relates to developments in the euro area, where the latest

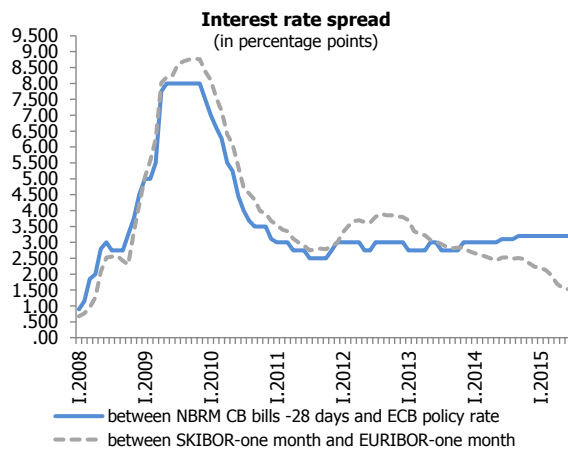
⁶⁸ During the quarter, the NBRM's Operational Monetary Policy Committee held three sessions on 14 April 2015, 12 May 2015, and 9 June 2015, when it reassessed the monetary policy setup.



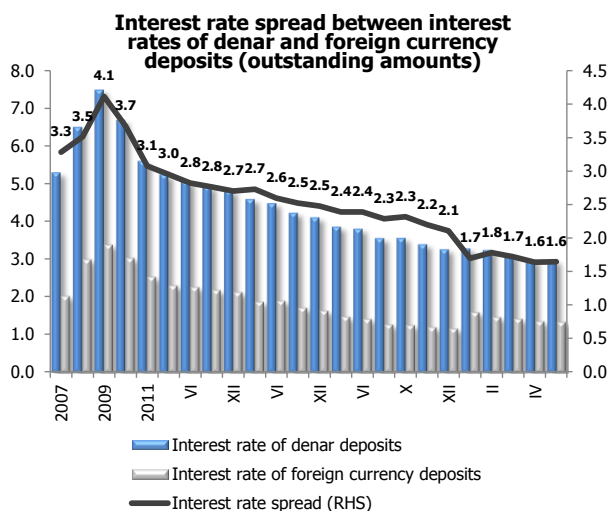
**Interventions on the foreign exchange market
by NBRM**
(in EUR million)



Source: NBRM



Source: NBRM, ECB (www.ecb.int) and De Nederlandsche Bank (www.statistiek.dnb.nl).



Source: NBRM

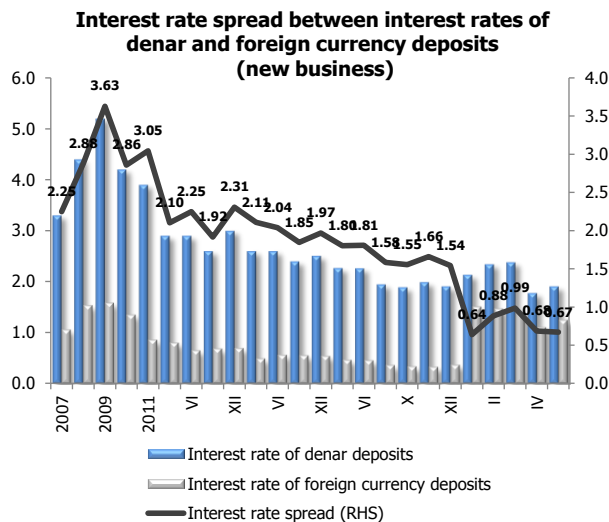
ECB projections remained almost unchanged, but still indicates a further reduction of the downward risks. On the other hand, concerns about Greece's debt crisis are again brought to the fore in this period (particularly in June), which stresses the present uncertainty in the environment. In the context of Greek developments and uncertainty about the future course of events, in late June, the National Bank took preventive measures⁶⁹ to manage capital flows. Those are temporary protective measures, introduced to prevent the threat of any significant outflows of capital from the domestic economy to Greece and thereby prevent significant disturbance to the equilibrium in the balance of payments and the stability of the financial system. In terms of domestic risks, although no significant adverse effects of the political developments on the economy have been registered in this period, yet, some indicators have shown initial unfavorable signals (lower industrial production, movements in currency exchange market, shifts in household deposits) indicating a need greater vigilance and monitoring of all developments. In such conditions, **it was assessed that the current monetary policy stance is appropriate and sufficient to support the domestic economy. Leaving the zone of accommodative monetary policy in the next period will depend on the materialization of identified risks and the effects on the external position of the economy and on foreign reserves.**

After the latest cut in policy rate in September 2014 (to 0.05%), during the first and the second quarter of 2015, the ECB kept its policy rate unchanged. According to the ECB, non-standard monetary policy measures continue to generate positive effects, aimed at further easing of financial conditions, improving inflation expectations and easing of terms of lending to the private sector.⁷⁰ In such circumstances, the interest rate spread between the CB bill interest rate and the ECB policy rate in June remained at 3.2 percentage points, the level from September 2014. Short-term interest rates in the domestic financial market moved down during the second quarter given the cut of interest rates on the NBRM deposit facilities in March 2015. The short-term market interest rates were relatively

⁶⁹ For more details on the preventive measures of the NBRM, see the Decision on the introduction of special protective measures (Official Gazette of the Republic of Macedonia No. 107/15) at:

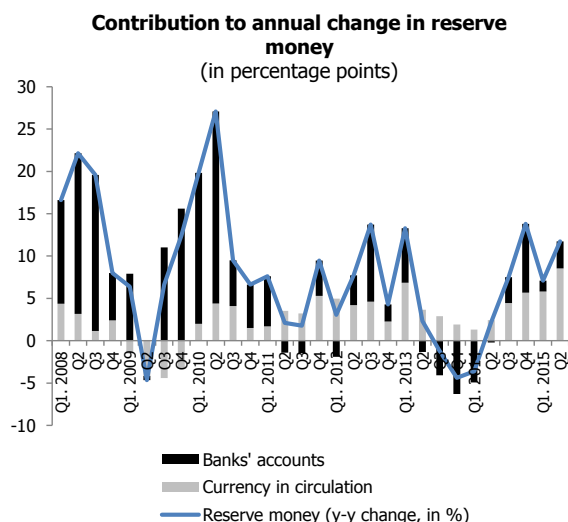
http://www.nbrm.mk/WBStorage/Files/Regulativa_Odluka_vove_duvanje_posebni_zastitni_merki0.pdf

⁷⁰ <https://www.ecb.europa.eu/press/pressconf/2015/html/is150603.en.html>



stable on the European financial market. These developments resulted in narrowing of the interest rate spread between one-month SKIBOR⁷¹ and one-month EURIBOR from 2 percentage points in March to 1.5 percentage points in June. Within the banking sector, deposit interest rates during this period decreased, which was particularly noticeable among interest rates on Denar deposits, wherefore the interest rate spread between the interest rate on newly received Denar deposits and the interest rate on newly accepted foreign currency deposits amounted to 0.7 percentage points in May 2015 compared to 1 percentage point in March. However, it is noteworthy that the interest rates on newly received deposits are marked by variable movements⁷², which can result in frequent and temporary adjustments of the interest rate spread. Interest rate spread between interest rates on total Denar and total foreign currency deposits was stable and in May equaled 1.6 percentage points.

2.1. Banks' liquidity and interbank money market developments



During the second quarter of 2015, bank liquidity⁷³ increased by Denar 126 million, compared to the end of the first quarter. Thus, in June, the balances of banks' accounts with the NBRM⁷⁴ stood at Denar 15,909 million. In May, reserve money⁷⁵ increased by 11.7% on an annual basis, compared to March 2015, when it increased by 7.1%.

During the second quarter of 2015, the autonomous factors contributed towards withdrawing net liquidity of Denar 2,964 million. Within these frames, the largest contribution to the decline in liquidity was made by the NBRM interventions with market makers on the foreign exchange market, when liquidity of Denar 2,327 million was withdrawn through the net sale of foreign currency. Government transactions were also used to withdraw liquidity in the amount of Denar 346 million. In this quarter, liquidity was also withdrawn through the currency in circulation (totaling Euro 609 million), mainly reflecting the increased demand for cash

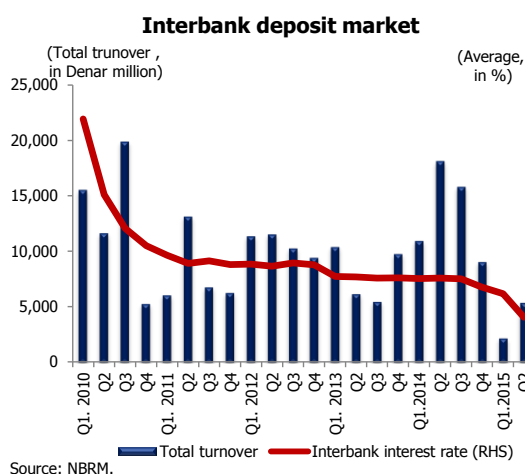
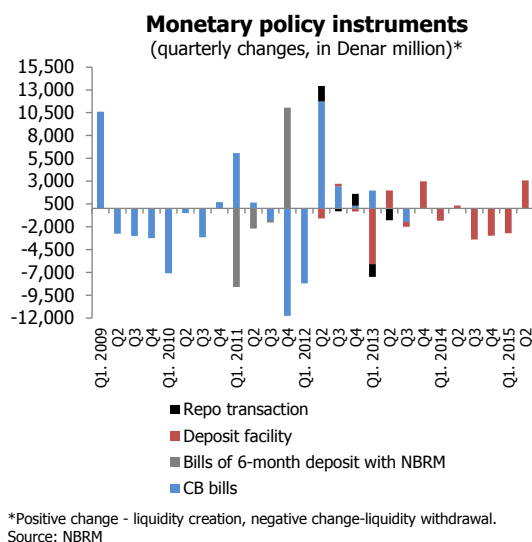
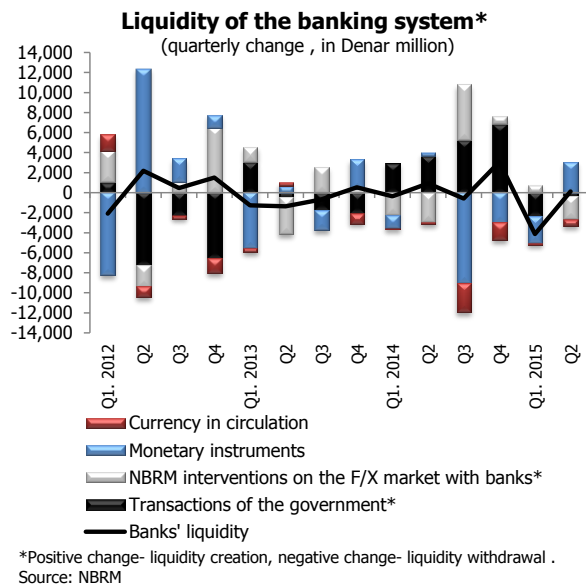
⁷¹Interbank interest rate on Denar deposits, calculated using quotations of reference banks.

⁷²Volatility of interest rate on newly accepted deposits results from the fact that they are driven by the volume of newly accepted deposits (which can vary from month to month) and their interest rate.

⁷³Refers to the change in banks' account balances with the NBRM.

⁷⁴Refers to Denar accounts of banks required to allocate reserve requirement.

⁷⁵Includes reserve requirement in foreign currency.



immediately after the payment of agricultural subsidies in May.

In the second quarter, the NBRM's monetary instruments contributed towards creating net liquidity of Denar 3,090 million. The change in monetary instruments in this period fully arises from changes in the NBRM deposit facilities, while the CB bills remained stable on a quarterly basis. In the period from April to June, three CB bill auctions were held, with volume tender and fixed interest rate of 3.25%. The new rule for forming the supply of banks according to the share in the reserve requirement in denars, which entered into force in March⁷⁶, contributed to stabilization of demand for CB bills, wherefore in the auction held in April, the demand was equal to the amount offered. In May, the demand was moderately lower than the supply (by Denar 107 million), which resulted in a temporary reduction in the level of CB bills, and in June, the demand was again positioned at the level of the offered amount. Thus, quarterly, CB bills had a neutral effect on the level of liquidity in the banking system. Amid reducing of liquidity through autonomous factors, the banks provided a portion of the needed liquidity through seven-day deposit facilities, which in the period from April to June, dropped by Denar 3,100 million. The overnight deposit facility again rose insignificantly by Denar 10 million compared to the previous quarter. During the second quarter of 2015, banks allocated excess liquid assets over the reserve requirement (in Denar s) of 0.4% on average, which is almost at the level of the average of the previous quarter.

In the second quarter of 2015, the interbank deposit market (unsecured segment) reported a total turnover of Denar 5,366 million, which is 2.5 times more compared to the first quarter of 2015. In the second quarter of 2015, compared to the second quarter last year, the activity at the interbank money market decreased by 70.4%. Analyzed by maturity segment, in the second quarter, intraday transactions had a dominant share in the total turnover in the interbank money market, making up 94% of the total transactions, followed by seven-day transactions, with share of 6%. The interbank interest rate on overnight transactions (MKDONIA) decreased and averaged 0.97% in the second quarter (1.48% on average in the first

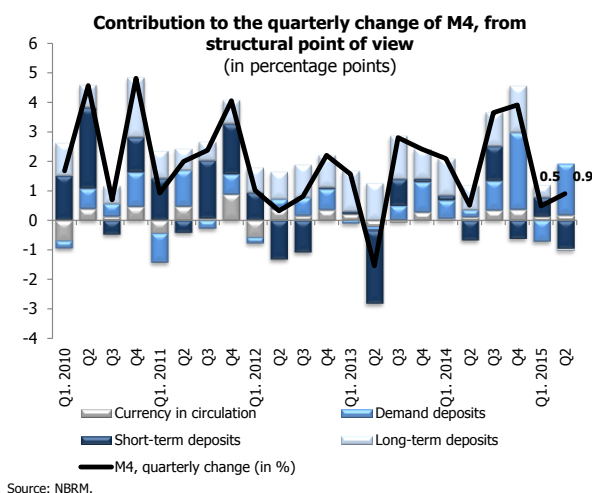
⁷⁶ For more details about the changes in the setup of CB bills auctions see the Decision amending the Decision on CB bills (Official Gazette of the Republic of Macedonia No. 35/15)

quarter)⁷⁷. The interbank interest rate (MBKS) also decreased and averaged 0.93%, in the first quarter (1.36% on average, in the previous quarter). In the second quarter of 2015, the **secondary money market** transactions totaled Euro 423 million, mostly due to the transactions in treasury bills (accounting for 71% of total transactions) and in government bonds. The total amount traded in the second quarter of 2015 is lower by 36.4%, on a quarterly basis.

2.2. Monetary and credit aggregates

The second quarter of 2015 registered a moderate acceleration in the quarterly rate of monetary growth compared to the previous quarter, amid generally favorable real sector developments and further growth of credit activity. Analysis of the growth structure indicates more intensive increase of the most liquid monetary aggregate M1 (currency in circulation and demand deposits), which was the only driver of the quarterly expansion of the money supply in the second quarter. Term deposits (both short- and long-term) decreased on a quarterly basis. Analyzed by sector, the second quarter registered a growth in corporate deposits. On the other hand, household deposits moderately decreased on a quarterly basis after a long period, in part probably reflecting the uncertainty about domestic and global political and economic environment. With respect to lending, the second quarter registered further solid support of the banking sector to the two most important segments of the economy. The credit market developments are explained by the growth of both supply of (amid favorable risk perceptions of banks⁷⁸) and demand for loans. Annually, at the end of June, total loans increased by 9% (9.2% at the end of March).

2.2.1. Monetary aggregates



Broad money M4 continued to grow during the second quarter of 2015 at moderately accelerated pace compared to the previous quarter, at 0.9% quarterly growth rate as of June (0.5% at the end of March). The further monetary expansion is mainly associated with the maintenance of favorable economic trends and the strengthened credit activity. Structure analysis shows that the growth entirely derives from the quarterly increase of the narrowest monetary aggregate M1, primarily driven by the growth in deposits. Currency in circulation acted in the same direction, but on a significantly smaller scale. This accelerated growth of the most liquid money can in part be associated with the payment of

⁷⁷ MKDONIA and MBKS were cut due to the reduction of the interest rates on deposit facilities by the NBRM in March 2015.

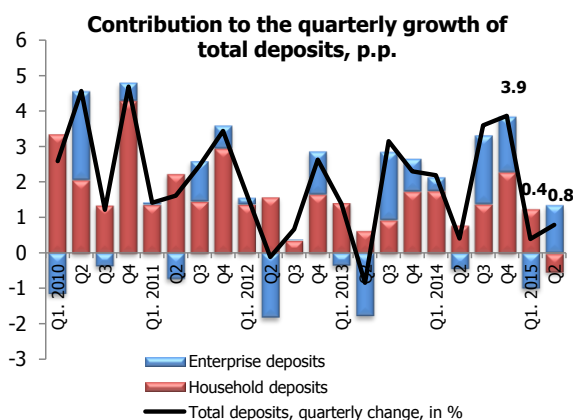
⁷⁸ According to the results of the latest Bank Lending Survey conducted in June 2015 that shows improved risk perceptions as a factor that affects the credit standards primarily applied to the approval of corporate loans.



Total deposits

	2013				2014				2015	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
q-o-q growth, %										
Total deposits	1.4	-0.8	3.2	2.3	2.2	0.4	3.6	3.9	0.4	0.8
contributions to quarterly growth, p.p.										
Deposit money	-0.2	0.5	0.6	1.1	0.7	0.3	1.1	2.8	-0.8	1.9
Denar deposits	1.1	0.5	1.2	0.9	0.9	0.1	1.3	1.5	0.0	-1.1
Foreign currency deposits	0.5	-1.9	1.3	0.3	0.6	0.0	1.3	-0.4	1.2	0.0
Short-term deposits	-0.1	-2.6	1.0	0.1	0.3	-0.7	1.3	-0.7	0.7	-1.0
Long-term deposits	1.7	1.3	1.5	1.1	1.3	0.9	1.2	1.7	0.5	-0.1

Source: NBRM.



Source: NBRM.

Household deposits

	2013				2014				2015	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
quarterly change, in %										
Total household deposits	2.0	0.9	1.3	2.4	2.4	1.1	1.9	3.2	1.8	-0.7
contribution to quarterly change of total deposits, in p.p.										
Deposit money	-0.1	0.2	-0.1	1.0	0.5	0.2	0.2	1.9	0.1	-0.2
Denar deposits	1.2	0.8	0.8	1.1	1.2	0.7	0.9	1.1	0.7	-0.4
FX deposits	0.8	-0.1	0.6	0.3	0.7	0.2	0.9	0.2	1.0	-0.1
Short-term deposits	0.2	-0.4	-0.2	-0.2	0.2	-0.2	0.2	-0.2	1.1	-0.7
Long-term deposits	1.8	1.1	1.6	1.6	1.7	1.1	1.5	1.4	0.6	0.1

Source: NBRM.

subsidies to tobacco growers and farmers⁷⁹. Long-term and particularly short-term deposits reduced in the second quarter, with the demand deposits, whose growth significantly intensified, being the only generator of the further increase of deposit base. These developments are contrary to those observed in the first three months of the year, when term deposits contributed to the increase of total deposits, while demand deposits decreased partly due to the seasonal adjustment of demand for liquidity after the New Year and Christmas holidays. Analyzing the currency structure, Denar deposits increased (contrary to the relatively fast decrease in the first quarter primarily driven by demand deposits) amid a slight growth of foreign currency deposits. In such conditions, the level of euroisation, as measured by the share of foreign currency deposits in money supply M4 decreased from 38.2% at the end of March to 37.9% in June. In the household sector, the share of foreign currency deposits in total deposits (excluding demand deposits) in June equaled 55%, compared to 54.8% in March. **On annual basis**, the monetary growth as of June accelerated to 9.2% from 8.8% at the end of March.

The second quarter registered further expansion of the deposit base of the banking system, with quarterly growth rate of 0.8% which is double compared to the previous quarter (0.4% at the end of March). Moreover, during this period, some changes in the growth structure have been noted, namely, more intensive increase of corporate deposits and lower household deposits. **Thus, the households, as sector that traditionally generates surplus, registered a 0.7% quarterly decrease of deposits, after a long period of time (an increase of 1.8% in the previous quarter).** Total household savings registered a slight decrease during May and June (monthly growth in April), which amid continuous favorable performance of the domestic economy, is most likely associated with the uncertainty about recent domestic political developments and high uncertainty about the resolution of the economic and political situation in Greece (especially in June). However, the decline in household deposits in this period was relatively small, with a slower pace in June compared to May, which may indicate temporary trends and expectations for their stabilization in the next period. Analyzing the structure, the decline was entirely caused by the reduction in short-term deposits amid small

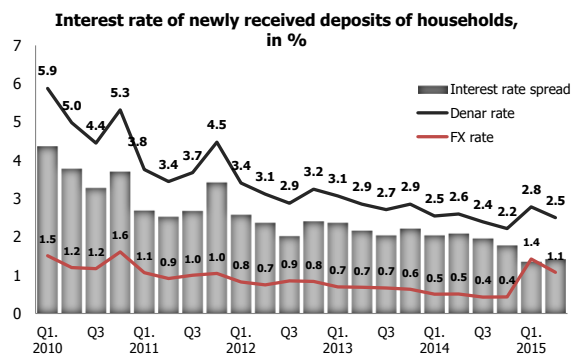
⁷⁹ In May, the Ministry of Finance paid Denar 800 million as subsidies to tobacco growers, and in June it paid about Denar 80 million as subsidies to farmers.



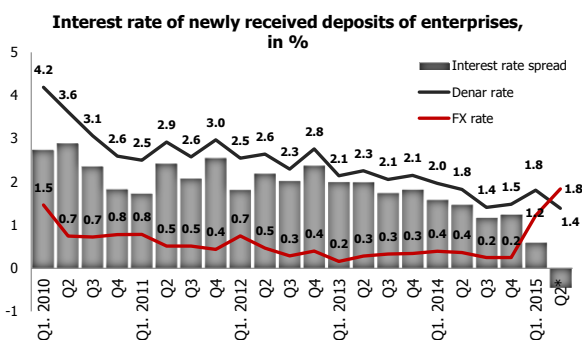
Enterprise deposits

	2013				2014				2015	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
квартални промени, во %										
Total household deposits	-1.5	-7.8	9.1	4.1	1.7	-2.0	8.8	6.8	-4.2	5.9
contribution to quarterly change of total deposits, in p.p.										
Deposit money	-1.4	1.3	2.9	1.9	1.1	0.2	3.3	7.6	-4.3	8.1
Denar deposits	0.1	-1.3	2.6	1.6	0.2	-1.8	2.8	1.3	-1.7	-2.6
FX deposits	-0.3	-7.8	3.5	0.7	0.4	-0.4	2.7	-2.1	1.8	0.5
Short-term deposits	-1.5	-9.4	5.0	2.1	0.3	-2.0	4.8	-2.4	-1.1	-1.6
Long-term deposits	1.4	0.3	1.1	0.2	0.3	-0.2	0.6	1.5	1.2	-0.6

Source: NBRM.



*Q2 2015 refers to May.
Source: NBRM.



*Q2 2015 refers to May.
Source: NBRM.

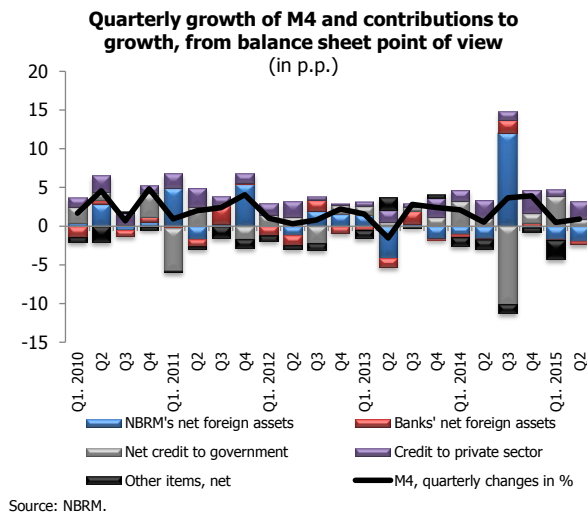
increase in long-term deposits compared to the growth of both components in the previous quarter. Observing the currency structure, the quarterly decrease was mostly due to the decrease of Denar savings during May and June. Foreign currency deposits recorded a moderate decrease in the second quarter, which comes after relatively high growth in the first quarter that in part probably resulted from certain international markets developments⁸⁰. In such conditions, the **annual growth rate** of total household deposits at the end of June was 6.2%, which is a slowdown compared to the end of March when it was 8.1%.

After declining in the first quarter of 2015, total corporate deposits registered a quarterly growth of 5.9% (a decrease of 4.2% in the previous quarter). Analyzed on a monthly basis, the higher growth in deposits is mainly due to the performance in June and to a lesser extent in April, while May registered a monthly reduction of total deposits primarily due to the payment of dividend by a domestic company to the government and a foreign investor. According to the analysis of the growth structure, demand deposits are the only generator of the quarterly increase in total corporate deposits compared with the previous quarter when they were drivers of their decline. The contribution of short-term deposits is again negative and higher compared with the previous quarter, with the long-term deposits acting in the same direction (as opposed to their growth in the first quarter). Such movements in the monthly pace of growth of total deposits and frequent shifts in the structure of growth just confirm the volatile nature of corporate deposits which are still closely related to the companies' need for liquidity and changes in economic activity. Analyzing the currency structure, Denar deposits account for about 92% of the quarterly growth (contrary to their faster decrease in the first quarter) amid moderately positive contribution of the foreign currency deposits. **The annual rate of growth** of total corporate deposits at the end of June was 17.8%, which is almost twice higher compared to March (9.0%).

According to the analysis of the yields from new savings, interest rates⁸¹ on newly received Denar and foreign currency

⁸⁰ In January 2015, the central bank of Switzerland decided to leave the target of the Swiss franc against the euro that resulted in appreciation of the Swiss franc against the euro and most other currencies.

⁸¹ As of January 2015, interest rate data of banks and savings houses have been collected under the new interest rate methodology, while data for the previous period were collected under the old methodology. For more detailed information see Quarterly Report, May 2015, p 53.



deposits of households at the end of May equaled 2.5% and 1.1%, respectively, which compared to the end of March is by 0.3 percentage points less in both categories. In such conditions, the interest rate spread between them remained unchanged. The interest rates on newly received corporate Denar and foreign currency deposits equaled 1.4% and 1.8%, respectively, which compared to the end of March suggests a decrease in proceeds from Denar savings and an increase in proceeds from foreign currency deposits (by 0.4 percentage points and 0.6 percentage points, respectively). In such conditions, foreign exchange savings for the first time provide higher proceeds than the Denar savings, making the interest rate spread between them negative⁸². In May, interest rates on *total* Denar and foreign currency deposits of households equaled 3.0% and 1.3% respectively, while the interest rates on Denar and foreign currency deposits of the corporate sector equaled 2.8% and 1.5%, respectively.

Structural analysis of the growth of money supply (from balance sheet perspective) indicates intense positive contribution of loans to the private sector, with the net loans to the government acting in the same direction, yet to a lesser extent. Similar to the previous quarter, net foreign assets of the monetary system, mainly of the NBRM⁸³, and less of the banking sector, acted towards reducing the money supply.

2.2.2. Lending activity

Total credits of private sector

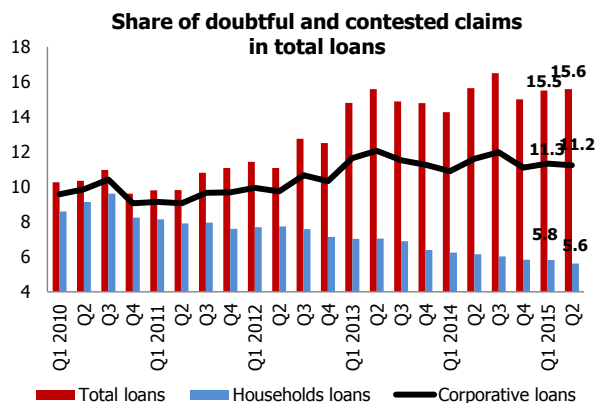
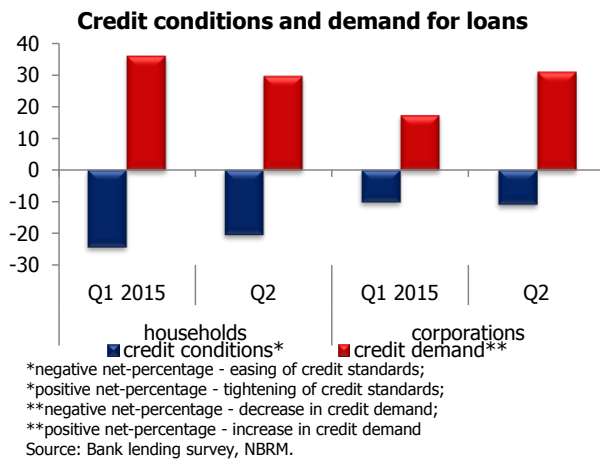
	2013				2014				2015	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
	quarterly change, in %									
Total credits of private sector	0.7	1.9	0.6	3.0	1.8	2.9	1.4	3.6	1.1	2.7
Contribution in quarterly change of total credits (in p.p)										
Denar credits	0.4	1.6	1.4	2.9	1.6	2.7	1.3	3.1	0.7	3.2
Foreign currency credits	0.3	0.3	-0.8	0.1	0.2	0.1	0.1	0.5	0.4	-0.5
Short-term credits	-0.1	0.6	-0.4	0.7	0.7	0.4	0.0	1.7	-0.5	0.0
Long-term credits	-0.6	0.6	1.6	2.3	1.2	1.3	0.9	2.4	1.2	2.5
Households	0.4	1.4	1.0	1.2	0.9	1.6	1.2	1.0	1.0	1.8
Corporations	0.3	0.5	-0.4	1.9	0.9	1.2	0.2	2.6	0.1	0.9

Source: NBRM.

Solid credit support to the real economy by the domestic banking system continued during the second quarter of 2015. **The quarterly growth rate of total credits extended to the private sector at the end of June was 2.7%, which is an acceleration compared to the pace of growth in the previous quarter (1.1% at the end of March).** These credit market developments have been noted amid ongoing economic growth of the domestic economy, which further creates a solid demand for

⁸² This shift is a combination of methodological changes under the new methodology for interest rates and the volatility in the movements of interest rates on newly approved loans and newly received deposits. The new methodology mainly affected the level of deposit interest rates because interest rates on demand deposits and overnight deposits are no longer included in the calculation of interest rate on total deposits. Moreover, the negative interest rate spread could be a temporary shift as a result of the volatile nature of interest rates on newly accepted corporate deposits.

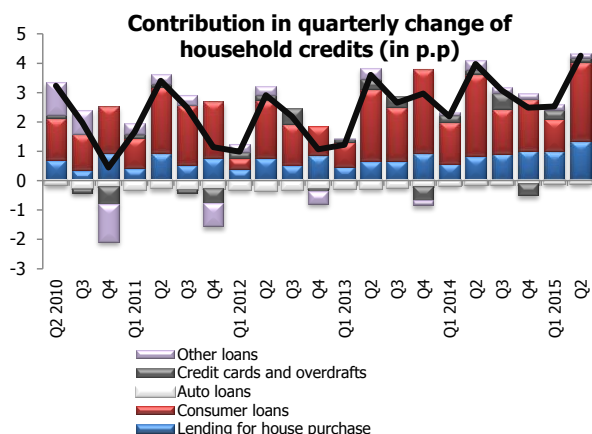
⁸³ The reduction in net foreign assets in the second quarter largely reflects the growth of foreign liabilities of the NBRM, amid simultaneous reduction of foreign assets of the NBRM.



Source: NBRM.

	2013				2014				2015	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
quarterly change, in %										
Total credits of households	1.1	3.4	2.5	2.8	2.1	3.9	2.9	2.4	2.4	4.2
Contribution in quarterly change of household credits (in p.p)										
Denar credits	1.2	3.6	2.6	2.8	2.1	3.9	3.0	2.3	2.3	3.9
Foreign currency credits	-0.1	-0.1	-0.1	0.0	0.0	0.1	0.0	0.1	0.1	0.2
Short-term credits	0.1	0.4	0.3	-0.6	0.2	0.3	0.4	-0.4	0.2	0.2
Long-term credits	0.9	2.7	2.1	3.8	1.8	3.5	2.5	2.8	2.0	3.9

Source: NBRM.



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

loans by the corporate and the household sectors. Thus, according to results of the latest Bank Lending Survey⁸⁴, the second quarter registered higher demand for corporate loans with a higher intensity than in the previous survey, while retaining the pace of growth of the household demand for loans. Analyzing credit supply, amid further increase in total deposit base, no significant changes have been noted in the banks' assessments about the direction of changes in the terms of lending. Namely, according to the survey, banks still indicate moderate net easing of the terms for granting corporate loans and larger net easing of the terms of lending to households. Spurred on by these favorable developments, the second quarter registered significant acceleration of credit activity to the two most important segments of the economy. This performance is also supported by the stabilization of the share of doubtful and contested claims in total loans at 11.2% at the end of June (11.3% at the end of the first quarter)⁸⁵.

The analysis of maturity structure shows that the growth in total loans is still driven by increased long-term lending, while short-term loans remained at the similar level as in the previous quarter. From currency aspect, Denar credits generates the overall quarterly increase in total loans, with such growth being the highest quarterly increase of Denar loans in the period after the onset of the financial crisis. On the other hand, loans in foreign currency decreased on a quarterly basis contrary to the positive contribution in the previous quarter. **Annually**, at the end of June, total loans increased by 9% (9.2% at the end of March).

Amid intense pace of growth of total loans which is over three times higher than the quarterly increase of the deposit base, in the second quarter there was an increased utilization of deposits for lending to the private sector, for the second consecutive quarter. Thus, at the end of June, loan/deposit ratio was 91.7% (90% at the end of March).

Loans to the household sector continued to grow during the second quarter at a significantly faster pace compared with the previous quarter. **Thus, the quarterly growth rate at the end of June accelerated to 4.2%, from 2.4% at the end of March.** Analyzed by

⁸⁴ For more information, also see Bank Lending Survey at <http://nbrm.mk/?ItemID=F7AC78DEE498764FBAF39049F726CE3C>.

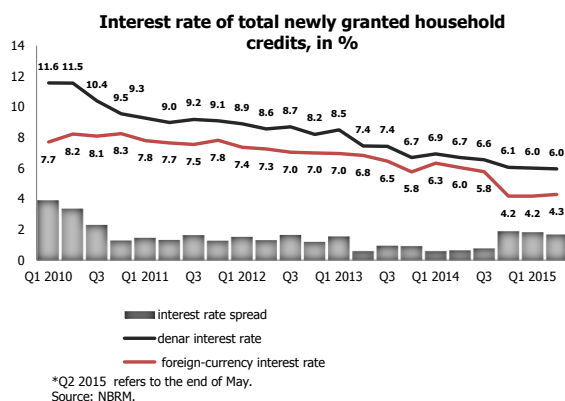
⁸⁵ According to monetary statistics data.



Total credits of corporations

	2013				2014				2015	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
	quarterly change, in %									
Total credits of corporations	0.5	0.9	-0.7	3.2	1.5	2.0	0.3	4.5	0.1	1.6
Contribution in quarterly change of corporation credits (in p.p)										
Denar credits	-0.1	0.2	0.5	3.0	1.2	1.9	0.1	3.7	-0.5	2.7
Foreign currency credits	0.5	0.7	-1.2	0.2	0.3	0.2	0.2	0.8	0.6	-1.1
Short-term credits	-0.3	0.8	-1.0	1.6	1.0	0.6	-0.3	3.2	-1.1	-0.1
Long-term credits	-1.6	-0.8	1.1	1.3	0.7	-0.2	-0.2	2.2	0.6	1.4

Source: NBRM.

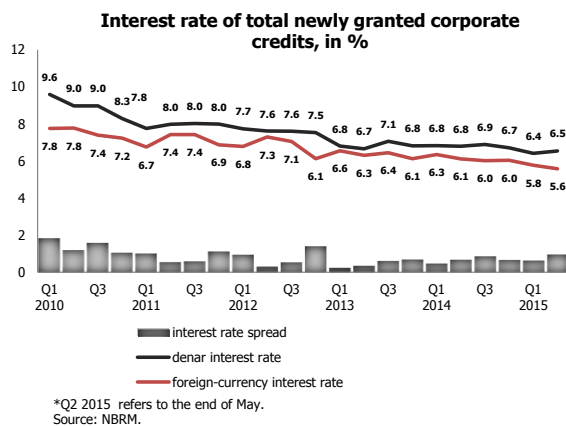


categories of loans, intensive lending to households is explained by the higher growth in consumer loans with a share of 63% in the quarterly growth (43% in the first quarter), with further growth of housing loans. Such performances are generally in line with the banks' answers provided in the latest Lending Survey, which shows retention of favorable developments in the supply and demand of credits. Thus, banks point to further moderate net easing of the lending terms amid increased demand for loans. Analysis of the structure of growth shows no major shifts in the maturity structure and currency denomination. Thus, long-term credits and loans in domestic currency continue to drive most of the growth in loans, with the short-term loans and foreign currency loans acting in the same direction, but to a lesser extent. **On annual basis**, the growth rate of household loans accelerated to 12.4% at the end of June from 12.1% at the end of March.

In the second quarter of 2015, there was significant boost of banks' credit support to the corporate sector with the quarterly growth of corporate loans making up 34% of the increase in total loans (share of 6% in the previous quarter). The quarterly growth rate of corporate loans at the end of June was 1.6% indicating more intense acceleration compared to the previous quarter, when under the influence of seasonal factors it registered a minimum rate of quarterly growth (0.1%). Such changes correspond to the answers given by banks in the Lending Survey conducted in June. Thus, after the temporary deterioration of the banks' risk perceptions in the first quarter, the results for the second quarter show improvement in the banks' expectations for the overall economic activity and expectations for the outlook of the branch of the company and the collateral risk⁸⁶. Some favorable developments have also been observed in the demand for corporate loans, which in the second quarter registered a faster net increase compared with the previous survey, while retaining the perceptions of moderate net easing of the lending terms. An additional contribution to the positive developments in the corporate lending has been made by the support to SMEs through the use of funds from the EIB credit line⁸⁷. On the other hand, within the non-standard measure to encourage lending to net exporters and producers

⁸⁶ Only 11% of banks on average find that these factors lead to more conservative policies for approving loans to corporate sector (39% on average in the previous survey).

⁸⁷ During the second quarter, the fifth tranche of EIB 4 credit line – Euro 100 million was withdrawn in the amount of Euro 10.3 million.



of electricity, immediately after the relatively high growth in the first quarter (of Denar 2,489 million), in the period April-May, there was a modest increase of Denar 120 million, which was fully implemented in May⁸⁸. With respect to the maturity structure of the growth, long-term lending explains the overall quarterly increase in total corporate loans, while short-term loans registered further decrease, but at a significantly slower pace compared with the decline registered in the previous quarter. With respect to currency, the quarterly growth stems from the intense increase in Denar loans, while loans in foreign currency registered a significant decrease. These developments are contrary to the performance in the previous period when foreign currency loans were the only driver of quarterly growth. Despite the quarterly acceleration, **annually**, corporate lending showed a moderate slowdown to 6.7% in June from 7.1% at the end of March.

According to the data as of May, there were no significant changes in the **price of newly approved loans and total loans** to the private sector⁸⁹. Thus, interest rates on total loans to household and corporate sectors equaled 7.1% and 6.7%, respectively, which compared to the end of March indicates a minor decline in the price of loans to households. Interest rates on newly approved loans were maintained at levels similar to the previous quarter (5.9% and 6.3% for loans to households and companies, respectively).

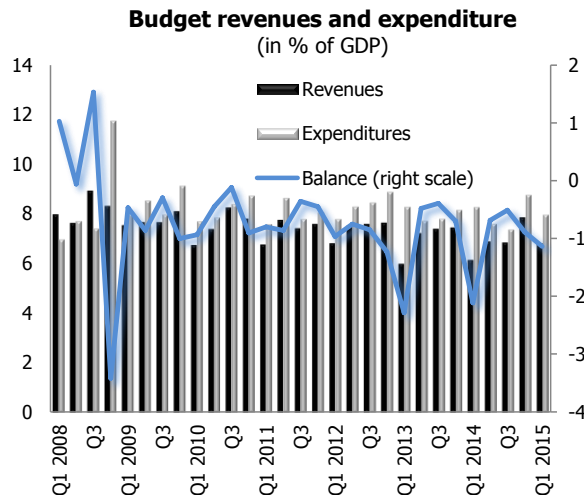
III. Public finances

In the first quarter of 2015, the Budget of the Republic of Macedonia (central budget and budgets of funds) registered a strong annual growth of budget revenues of 17%, while the growth of budget expenditures was more moderate and equaled 1.5%. The significant increase in revenues is greatly due to the recent tax changes which mean abolition of the anti-crisis measure that exempted retained earnings of the companies from taxation. Despite the strong revenue growth, the share of expenditures in GDP still exceeds the share of revenues, and therefore, the first quarter registered budget deficit of 1.1% of GDP. The budget deficit in this quarter was financed mainly through government deposits, and less through new issues of government securities. Total revenues continued increasing in the period April-May 2015 and accounted for 11%, which

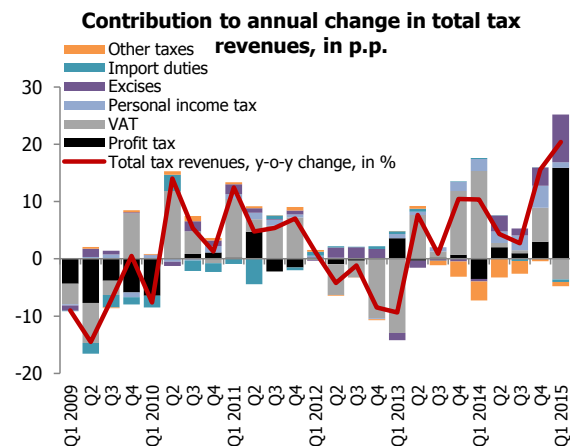
⁸⁸ In April, the new loans granted within the non-standard measures to encourage lending to net exporters and producers of electricity recorded a moderate monthly decline of Denar 84 million, while in May, loans to net exporters increased by Denar 204 million.

⁸⁹ As of January 2015, interest rate data of banks and savings houses have been collected under the new interest rate methodology, while data for the previous period were collected under the old methodology. For more detailed information see Quarterly Report, May 2015, p 53.

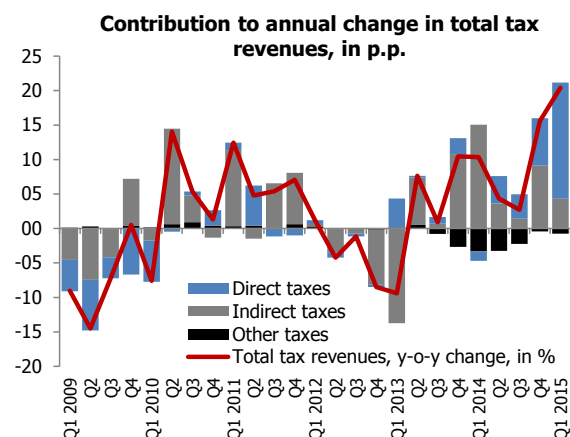
was followed by growth of budget expenditures of 7.9%. Budget deficit in this period was lower and constituted 0.3% of GDP.



Source: MoF and NBRM calculations.



Извор: Министерство за финансии.

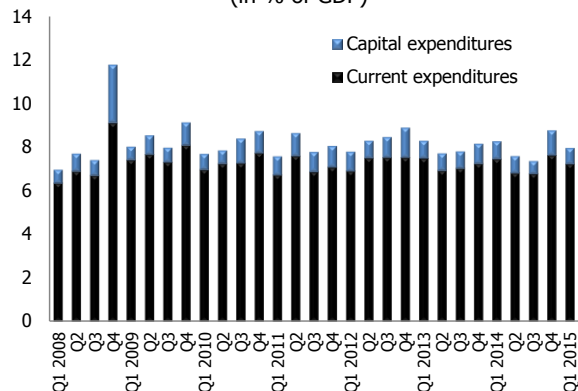


Source: Ministry of Finance.

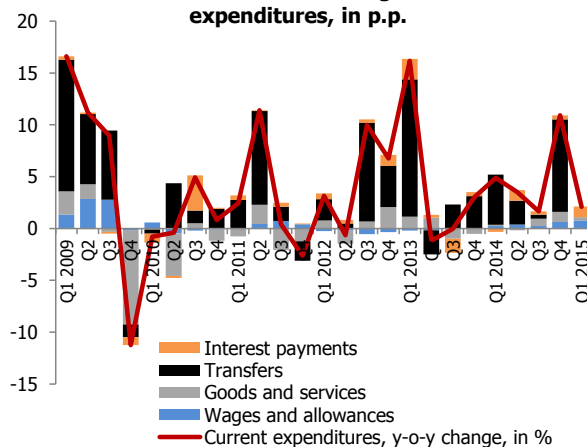
In the first quarter of 2015, the total revenues in the Budget of the Republic of Macedonia⁹⁰ continued to grow at a faster pace. The growth rate was 17%, primarily due to changes in tax policy at the beginning of the year. Thus, the share of budgetary revenues in GDP was 6.8%, which is higher than in the same quarter of 2014 (6.1%), but lower than the previous quarter (7.9%). If we analyze the individual revenue items, it can be concluded that the main driver of growth of budget revenues is income tax, whose collection continued to accelerate, amid growth of 20.4%, thus contributing 11.5 percentage points to the growth of total revenues. Such change in tax revenues results primarily from the substantial collection of direct taxes, particularly the increase in revenue of income tax of 278.4%. High inflows of this tax recorded in this period correspond to the abolition of the anti-crisis measure earlier this year, which released undistributed profits of companies from taxation⁹¹. Income tax revenues continued to grow during the first quarter, but at a significantly slower pace compared to the previous quarter (6.4% versus 27.4% annual growth in the previous quarter). Indirect taxes also recorded growth, but at a slower pace compared to the previous quarter. The growth is entirely due to the significant performance of revenues from excise duties, which rose by 49.1% on an annual basis, making the second largest contribution to the growth of tax revenues. High growth of this revenue item is probably a combination of multiple factors such as lower base effect, introduction of new excise duty on oil coke, transferred effect of last year's increase in excise duty on cigarettes per piece and regular growth of the amount of this excise duty early this year. In contrast, revenues from VAT and import duties in the first quarter of the year decreased (by 6.6% and 7.3% respectively) and consequently, their contribution to the growth of tax revenues was negative. Revenues from VAT reduced for the first time after 2012, and given the further growth of private consumption, it was probably due to the negative effects of the drastic reduction in oil prices during this period. In the first quarter, total inflows on the basis of social contributions increased at faster pace, achieving growth of 7.1%, amid more intensive increase of collection in all subcategories.

⁹⁰ Central budget and budgets of funds.

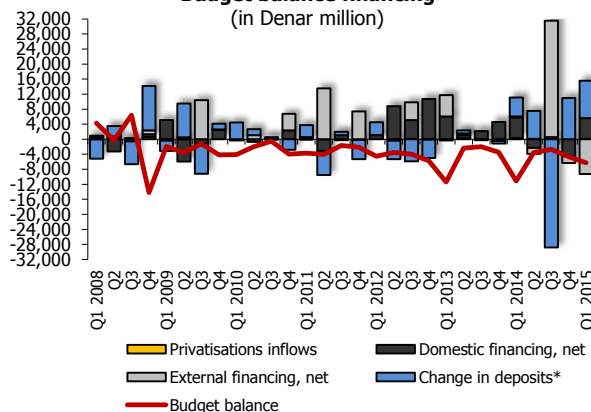
⁹¹ The collection of this tax was particularly high in March since this is the period when the difference between the advance payment paid the previous year for profit in tax balances in the final accounting are paid.

**Budget expenditures composition**
(in % of GDP)

Source: MoF and NBRM calculations.

Contribution to annual change in current expenditures, in p.p.

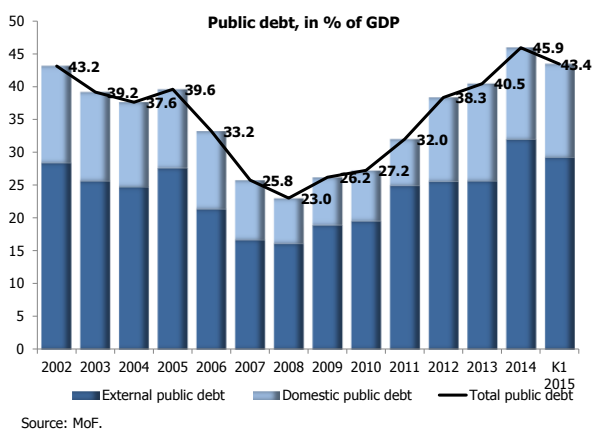
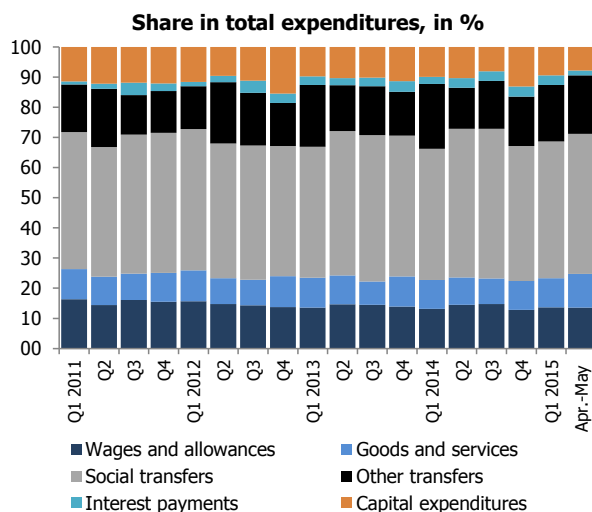
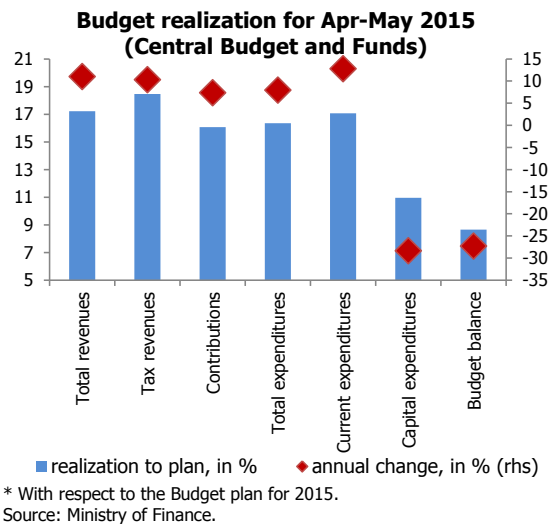
Source: MoF and NBRM calculations.

Budget balance financing
(in Denar million)* Positive change- deposits withdrawal; negative change-deposits accumulation.
Source: MoF.

The evident increase in contributions for pension and disability insurance, and health insurance is probably due to the legislative amendments introduced earlier this year that require payment of benefits for work performed on the basis of copyright contracts and in part stems from the further growth of the number of employees. Non-tax revenues also registered a high growth of 26% annually, mainly due to the growth in revenues from additional activities.

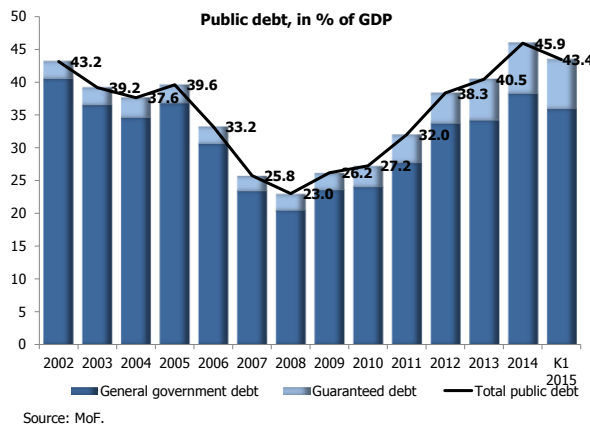
In the first quarter of the year, the total expenditures slowed down by 1.5% on an annual basis (13.1% in the previous quarter). Hence, their share in GDP decreased to 8%, from 8.8% in the previous quarter and 8.3% in the same quarter of the previous year. More precisely, this performance results from both the slower growth in current expenditures, and the lower capital expenditures. The 2.1% growth of **current expenditures** in the first quarter was mainly driven by the intense increase in expenses for wages and benefits (5.3% annually), as a second-round base effect of the previous wage increase in the public sector. Unlike them, there was delayed execution of the cost of goods and services, while the total transfers registered no change compared to the same quarter of the previous year, although other transfers that include subsidies registered significant reduction. After the high growth in the previous quarter, at the beginning of this year, **capital expenditure** were by 3.8% lower on an annual basis. This made their share to go moderately down both in GDP and in total expenditures (to 0.7% and 9.4%, respectively).

In the first quarter of 2015, the budget deficit totaled Denar 6,301 million, constituting 1.1% of GDP. This is almost twice less than the deficit in the same period of 2014 with a rate of execution of about 34% of the total deficit projected for the year. With respect to funding, in this quarter, the government deposits were the main source of funds for covering the negative budget gap, with share of about 60% in the total budget financing needs. Additional inflows were registered this quarter through government borrowing on the domestic market, in the net amount of Denar 5,631 million. On the other hand, the net external debt decreased by Denar 9,258 million, mainly due to the early repayment of the outstanding US Dollar 174 million of the country's debt to the IMF based on PCL in February 2015.



In the period April-May 2015, total revenues increased by 11% compared to the same period last year, mainly due to the higher collection of tax revenues, which grew by 10.3% on annual basis. More detailed analysis suggests that, similar to the first quarter, the main driver of growth in total revenues are direct taxes, especially income tax, whose twice as high collection made this tax to make the largest single contribution to the growth of total revenues in this period. Further growth has been perceived in revenues from income tax (5.5%). On the other hand, unfavorable movements in this period were observed in indirect taxes. This particularly applies to VAT revenues, which, although slower, continued to decline on an annual basis (5%) in the two months of the second quarter, thus negatively affecting the growth of budget revenues. Moreover, analyzing the indirect taxes, only excise revenues were collected in an amount by 13% higher on an annual basis, in conditions of prolonged decline in inflows from import duties. During this period, revenues from social contributions continued to grow at a similar pace as the previous quarter, with growth recorded in all types of contributions. **The two months of the second quarter registered increased execution of budget expenditures, which increased by 7.9% on an annual basis.** This shift in expenditures entirely derived from the higher execution of current expenditure (12.8%), especially in the area of transfer payments. Within this item, particularly high growth was recorded in the category of other transfers, which among others includes payments of state subsidies. In respect of other expenditure categories, this period was marked by significant execution of costs for goods and services (up 18%), given the further growth of expenses for both wages and benefits. On the other hand, **capital costs** recorded a significant decline (of 28.4%) that followed the moderate decline in the previous quarter, which adversely affected the growth of total expenditures. In April and May, 17.2% of revenues and 16.4% of expenditures planned for 2015 were executed. In the period April-May, budget deficit amounted to Denar 1,601 million, or 0.3% of GDP⁹². The dominant source of financing the budget deficit in this period was the government borrowing on the domestic market and a smaller portion of the necessary funds has been provided by external sources. In such circumstances, these months registered moderate accumulation of deposits on the account with the NBRM.

⁹² Also, 0.3% of GDP according to the GDP projection of the Ministry of Finance.



As of 31 March 2015, total public debt⁹³ equaled 43.4% of GDP, which is a decrease of 2.5 percentage points of GDP compared with the end of 2014. The reduction in total public debt in this period largely stems from reduced external public debt, as a result of the premature deleveraging of the government to the IMF. Hence, the share of external public debt to GDP decreased from 31.9% to 29.2%, as opposed to the share of domestic public debt, which reported a small increase (from 14% to 14.2%). The first quarter registered a moderate decrease in the share of government debt⁹⁴ in total public debt (to 82.6%), compared to the share of guaranteed debt, which has been increasing for several quarters in a row, and reached 17.4%.

Budget of Republic of Macedonia (Central budget and budgets of funds) □

	2015 Budget	Q1	Apr.-May	Y-o-Y changes, 2015 period over the same period of the previous year, in %		Contribution to yo-y change, 2015 period over the same period of the previous year, in p.p.	
	planned, in Denar million	realized, in Denar million		Q1	Apr.-May	кв.1	апр.-мај
TOTAL REVENUES	163,280	37,779	28,133	17.0	11.0	17.0	11.0
Tax revenues and contributions	137,672	33,326	24,196	16.1	9.3	14.3	8.1
Taxes	87,465	21,935	16,158	20.4	10.3	11.5	6.0
Contributions	48,717	10,932	7,829	7.1	7.3	2.2	2.1
Non-tax revenues	17,078	3,240	1,849	24.7	11.8	2.0	0.8
Capital revenues	4,152	350	1,202	101.1	20.0	0.5	0.8
Foreign donations	3,578	784	755	28.1	69.7	0.5	1.2
Revenues from repayments of loans	800	79	131	-61.1	11.0	-0.4	0.1
TOTAL EXPENDITURES	181,777	44,080	29,734	1.5	7.9	1.5	7.9
Current expenditures	160,569	39,936	27,408	2.1	12.8	1.9	11.3
Capital expenditures	21,208	4,144	2,326	-3.8	-28.4	-0.4	-3.3
BUDGET DEFICIT/SURPLUS	-18,497	-6,301	-1,601				
Financing	18,497	6,301	1,601				
Inflow	44,667	16,709	2,304				
Privatisation receipts	0	0	0				
Foreign loans	16,159	1,018	331				
Deposits	23,321	9,928	-528				
Treasury bills	5,137	5,762	2,491				
Sale of shares	50	1	10				
Outflow	26,170	10,408	703				
Repayment of principal	26,170	10,408	703				
External debt	20,001	10,276	703				
Domestic debt	6,169	132	0				

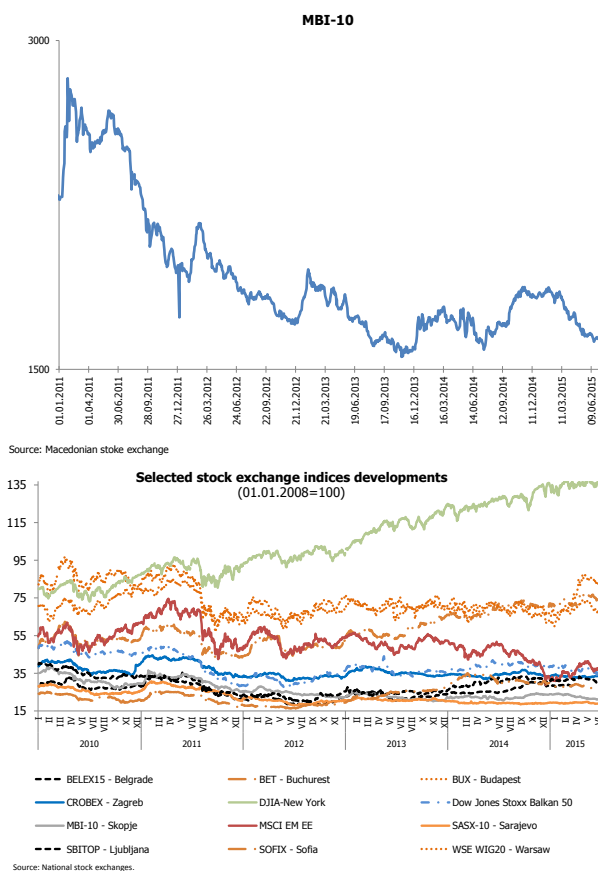
Source: Ministry of Finance and NBRM calculations.

⁹³ The public debt is defined under the Law on Public Debt (Official Gazette of the Republic of Macedonia No.165/14) , according to which it is the sum of the government debt and the debt of public enterprises established by the state or municipalities, municipalities within the city of Skopje and the city of Skopje, and companies that are wholly or predominantly owned by the state or by the municipalities, the municipalities within the city of Skopje and the city of Skopje, for which the Government has issued a state guarantee.

⁹⁴ Government debt is defined as a sum of debts of the central and the local government.

IV. Stock exchange indices and real estate prices

In the second quarter of 2015, the Macedonian MBI-10 dropped again, second in a row, with downward movement of the OMB index being registered in the second quarter. The values of most regional stock indexes also declined, partly because of the uncertainty in the external environment and the latest developments in Greece, but also due to other specific local factors. Real estate prices in the domestic market continued to increase in the second quarter, but noted a slowdown in the pace of growth, which, in the absence of significant changes in supply and demand for real estate, confirms the assessment for the temporary nature of the current growth.

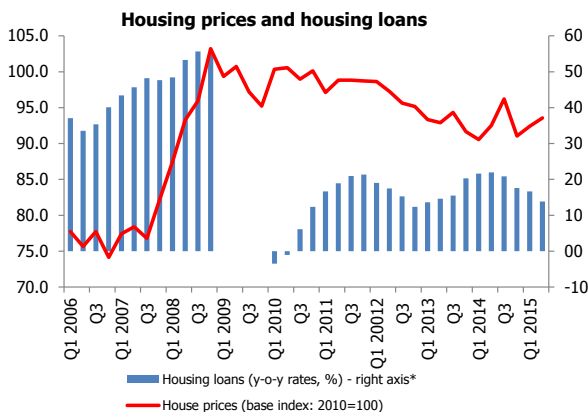
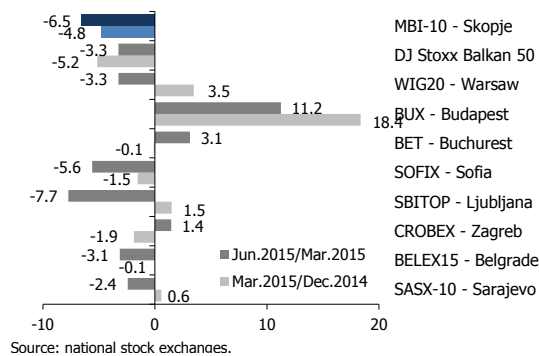


During the second quarter of 2015, the value of the Macedonian MBI-10⁹⁵ continued to decline, resulting in a fall of 6.5%, which is stronger than that registered in the first quarter (4.5%). Analyzing the dynamics of movement, the second quarter registered steady reduction of the value of the stock index which at the end of the quarter positioned at 1640.85. Such movements in the index reflect the lack of interest of domestic investors and the absence of major foreign institutional investors as well as increased risk aversion, taking into account the current uncertain political situation in the country, as well as the uncertain developments in the Greek economy. The total stock exchange turnover increased by 28.2% compared to the previous quarter, mostly due to the turnover based on conventional trading. The rise in turnover was largely driven by non-economic factors and reflects the increased turnover in bonds amid new issue of denationalisation bonds. At the end of June 2015, compared to the end of March 2015, the OMB index⁹⁶ dropped by 1.5% (compared to the end of the first quarter of 1.3%).

⁹⁵ On 16 June 2015, the Stock Exchange Index Commission made a regular revision of MBI10 and OMB indices. According to the Methodology for calculation of MBI10, the Commission decided MBI10 to be composed of the ordinary shares of Komercijalna Bank AD Skopje, Granit AD Skopje, Alkaloid AD Skopje, Stopanska Bank AD Bitola, Makpetrol AD Skopje, Makedonijaturist AD Skopje, Replek AD Skopje, Macedonian Telecom AD Skopje, NLB Tutunska Bank AD Skopje and Skopski Pazar AD Skopje.

⁹⁶ According to the Methodology for calculation of the Macedonian Stock Exchange Bond Index - OMB, the Commission decided OMB to be composed of the following bonds: denationalization bonds - sixth issue (RMDEN06), denationalization bonds - seventh issue (RMDEN07), denationalization bonds - eighth issue (RMDEN08), denationalization bonds - ninth issue (RMDEN09), denationalization bonds - tenth issues (RMDEN10), denationalization bonds - eleventh issue (RMDEN11), denationalization bonds - twelfth issue (RMDEN12), denationalization bonds - thirteenth issue (RMDEN13) and denationalization bonds - fourteenth issue (RMDEN14).

**Changes of the regional stock exchange indices, eop
December 2014/eop September 2014, (in %)**



Source: NBRM. Index of housing prices is calculated by the employees of the NBRM based on the data from the daily newspapers.
*Annual changes for 2009 are not calculated due to changes in methodology.

At the end of the second quarter of 2015, most values of the regional stock indices decreased. Thus, decline in indices was recorded in the stock exchanges in Ljubljana, Sofia, Warsaw, Belgrade and Sarajevo. Part of the downward trends in these indices could be attributed to the increased uncertainty in the external environment, especially the latest developments related to the Greek debt crisis. Certain impact was also made by specific local factors⁹⁷. The value of stock exchange indices increased only in few markets, such as in Budapest, Bucharest and Zagreb. The growth of the Budapest Stock Exchange index was the highest (11.2%), associated with the decision of the Hungarian central bank to cut the policy rate.

Apartment prices kept on increasing in the second quarter of 2015, but at a slower pace compared to the previous quarter. Thus, in the period April-June 2015, the index of apartment prices⁹⁸ went up by 1.2% on a quarterly basis (slightly lower than the growth of 1.5% in the first quarter), and growth of 1.1% on an annual basis (annual growth of 2% in the first quarter). When it comes to the structure of supply and demand for real estate as major determinants for the pricing, no significant changes has been noticed in this area in the second quarter of the year. Namely, the cumulative value of the buildings constructed in the period 2011 - 2015 (first quarter of the year) is higher by 66.3% compared with the period 2007 - 2010, and data show similar dynamics in building permits. In terms of demand for apartments, the permanent solid growth in home loans continued in the second quarter of 2015 and suggests further strengthening of demand. The slowdown of growth in the absence of significant changes in supply and demand for real estate supports the view that the current growth in property prices is temporary.

⁹⁷ <http://wire.seenews.com/>

⁹⁸ Hedonic index of housing prices, prepared by the NBRM on the basis of the notices of sale in the capital city, and published by the agencies dealing with trade in real estate. The price of the apartment is a function arising from the size of the apartment, the neighborhood in which it is located, the floor, whether the apartment has central heating and whether the apartment is new.

V. Analytical appendices

Box 1: Analysis of monetary transmission through the interest rates in the Republic of Macedonia

The interest rate policy of the central bank is one of the most important tools through which monetary impulses are transmitted to the economy. For monetary policy to be effective, it is necessary that changes in the policy rate be duly and timely transmitted first to the money market rates, and then to the interest rates in the economy. This is of particular importance given that these changes further affect the decisions of economic agents for saving, investing and spending. The first stage of transmission i.e. the money market is generally quick and complete, and when it comes to banking interest rates, incomplete transmission and certain time delay may occur in the transmission of monetary signals. The reason can be traced back to the fact that money markets do not always work as perfect markets and hence, the degree of transmission is different for different banks. In this regard, economic cycle and individual features of banks have an additional impact on the second stage of monetary policy transmission. Namely, in addition to the central bank policy rate, when forming their interest rate decisions, banks also take into account their capital positions, profitability, liquidity, structure of financing, loan portfolio quality and other indicators in the business. Hence, for effective implementation of monetary policy, it is crucial for the central banks to have proper understanding of the functioning of the transmission mechanism through interest rates and any changes that occurred over time under the influence of various (temporary or permanent) factors. In this context, the NBRM makes regular reassessment of the transmission through interest rates. The purpose of reassessments is timely identification of any changes in the magnitude of monetary transmission and possibly identifying factors that contribute to enhanced or hindered pass through of changes in the policy rate. This brings new knowledge about the functionality of the interest rates channel, contributing to effective formulation of monetary measures and successful implementation of monetary policy in the future.

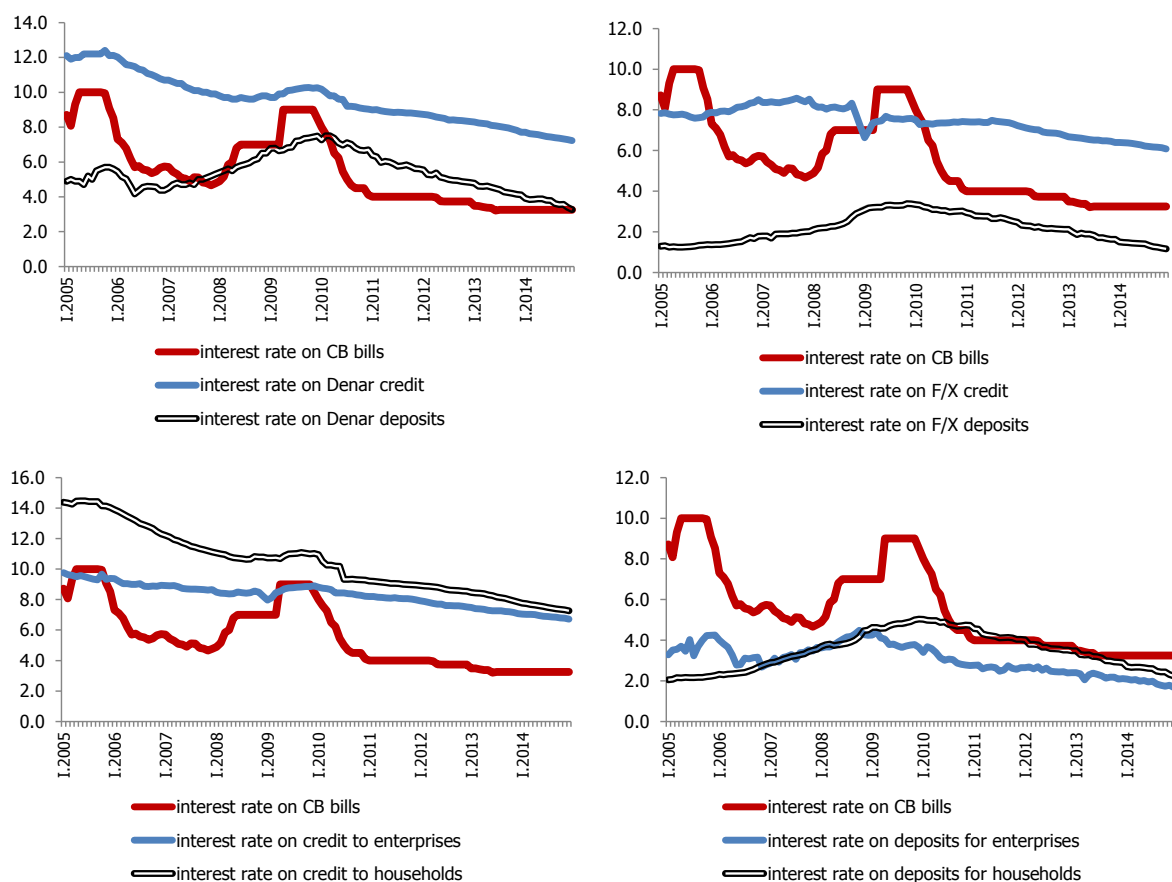
This analysis shows the results of the latest assessment of the transmission effects of the monetary policy through interest rates, with particular focus on the second stage of transmission to the interest rates of banks. The analysis was made using the techniques of panel cointegration, which means that it draws on individual micro-data by bank, on a monthly basis. Estimates for all interest rates have been made using the PMG (Pooled Mean Group) technique that allows short-term coefficients to vary across different banks, while long-term coefficients are the same for all banks. The analysis covers the period January 2005 - December 2014. For consistency, each specification includes two lags of all of the variables, which means that it covers a period of one quarter. We believe that this period is long enough to cover the interest rate pass through from CB bills rate to the interest rates on banks. The transmission ratios shown in the tables are the long-term coefficients.

The analysis uses the interest rate on CB bills as the NBRM policy rate⁹⁹, the interest rate on interbank deposit market (MBKS) and active and passive interest rates of banks. The transmission also takes into account the currency and sector structure of interest rates which allows perceiving of the responsiveness to the policy rate within these categories. The reason behind the inclusion of foreign exchange interest rates in the analysis is that similar to Denar interest rates, they are largely determined by the economic cycle, as well as balance sheet factors, including the structure of total sources of funding and their cost. Hence, when defining foreign exchange interest rates, despite

⁹⁹ Besides CB bill auctions, that represent the primary monetary policy instrument, the NBRM also uses other instruments, such as reserve requirement and deposit facility. In the last year of the analyzed period, the interest rates on deposit facility (overnight and seven-day) was cut, which amid unchanged interest rate on CB bills could affect the interest rate policy of the banks. However, these instruments have been used within a very short period (first introduced in April 2012), and therefore, we believe that its inclusion in the analysis would not have changed the results significantly.

foreign interest rates, banks probably take into account the interest rate on CB bills and by following the monetary policy directions, they optimize the portfolio to meet certain profit margin.

Chart 1 (interest rates, in %, annually)



Source: NBRM

The results of the first stage of monetary transmission through the interest rate on CB bills indicate almost full transmission of monetary signals on the interbank market. Thus, the transmission coefficient for MBKS is 0.98, suggesting that in the long run, the change in the CB bills interest rate of 1 percentage point would change the MBKS by 0.98 percentage points.

Analyzing the transmission to the Denar bank interest rates, the results indicate a very high, almost complete transmission with respect to the total deposit interest rate of 0.90 and weaker transmission to the interest rates on Denar loans of 0.64. These results indicate higher responsiveness of passive interest rates and asymmetric adjustment of banks' interest rates in the analyzed period. The results correspond with the data of the official statistics indicating larger adjustment in deposit interest rates of banks and accordingly, widening of the interest margin in the period after the crisis amid prevailing downward shift in the policy rate of the central bank. Greater responsiveness of these interest rates has also been noted in the crisis period when the interest rate spread of banks registered a decrease amid larger upward adjustments in deposit interest rates. **In terms of foreign exchange rates**, the pass through is moderately higher in the total lending interest rate and equals 0.80 versus 0.75 in the passive interest rate¹⁰⁰. However, these results should be interpreted with caution, given that the available data on foreign interest rates are of lower quality containing breaks in the series, with respect to both, time and cross-sectional dimension of the data. This probably stems from the historically lower usage of foreign exchange products¹⁰¹ by the banks

¹⁰⁰ With this, the analysis suggests greater transmission in foreign currency loans compared to Denar loans.

¹⁰¹ It should be borne in mind that in this analysis, the Denar interest rates include interest rates on loans and deposits in

compared to Denar products, for which there are available data for nearly all banks present in almost all periods of the analysis. Hence, we believe that these results should be treated as indicative.

Analyzed by sector, the responsiveness of the interest rates on household Denar loans and deposits to changes in the interest rate on CB bills proved to be stronger compared to the corporate interest rates and is more pronounced in the deposit interest rates (more than double compared to the corporate sector). Unlike the Denar interest rates, the level of transmission in the foreign exchange interest rates is different in the loan market and the deposit market. Thus, with respect to foreign currency loans, the transmission is stronger in the corporate interest rate (0.75 vs. 0.41 in the households), while in terms of deposits, similar to Denar interest rates, the cost of household deposits adjusts quickly to changes in interest rate on CB bills and equals 0.77 (0.26 in the corporate sector). Greater transmission on the side of deposit interest rate of the households is expected given that it is highly atomized sector with widely dispersed structure of deposits, which allows relatively easier adjustment of the interest rate terms by banks. Additional factors are the relatively limited alternatives of the household for investing savings, despite in the form of deposits. Concerning the corporate sector, their relations with banks typically include a wider range of services, which together with the usually higher concentration of deposits, contributes to greater "negotiating power" of the corporate sector when defining the terms of the deposit instruments. Hence, the yield on corporate deposits can often be subject to contractual interest, which means weaker responsiveness of the interest rates of this sector to changes in the NBRM policy rate.

Table 1 Results of the monetary transmission between the interest rate on CB bills and the analyzed banks' interest rates

Interest rate pass-through from CB bills interest rate to:	2005 M1 - 2014 M12
Money market interest rate (MBKS)	0.98
Interest rate on Denar credit	0.64
interest rate on Denar credit to enterprises	0.52
interest rate on Denar credit to households	0.61
Interest rate on Denar deposits	0.90
interest rate on Denar deposits to enterprises	0.56
interest rate on Denar deposits to households	1.31
Interest rate on F/X credit	0.80
interest rate on F/X credit to enterprises	0.75
interest rate on F/X credit to households	0.41
Interest rate on F/X deposits	0.75
interest rate on F/X deposits to enterprises	0.26
interest rate on F/X deposits to households	0.77

Source: NBRM calculations.

In order to check the robustness of the results, additional specifications have been estimated, which besides CB bills include additional variables that could affect the transmission to the appropriate domestic and foreign exchange interest rates. The estimation was made for the main categories of interest rates, i.e. total interest rates on Denar and foreign currency loans and deposits. The specification of Denar interest rates includes the reserve requirement¹⁰² and foreign interest rate - one-month EURIBOR as additional variables, while for the foreign exchange interest rates it includes only the foreign interest rate. The reserve requirement is included as an additional monetary instrument that the central bank uses and which could affect the

denars and in denars with FX clause, while foreign exchange interest rates include only interest rates on foreign currency loans and deposits.

¹⁰²The calculations use one weighted reserve requirement rate.

monetary transmission, while the inclusion of EURIBOR is associated with the character of the Macedonian economy as open and sensitive to developments in international markets. It is concluded that in these additional specifications, the CB bills coefficients remain statistically significant, without major changes in their value, indicating stability of the results. Of the remaining results, it is noteworthy to mention that interest rates on Denar deposits show responsiveness to the one-month EURIBOR, but still lower than the interest rate on CB bills. In terms of foreign exchange interest rates, the one-month EURIBOR is an important variable in all of the specifications, and the resulting coefficients for the one-month EURIBOR are higher than the coefficients of the CB bills, which register moderate downward correction relative to the baseline specification. These results may suggest that when defining the foreign exchange interest rates, the domestic banks, despite the domestic interest rate, take into consideration the changes in interest rates in foreign markets.

Table 2 Analysis of the stability of the results - comparison of the results from various specifications of the equations

(with and without inclusion of reserve requirement / EURIBOR)

		results with included RR/ EURIBOR	results with CB bills only
		2005m1 -2014m12	2005m1 -2014m12
Interest rate on Denar credit	CB bills RR	0.71 0,09 [#]	0.64
Interest rate on Denar deposits	CB bills RR	0.73 0,14 [#]	0.90
Interest rate on F/X credit	CB bills Euribor	0.55 0.63	0.80
Interest rate on F/X deposits	CB bills Euribor	0.63 1.89	0.75

[#] Statistically insignificant.

		results with included EURIBOR	
		2005m1 -2014m12	2005m1 -2013m12
Interest rate on Denar credit	CB bills Euribor	0.60 0,07	0.48 0.03
Interest rate on Denar deposits	CB bills Euribor	0.79 0,43	0.34 0.17

[#] Statistically insignificant.

Source: NBRM calculations.

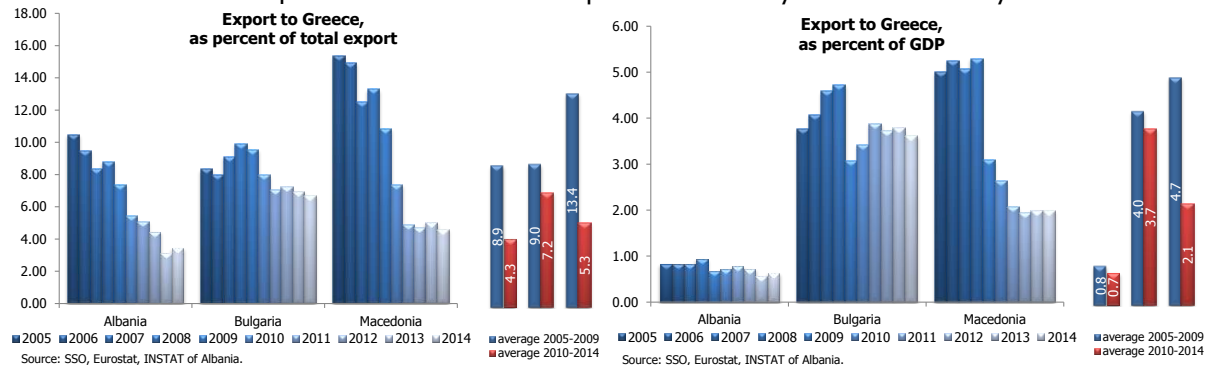
In summary, our analysis shows relatively solid functionality of the interest rate channel, given that the estimated coefficients for the main categories of banks' interest rates range from 0.64 for interest rate on Denar loans to 0.9 for interest rate on Denar deposits. Sector-by-sector analysis shows greater responsiveness of the household interest rates that is true for most analyzed interest rates. However, it should be borne in mind that the analysis covers a relatively short period of time, which is also a period of many changes in the banking system and shocks to the economy that are not directly included in the analysis, but may have influenced the interest rates dynamics. Hence, the results should be treated more as an indication rather than systematic conclusions about the functionality of the monetary transmission through the interest rates in the Macedonian economy.

Box 2: The analysis of the effects of the Greek crisis on the export sector of the Republic of Macedonia, with an additional focus on selected economies in the region

The problems that the Greek economy faced with in the last five years reflected on the economic performance of most countries in the region with which Greece has significant commercial and financial ties, including on the Macedonian economy. The Greek crisis transmitted on the region

through multiple channels, but according to the estimations, the crisis spillover mostly reflected on the foreign trade, the inflows based on foreign direct investment, migrant transfers from Greece and reduced lending by the banking sector, but with different size and dynamics in each of the economies¹⁰³. **The focus of this analysis is narrower, i.e. it refers to determining the implications of the Greek debt crisis on the international trade of the Republic of Macedonia with a particular emphasis on changes in the export activity.** In this context, additional comparative analysis was made of the severity of these effects with those in the economies of Bulgaria and Albania. These two countries were selected on the basis of the great importance of the Greek market for their export sector¹⁰⁴.

Chart 1 Share of the exports to Greece in total exports and GDP by individual country



Traditionally, the Greek economy is an important export market for Macedonian companies. Before Greece's debt crisis, exports to this country accounted for 13.4% of total exports and 4.7% in the nominal GDP on average for the period 2005-2009. The global crisis had a pronounced negative impact on the economic position of Greece, which faced one of the biggest recessions in 2009. Greek economy recorded a cumulative decline in the activity of about 24% over the past five years and record high unemployment rate of nearly 27%, and at the same time the country became unable to service its liabilities to creditors. This situation in Greece had a significant effect on trade flows in the region, generally causing a reduction in the trade with Greek partners.

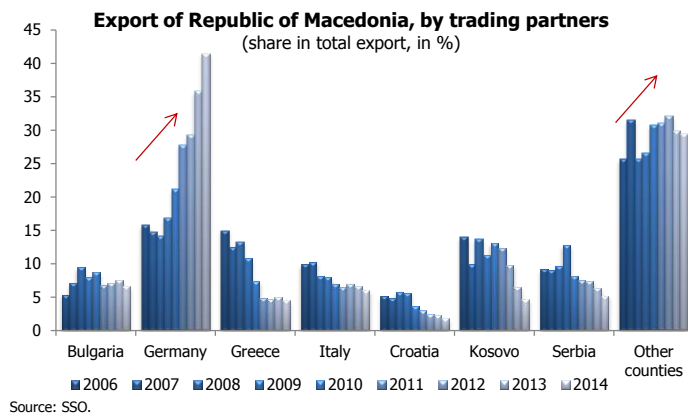
The global crisis initially caused a decrease in the Macedonian exports, and then in line with the recovery of foreign demand and influenced by factors specific to the Macedonian economy, Macedonian total exports intensified, growing by 5.2 p.p. of GDP relative to the pre-crisis period¹⁰⁵. Moreover, in the period of recovery the geographic distribution of Macedonian exports changed. The unfavorable economic situation in Greece, on the one hand, but also the entry of new foreign facilities aimed at the German market led to changes in the exports structure and greater concentration toward the German economy. Additionally, in recent years the export activity towards some of the newer EU member states, like Slovakia and Romania, has intensified, caused by the exports of the new companies in the economy, but also toward a part of the industrialized Asian economies, which is due to the geographical diversification of the export activity of metal industry. Changes in the external environment and restructuring in the domestic economy lowered the importance of the Greek market for our export sector, and for the period after the beginning of the crisis in Greece, the data indicate a reduction of the average share of exported goods to 5.3% in the total exports and 2.1% in GDP, which is by 8 percentage points and 2.6 percentage points, respectively, less than in the pre-crisis period.

¹⁰³ Spillovers of the Greek Crisis to Southeastern Europe: Manageable or a Cause for Concern?, Peter Backé, Sándor Gardó, Focus on European economic integration Q1/12, Oesterreichische Nationalbank (OeNB)

¹⁰⁴ The share of the exports to Greece in the total exports of the economy is significant also in the case of Montenegro, but due to lack of more detailed data it is not included in the analysis by country.

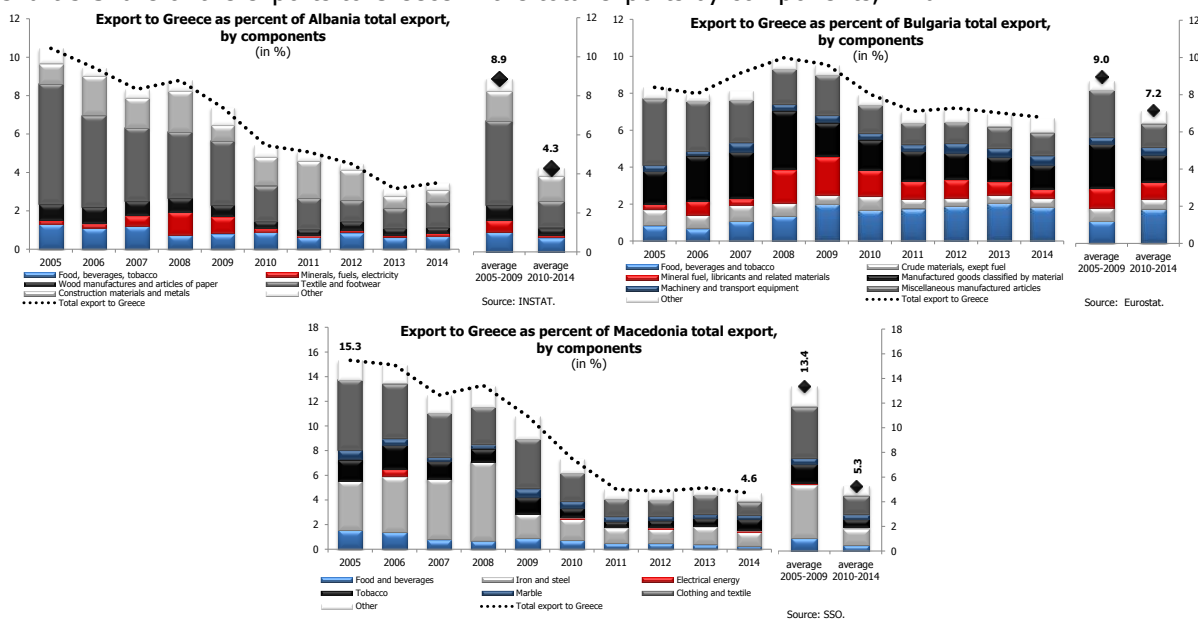
¹⁰⁵ The classification of the two periods is made in order to distinguish between the period before the Greek debt crisis (2005-2009) and the period during the crisis (2010-2014).

Chart 2 Structure of the Macedonian export by trade partners



Similar movements, although with different strength were evident in the share of exports to Greece' in the total exports of Albania and Bulgaria. Namely, in the period after the crisis there was a gradual decrease in the importance of Greece as an export partner for both economies. In the case of Albania, the share of exports to this economy shrank from 8.9% in the pre-crisis period to 4.3% in the period since the beginning of the crisis. On the other hand, Bulgarian exports to Greece showed greater resilience. Although there is a decline in the relative importance of this market for the export sector of the Bulgarian economy (a change in the share in total exports from 9% to 7.2%), however the intensity is more moderate.

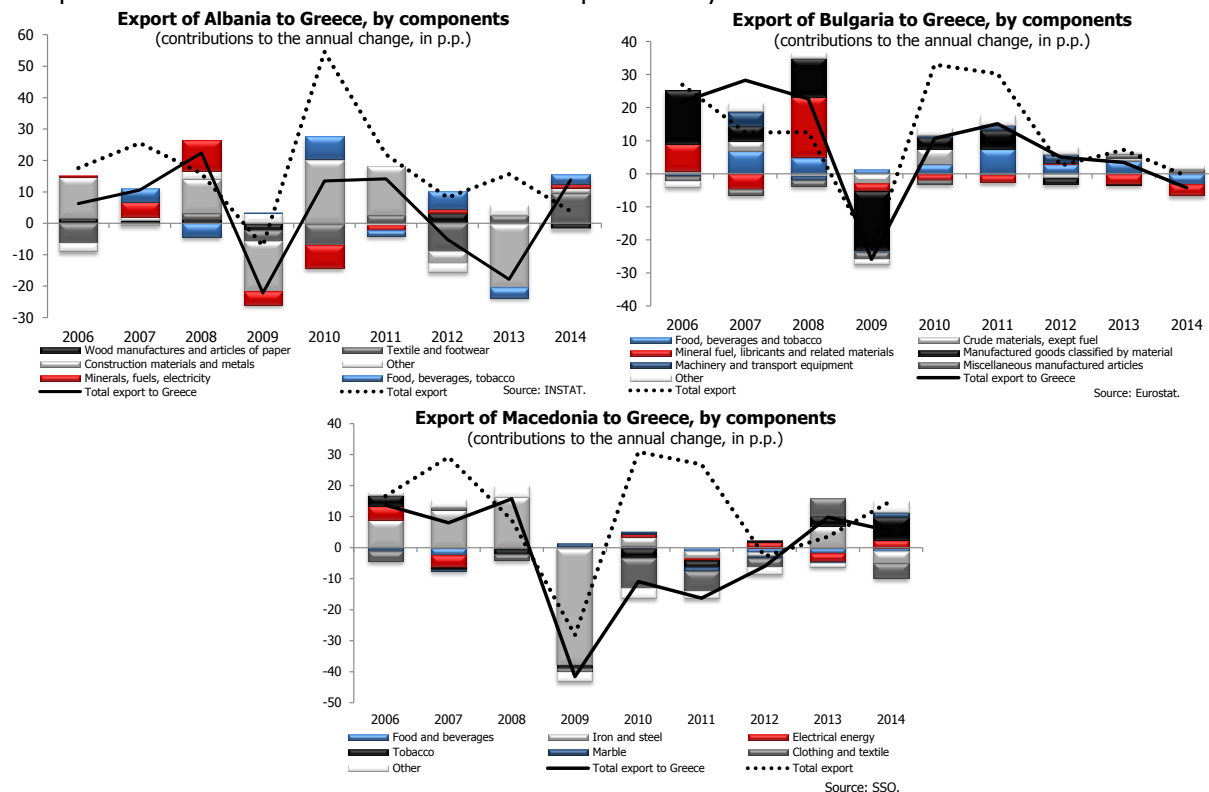
Chart 3 Share of the exports to Greece in the total exports by components, in%



The explanation of the sensitivity of exports to a greater or lesser extent reflects the structure of the products that are exported to Greece. Namely, exports of these countries to Greece is dominated by products which are highly sensitive to price changes and shocks in foreign demand, such as agricultural products and products of the textile and metal industries. These sectors of the economy are often exposed to vulnerability as a result of the low level of processing of their products and relatively low sectoral profitability. An analysis of exports by components confirms the above. Namely, the reduced importance of the Greek market in the past five years is mostly due to lower exports of clothing and textiles and iron and steel. Analyzed by individual countries, in Albania, reduced exports to the Greek economy is mostly due to the loss of the market for export of the textile industry. As much as 65% of the change between the two periods can be attributed precisely to the performance of this industry on the Greek market. In the case of Macedonia predominant is the effect of the metal processing sector with 37%, ahead of the textile cluster whose performance explain

nearly 33% of the change in the share of exports to Greece in the total exports between the two periods, followed by adjustment of the export of tobacco and food. In Bulgaria, despite the higher resilience of the total exports to Greece, the exports of the textile sector registered significant negative developments. In fact, estimates indicate that 77% of the change between the pre-crisis period and the period after the beginning of the crisis were caused by the lower exports of clothing, textiles and footwear¹⁰⁶. The higher resilience in the case of Bulgaria is a result of positive changes in the structure of Bulgarian exports to Greece in the past, i.e. increased exports of food products and tobacco, as well as other products with a higher degree of processing, classified in the category machinery and equipment, as opposed to more traditional products.

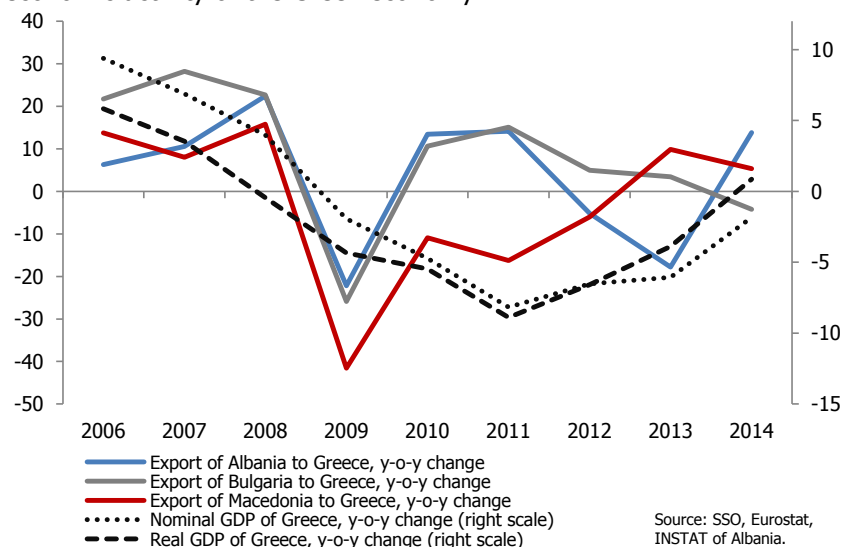
Chart 4 Contributions of individual components to the annual change in the exports to Greece and comparison with the movement of the overall export activity



Although the effects of the developments in the Greek economy on the export performance of the three analyzed economies are undisputed, their total export activity showed significant resilience to the direct effects of this external shock. Namely, in the last five years, the exports of Albania achieved an average growth of 20.8%, while the exports to Greece increased by only 3.7% on average, compared with 14.5% versus 6% in the case of Bulgaria. On the other hand, Macedonian exports on the Greek market registered an average decline of 3.6% despite the achieved high average growth of total export activity of 14.7%. The analysis on the basis of the relative share of these categories in GDP, only indicates that the share of exports in GDP in the period after the beginning of the crisis recorded a more significant growth, amid simultaneous reduction of the relative importance of the Greek market, which is especially evident in the case of Macedonia, while in other countries the changes are not so pronounced.

¹⁰⁶ Exports of textiles and clothing in the data for Bulgaria are classified in the category "products classified by materials" and "miscellaneous finished products".

Chart 5 Annual changes in the exports of the three countries to Greece and the movement of the economic activity of the Greek economy



Such export performances in the three analyzed economies show that despite the initial negative shock and the continuing uncertainty related to the Greek economy, generally, the economies coped well with the adverse effects of the Greek crisis. However, the period of increased economic uncertainty emphasized the vulnerabilities of certain export sectors such as textiles and metal sectors, but it also highlighted the flexibility of the economies in terms of shifting part of their exports to other economic markets or products. Moreover, in the case of Macedonia it is especially important to emphasize the importance which the structural changes had on the export sector during the crisis period, whose positive effects acted as "shock absorbers" for the negative implications of the Greek debt crisis on exports in the past five years.

Box 3: Economic activity in Macedonia through a regional prism – what does the statistics on regional accounts show?

In an economy which aspires to a higher level of economic development, the issue of growth, its dynamics and sustainability, often embarks on the evaluation of factors of the overall economic growth, "bottlenecks" that hinder its greater intensification and reduction of economic disparities relative to highly developed economies. However, when it comes to economic disparities, except for the differences between individual countries, there is yet another important dimension - the issue of regional disparities within the economy itself. Although the economy as a whole can grow at a satisfactory pace, it does not exclude the possibility that this process comes along with economic polarization, by creating a pole of high growth of activity and employment, as opposed to the pole where the activity and absorption of labor is low. The emergence of such economic inequality within the economy can have major social implications, and consequently, large fiscal effect, may seriously disrupt urban-rural balance in an economy, increase the vulnerability of the economy to shocks due to the high concentration, disable the use of comparative advantages of different regions and thus, in the long run, put in question growth sustainability.

Literature suggests that the regions in an economy gradually converge in the area of income they generate, as a result of proper utilization of their comparative economic advantages. This, in turn, suggests that by increasing the degree of economic development, regional inequality could reduce. However, practice shows that the rising level of development does not come along with the reduction of disparities in each country. Theoretical support or explanation of these conditions can be found in the Williamson (1965) hypothesis that researchers in this field are trying to empirically test. This hypothesis states that the regional disparities increase in the early

stages of development, followed by convergence in the later stage (the curve's shape resembles an inverted U). This is because in the early stages of rapid growth, there are few centers of concentration of capital and labor. With the intensification of growth, the cost of production factors in these centers grows, and the marginal efficiency decreases, which leads to a gradual displacement to other parts, and thus, to greater regional convergence. However, the reasons of regional inequality in countries with rapid growth, even in those that have already reached a high level of economic development, can be located beyond the movement of the production factors. Institutional restrictions, inadequate system of fiscal transfers, poorly targeted subsidies are also reasons that may prevent greater regional convergence.

The issue of regional disparities is particularly topical issue in the European Union as a common market of many countries, which has prospects for further expansion and where the need for a coherent and balanced growth and economic inclusion is particularly pronounced, which is the reason behind the great attention that the EU pays to the issue of regional disparities through the so-called Cohesion policy¹⁰⁷. Some empirical researches in this field were concentrated in the period just before and after the big expansion of the EU with 10 new member states in 2004 (see for example Szorfi, 2008¹⁰⁸) in order to understand the differences in the degree of regional disparities between new and old member states, to assess the relationship between their level of development and the regional inequality, and certainly to consider the effects on the Cohesion Policy of the EU. It can mainly be concluded that the new member states (most of them from the former "socialist bloc") have greater disparities than older members, but dynamically, their disparities have been decreasing, while in the old member states they stagnate.

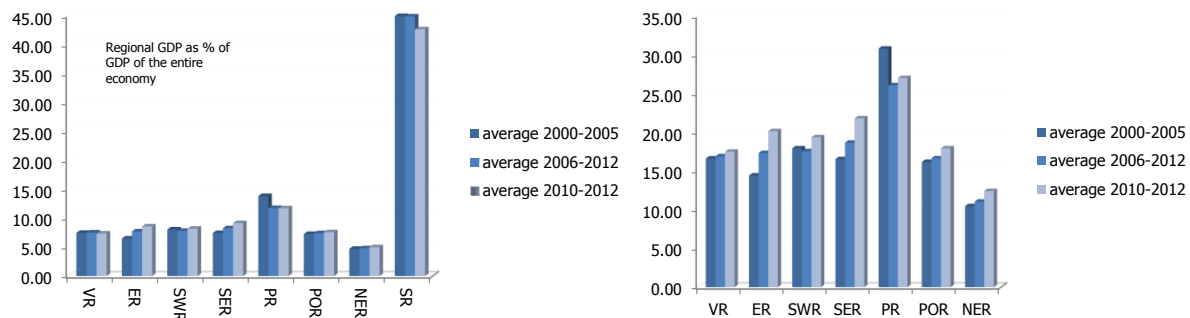
Considering the importance of regional disparities in general and in the context of EU membership and the fact that this issue is not exploited in the Macedonian case, it would be interesting to give a brief overview of the regional distribution¹⁰⁹ of economic activity in Macedonia. The ambition of this analysis is not to precisely identify the causes of any disparity or to propose measures for balanced regional development. The objective is to provide an initial perception of certain economic parameters by region, in order to get a picture of their financial position. For this purpose we use data from the regional accounts of the State Statistical Office, through which we can get an initial picture of whether there is and how large the concentration in GDP creation is by individual region, what is the distribution of per capita GDP and whether it points to large disparities between regions, a picture on distribution of investment activity and an overview of the dynamics of unemployment by region.

¹⁰⁷ Cohesion Policy is a framework for funding of a wide set of projects and investments that aim to reduce regional disparities and increase cohesion.

¹⁰⁸ B. Szorfi, "Development of Regional Disparities - Testing the Williamson Curve Hypothesis in the European Union", Focus on European Economic Integration 2/07, ONB.

¹⁰⁹ The regions are defined in the Nomenclature of Territorial Units for Statistics - NTUS (Official Gazette of the Republic of Macedonia No. 158/2007) and amendments (Official Gazette of the Republic of Macedonia No. 10/2014): Vardar Region (VR), East Region (IR), Southwest Region (SWR), Southeast Region (SER), Pelagonia Region (PR), Polog Region (PR), Northeast Region (NER) and Skopje Region (SR).

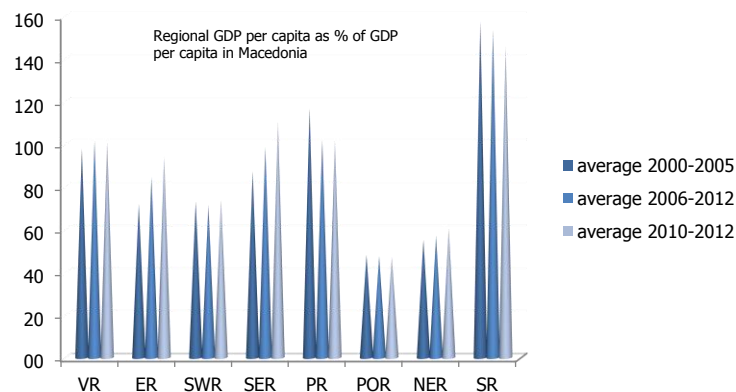
Chart 1 GDP distribution by region (in %)



Data source: SSO and NBRM internal calculations.

The chart above gives a first indication of the relatively large concentration of economic activity in one region, i.e. in the Skopje region, while the role of other regions is significantly smaller and relatively balanced. This region creates around half the GDP of the Macedonian economy, signaling the existence of a key pole of growth. The activity in other regions on average ranges from 11% to 28% of the activity in the Skopje region. Dynamically speaking, data show little change in the position of regions in the last period 2010-2012, when the meaning of "Macedonian key pole of growth" moderately declines, while all other regions (excluding Pelagonia region) have a greater importance in the creation of GDP in the domestic economy. Of course, individual regions do not have the same size, nor balanced population. Hence, a more representative picture of regional disparities could be obtained through the indicator for GDP per capita. **The conclusion about the relatively high concentration of growth in one region remains valid, even when it is controlled for population size, but its weight is lower though.** In fact, these figures still show the highest level of development of Skopje region, which has a GDP per capita by 1.5 times higher than that for the whole economy. However, four regions gravitate around GDP per capita for the whole economy, and only two, according to this indicator, significantly lag behind the average of the region. At the same time, dynamically speaking, in this indicator the level of development of most of the regions increases, compared with the indicator at the level of the entire economy, suggesting some positive developments regarding the issue of regional disparities.

Chart 2 Distribution of GDP per capita, by region

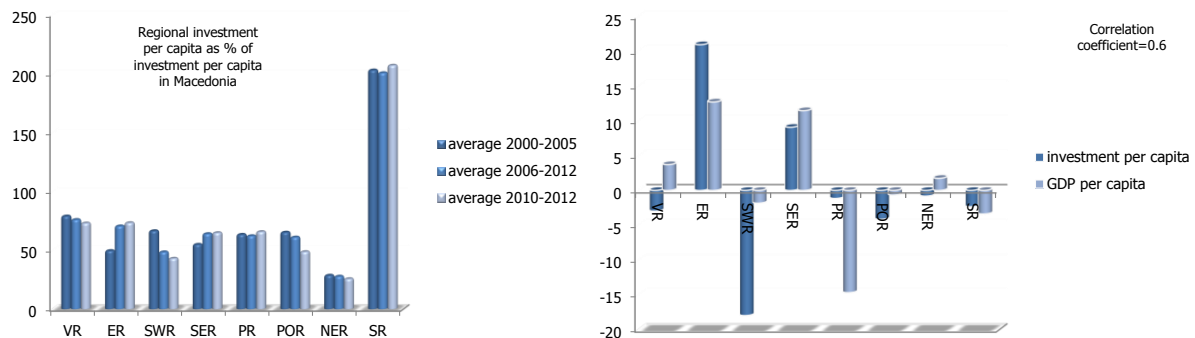


Data source: SSO and NBRM internal calculations.

Growth factors in individual regions, and thus factors that contribute to shifts in regional disparities can be different. Fundamentally, investment activity is one of the factors that should accelerate the growth and increase the level of economic development, which would lead to high level of synchronization between these two parameters. The analysis of regional data on investments in fixed assets in Macedonia suggests two conclusions. First, the size of investments in fixed assets per capita leads to significantly greater regional disparities compared with those to which the indicator for GDP per capita refers. Contrary to the Skopje region where the size of investments is about two times higher than the same at the level

of the overall economy, other regions significantly lag, while the most developed region in this regard, on average have investments per capita of around 70% of the same at the level the overall economy. The different picture of GDP and investments in fixed assets for different regions shows that in some of them the growth is generated from other sources - such as export from investment non intensive facilities, in some of them from consumption, while in some regions it is probably significantly supported by foreign savings (remittances). Second, dynamically observed, changes in GDP per capita in two sub-periods (2000-2005 and 2006-2012) and changes in investments in fixed assets per capita are basically synchronized, i.e. in regions where investments registered positive shift in this period, GDP also registered positive movement. These two findings point to the role of investments in the process of increasing the level of economic development, and the need for equitable distribution of new investments which will mitigate regional disparities.

Chart 3 Distribution of investments per capita by region and relation between investments and GDP by region



Data source: SSO and NBRM internal calculations.

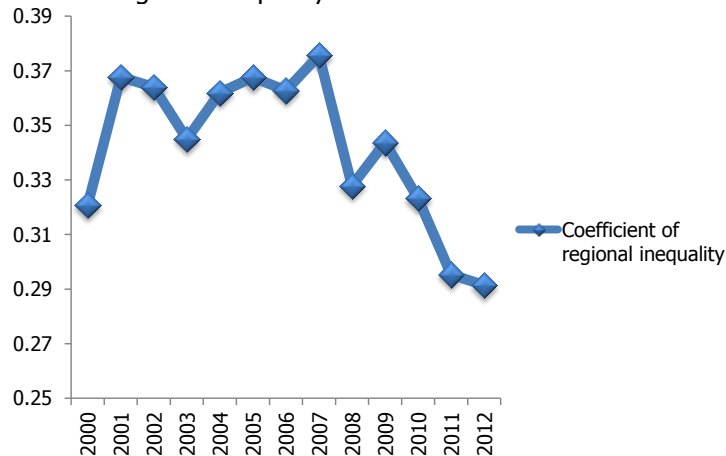
*(average 2006-2012/average 2005-2000).

This simple visual analysis of the economic parameters of individual regions indicates existence of regional disparities in Macedonia and existence of poles of growth, and that polarization particularly occurs when analyzing the distribution of investments. Dynamically speaking, disparities are decreasing, yet the verification of this conclusion requires application of a more formal approach to the analysis. Usually, a simple variation ratio is used for measuring inequality, which is a weighted standard deviation of GDP per capita by region, divided by GDP per capita for the whole economy.

$$ineq_{it} = \sqrt{\frac{1}{N} \sum_{r=1}^n (inc_{rt} - inc_{it})^2} / inc_{it},$$

where inc_{rt} indicates GDP per capita in the region, while inc_{it} indicates GDP per capita for the overall economy. Dynamic analysis of this ratio confirms the thesis that regional disparities in the Macedonian economy are decreasing. If this ratio is compared to the one in some countries of Southeast Europe, shortly before joining the EU and thus, before the possibility of using cohesion funds for balanced regional development, we can say that compared to some countries (for example Bulgaria, Poland), regional inequality in Macedonia is greater and comparable to countries such as Hungary and Romania. The inequality is significantly lower than that in Slovakia.

Chart 4 Regional inequality ratio



Coefficient of regional inequality*	
Macedonia	0,34
Bulgaria	0,21
Czech Republic	0,35
Hungary	0,30
Poland	0,20
Romania	0,35
Slovak Republic	0,61
Germany	0,24
Great Britain	0,29

* Szorf (2008), Macedonia - internal calculations and average value for the period 2000-2012 - for other countries 1995-2004 - before accession to the EU (Germany and Great Britain are included as developed economies, where the ratio is relatively stable).
Source: NBRM calculations.

The decreasing dynamics of regional inequality ratio corresponds to the Williamson hypothesis, given that the decline is expressed in the phase of accelerated growth and faster real convergence. At the same time, probably the structural changes that have occurred in the economy since 2009 and that imply opening of new facilities in multiple locations in the country also contribute to reducing disparities. Given that these changes have been taking place continuously, it is likely that regional data after 2012 will show a further reduction of disparities. However, the conclusion remains that there is room for significant improvements in this area, by defining priorities and taking comparative advantages of different regions. *Regional Development Strategy of the Republic of Macedonia for 2009-2019* is one of the strategic documents, as amended in late 2014¹¹⁰, which sets quantitative strategic priorities in this regard, as well as targeted measures for achieving more balanced regional development. The fact that the current situation points to the gap relative to strategic priorities¹¹¹ just confirms the need for further balancing of regional development in the Macedonian economy, i.e. reducing regional disparities.

¹¹⁰http://arhiva.vlada.mk/registar/files/Strategija_za_Izmenuva_nje_i_Dopolnuvanje_%20na_Strategijata_za_RR_na_RM.pdf

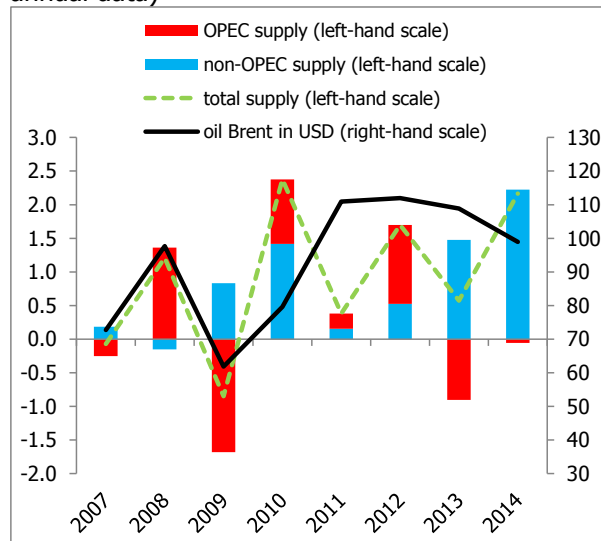
¹¹¹ The average GDP per capita of the Republic of Macedonia to reach at least 42% of the EU average, the least developed region to reach at least 26% of the EU average, the difference in GDP per capita in the most developed and the least developed region not to exceed 2.2 times.

Box 4: Comparison of the movement of world oil prices with the movement of selected indicators of domestic economic activity

The latest cut of world oil prices and their maintenance at a relatively low level is expected to support global economic activity. Namely, the reduction of oil prices in this period results from the increased supply of this energy (Chart A), in times when the global demand gradually recovers. Global oil supply is supported by the high growth in the production of shale oil in the United States and the continued production in Russia, Iraq and Libya. Additionally, in June 2015, OPEC again decided to preserve its production target in order to keep its market share. In such circumstances, the lower price of oil supports the growth of real disposable income and profits of the corporate sector and these channels can be used to stimulate economic activity. On the other hand, in times when the fall in world prices results from the reduced global demand, the net effect on economic activity can be harder to predict given that real income growth and profits will in part (or in full) be offset by the lower global demand. In global terms, according to the ECB analysis, the last drop of oil prices is expected to transfer income from net oil exporters to net oil importers, with a positive net effect of 2% of the world GDP¹¹². As the oil importers, on average, have a higher propensity to spend, higher financial inflows will encourage global demand and hence, global economic growth.

Chart A
Global oil supply

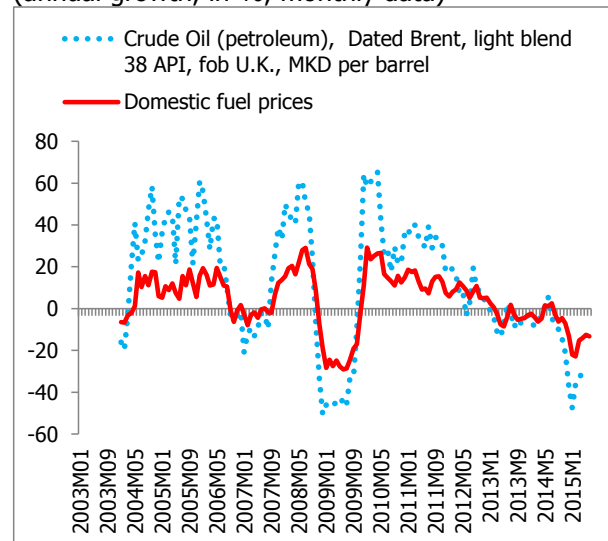
(annual growth in millions of barrels per day, annual data)



Source: US Energy Information Agency.

Chart B:
Price of Brent oil and domestic prices of oil derivatives

(annual growth, in %, monthly data)



Source: Prices of primary products from the IMF, SSO and NBRM calculations.

The purpose of this article is, through a simple visual analysis, to perceive the connection in the movement of oil prices and some indicators of domestic economic activity, particularly focusing on the developments in the last period. For oil importing economies, as our economy, the last cut of oil prices has put significant downward pressure on inflation in the short term. Direct effects are rapid and visible in the energy component of consumer prices¹¹³. Also, lower energy prices can affect other prices through indirect effects, which will probably be transmitted with certain time lag¹¹⁴. In addition, they can cause side effects on the formation of prices and wages. All these changes can affect the real disposable income and profits of the corporate sector and thereby, act on the activity in the domestic economy. For the purposes of this box,

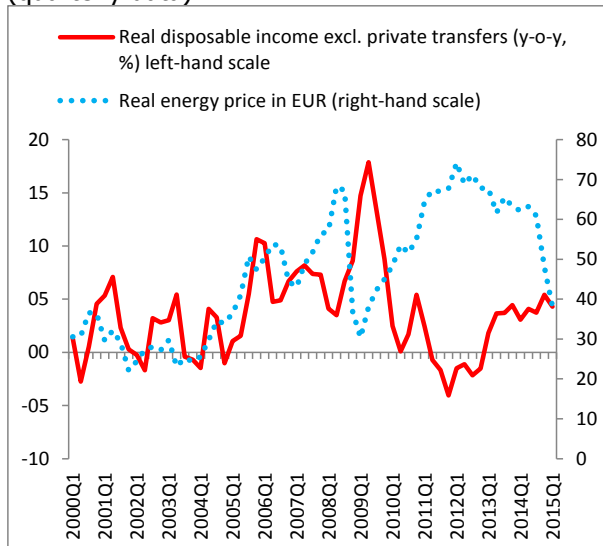
¹¹² „The recent oil price decline and the euro area economic outlook“, Economic Bulletin, ECB, Issue 1/2015.

¹¹³ The prices of oil derivatives in the domestic economy are based on the movement of prices of oil derivatives in US dollars and the US dollar/euro exchange rate.

¹¹⁴ See Box: Indirect effects of oil prices on inflation, Quarterly Report, February 2015, NBRM.

disposable income is approximated as the sum of the nominal net wage bill and the nominal paid pension bill deflated by consumer prices. The indicator for the profit margins of the Macedonian corporate sector is calculated as the difference of the growth of the GDP deflator and the rise in unit labor costs. It is not a true picture of profitability of companies, but only an indication of their potential to generate profit based on the difference between selling prices and labor costs, which is usually one of the dominant costs in the cost structure.

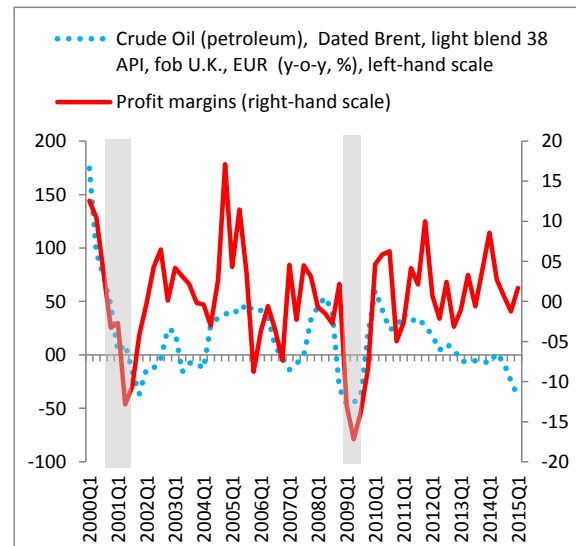
Chart C
Real disposable income and movement of real energy prices
(quarterly data)



Source: Prices of primary products from the IMF, Eurostat and NBRM calculations.

Note: Real energy price in euros has been formed using the Brent oil price in US dollars, the euro/US dollar exchange rate and consumer prices for Macedonia.

Chart D
Profit margin and oil prices (annual growth, in %; quarterly data)



Source: Prices of primary products from the IMF, Eurostat and NBRM calculations.

Note: Periods shaded in grey refer to shock in oil price.

The comparison of the movement in oil prices and the indicators of real disposable income and profit margin give an indication that in the last period, the cut of energy prices corresponds to the increase in real income. In times when the drop of oil prices is associated with lower global demand, as was the case in late 2008 and early 2009, there was downward adjustment of real disposable income (with some delay) and the profit margin. On the other hand, during 2014 and 2015, when the fall in oil prices predominantly resulted from the strong global oil supply, real income and profit margin also increased.

In summary, in Macedonia and in other oil importing economies, in the period of decline of world oil prices, favorable trends in the indicators of domestic economic activity have been observed, which is the reason for reassessment of the likely positive impact of this exogenous shock on the domestic economic activity. However, it must be emphasized that the growth of disposable income and profit margins in the domestic economy occur in a period of a favorable conjuncture in domestic economy followed by a continuous increase in the degree of capacity utilization and production growth and favorable developments in the labor market. This combination of multiple domestic and foreign factors hampers the precise quantification of the effect of international prices on the overall economic activity in the country. Hence, these comparisons should be interpreted only as a simple comparison of the dynamics of oil prices and selected indicators of economic activity in order to confirm that their relationship is as expected, taking into account the phase of economic cycle and factors that drive the price of oil.