National Bank of the Republic of Macedonia

Quarterly Report
February 2015

Contents

Introduction

During the fourth quarter of 2014, the interest rate at CB bill auctions remained 3.25%. The decision to keep the policy rate unchanged was based on the latest reassessment of the NBRM's macroeconomic projections in October and the performance of key macroeconomic and financial indicators. Namely, recent trends and macroeconomic projections confirmed the solid domestic economic growth, which creates no imbalances through inflationary pressures or pressures to reduce foreign reserves. Analyzing **global environment**, in this period, the global economic outlook deteriorated again, and the downward risks surrounding projections were further pronounced. This especially applies to the euro area, where the growth estimates were revised downward, and the risk of deflation is increasingly pronounced. Observing domestic indicators, GDP data indicated retention of **positive developments in economic activity**, partly supported by the **additional credit flows** from domestic banks. **Changes in the general price level** in the last quarter remained in the negative zone and ranged within the projected framework. In December, in conditions of solid currency positions of banks, in the foreign exchange market, foreign currency was purchased in a net amount sufficient to exceed the net sales from October and November. The dynamics of **foreign reserves** was slightly better than expected, at the level, which was sufficient to absorb any unforeseen shocks. In this period, it is perceived that **risks about future movements** are mainly exogenous, and related to potential changes in the dynamics of recovery of the global economic growth and the volatile and hardly predictable dynamics of global food and energy prices. **In environment of solid economic and credit growth, absence of inflationary pressures and foreign reserves as expected, and amid pronounced external risks and already taken measures for monetary easing, in the last quarter the monetary setup was deemed appropriate.**

The key macroeconomic parameters in the domestic economy were generally moving within the October cycle projections. In the third quarter, **the gross domestic product** registered an annual growth of 4.1%, which is a slightly higher growth rate than expected for this period. Thus, the economic activity remains in the area of positive quarterly and annual changes, for seven consecutive quarters. Analyzing sources of growth, the export sector remains the main driver, reflecting largely the growing exploitation of the potential of new export facilities. At the same time, investment activity gave additional strong impetus. In addition, private consumption continued to grow supported by the growth in disposable income, coupled with increased credit flows from domestic banks to the household sector. Namely, the growth of the real sector activity spills over into the labor market that registers increasing absorption of labor and higher real wages in support of private consumption. On the other hand, public spending made negative contribution to the growth. Increased domestic and export demand, amid import-dependent domestic economy, have created pressure for increased imports. In such conditions, the contribution of net exports to GDP growth in the third quarter remained negative. Relative to the projection, in the third quarter, the structure of growth was more favorable, contributing more to the investment consumption, at the expense of the private consumption. Available high frequency data for the last quarter of 2014 suggest that the activity is still in the area of solid growth, signaling that the economy generally follows the projected GDP growth trajectory.

During the fourth quarter, domestic prices declined on average by 0.4% annually, thus being in the zone of negative annual changes for the third quarter in a row. The pace of decrease in the general price level is as expected. Changes in domestic prices are estimated to have been mainly related to factors on the supply side. Namely, lower import prices of food and energy directly affect domestic prices, with the price effect of imported consumer goods from key trading partners also being lower (slowdown of foreign effective inflation). The last quarter is characterized by a gradual depletion of the negative contribution of food prices, while the negative effect of energy prices has become more pronounced, which corresponds to the downward movements of oil prices in the world market. **The core inflation** also registers downward movements. In the last quarter, it was negative for the first time in eighteen quarters and amounted to 0.3%. **On average, headline inflation for 2014** dropped by 0.3%, primarily due to the lower food prices, while the average annual core inflation remained positive and amounted to 0.6%. For 2015, the expectations for 1% inflation remain, and the risks about the projection amid sharp downward adjustments of the estimates for oil prices are currently downward. However, one should bear in mind that there is great uncertainty about the future movements in world oil prices and the possibility of sudden changes in this category.

Within the external sector, the current and capital account in the third quarter of 2014 recorded a surplus of Euro 120.4 million or 1.4% of GDP, which is slightly improved position of the current account than expected, amid improved trade balance. At the same time, the financial account registered high inflows of Euro 419.7 million or 5% of GDP. The government borrowing on the international capital market was the main source of creating foreign currency inflows, which in favorable financial market conditions provided early funding of future budgetary needs. However, the financial inflows in the third quarter were somewhat weaker than projected, in part because of the weaker direct investments. **According to the latest available data for the fourth quarter of 2014, foreign reserves were almost unchanged on a quarterly basis, and their dynamics was slightly more favorable than that projected in October.** The movements in the foreign exchange market were favorable, and therefore, a high amount of foreign currency was purchased in December and cumulatively for the entire quarter. The available external sector indicators for the fourth quarter are still insufficient making it difficult to obtain an accurate picture of the deviations in the position of the balance of payments compared with the projections. Data on foreign trade as of November point to improved export performance and smaller trade deficit than projected, while the net purchase from currency exchange operations currently indicates that the private transfer movements are as projected. It should be noted that the October data on the balance of payments point to favorable developments in the current account, with surplus for five consecutive months, which has not been observed so far. On the other hand, as of October, the balance of payments signals smaller than expected financial inflows in the economy. The analysis of foreign reserves adequacy indicators shows that they continue to move within a safe zone. Despite such favorable developments, there are still risks clouding the future pace of foreign reserves. These risks are mainly related to unfavorable external surrounding, which can cause adverse changes in the external sector through different channels. The last ECB's measure taken in January 2015, which means a significant quantitative easing through the purchase of government and private securities, mitigates the negative risks to the growth of the European economy. However, it takes time to perceive the extent to which this policy will transmit to the real sector of the economy of the euro area.

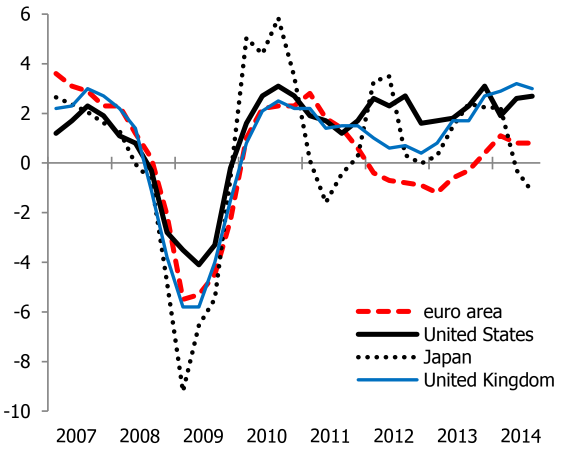
In the last quarter, the lending activity continued to increase amid sound fundamentals of the banking system, higher deposits, improving risk perceptions of the private sector, increased interest to finance businesses with bank loans at favorable interest rates. In this period, the new credit flows from banks were almost double the average quarterly amount approved in the previous three quarters. In addition, the share of lending to the corporate sector in total loans is higher than its average share in the first three quarters. At the end of December, total loans were higher by 10% on an annual basis, with the growth in loans in 2014 being by 1.6 times higher than that registered in the previous year. In addition, loans exceeded their projection for 2014 and confirm the possibility of achieving a projected credit growth of 9% - 10% annually for the next two years. Also, in the last quarter, the deposit base kept on increasing, whereby the total deposits grew by 10.4%, annually. The current changes in the credit market suggest gradual materialization of the effects of the monetary easing and of the non-standard measures on the credit support for the private sector, as well as improved banks' perceptions and expectations for the risk of these loans. Although these are positive developments in the credit market, it should be borne in mind that the existing adverse risks from the external environment also pose a risk to the creation of additional deposit potential and the perceptions and expectations, and thus, to the credit market activity.

In summary, recent developments suggest further maintenance of an adequate level of foreign reserves, reduced inflationary pressures and enhanced credit support of the economic growth by the banking sector. In such conditions, it was assessed that the economy created conditions for sustained recovery of the private sector without any additional monetary stimulus, i.e. that the support of the local economy through monetary policy measures is sufficient. Leaving the zone of accommodative monetary policy in the next period will depend on the changes in the external position of the economy and the effects on foreign reserves. The NBRM will continue to monitor the developments closely and if necessary, will make appropriate changes in the monetary policy for successful achieving of objectives.

I. Macroeconomic developments
1.1. International economic surrounding[1]

The global economy indicators suggest improved economic performance in the third quarter of 2014, mainly as a result of the intensified economic activity in some of the developed countries. Namely, within this group, the United States has registered solid economic growth, while the economic performance in the euro area has been weaker. The main positive effects on these economies arise from the completion exhaustion of the process of financial deleveraging of the private sector, reduced demotivational effects of fiscal policies and of accommodative monetary policies. On the other hand, in some developing countries, the growth was suppressed due to structural issues, less favorable financial conditions and geopolitical tensions. The assessments indicate that in the next period, the global recovery will be gradual, fragile and uneven across countries and regions. The global inflation continued to move downward in the months of the fourth quarter, and in the following period, it is expected that there will not be any inflationary pressures, taking into account the expected downward movements in the prices of primary products in the world markets.

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

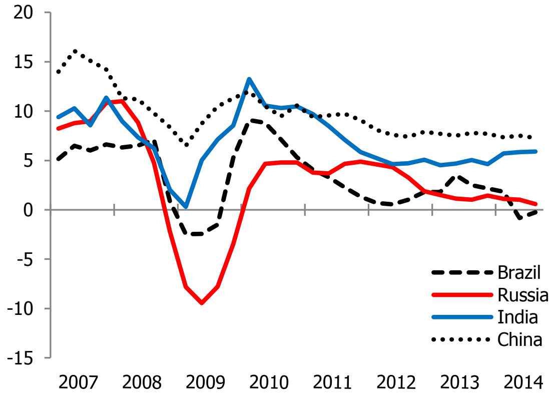


Source: Eurostat.

The global economy continues to recover gradually, but the recovery remains uneven among different countries and regions. After the moderate growth in the first and the second quarter of the year, the economic activity strengthened moderately in the third quarter, largely as a result of the improved fundamentals in some key developed economies. This particularly applies to the United States, where the growth of domestic demand, driven primarily by the growth of private consumption, contributed to further strengthening of the economic growth. In addition, the British economy achieved solid growth, given the eased lending terms and higher private consumption. On the other hand, the economic situation in the euro area and Japan is not very favorable, as their economies are characterized by low or negative growth in this period. In the third quarter, heterogeneous movements were observed in the emerging economies. Thus, as a large net importer of raw materials, the economy of India had benefited from the lower world prices of primary products, which given the increased market confidence and sound export demand, resulted in slightly higher GDP growth. On the other hand, the

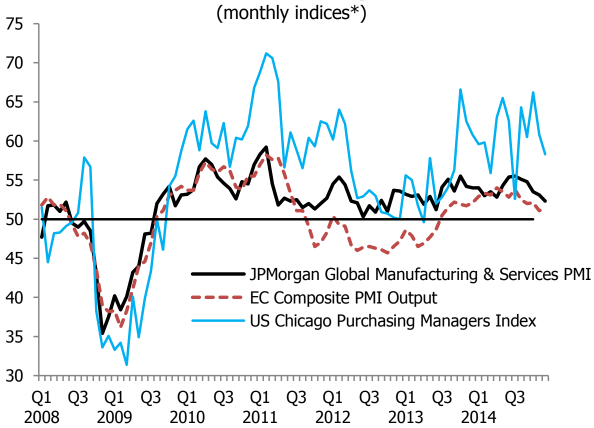
[1] The analysis is based on the ECB Monthly Bulletin for November and December 2014, the OECD Economic Outlook, November 2014, the monthly reports of the Deutsche Bundesbank, the reports of Capital Economics, the weekly reports of the National Bank of Greece and the press releases of Markit Economics.

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



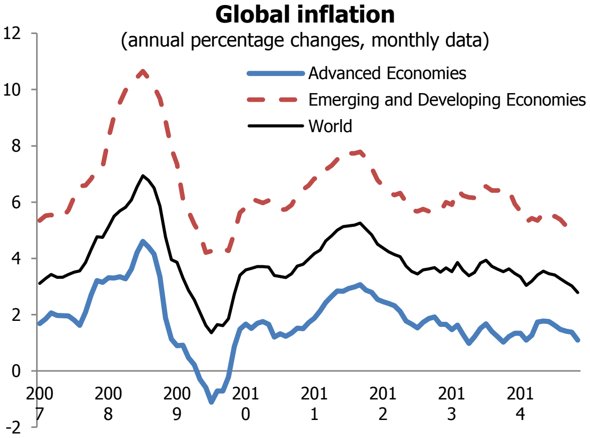
Source: OECD and IMF.

Global economic activity indicators
(monthly indices*)



*The PMI index reflects the percentage of respondents that reported better bussiness 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.

Global inflation
(annual percentage changes, monthly data)



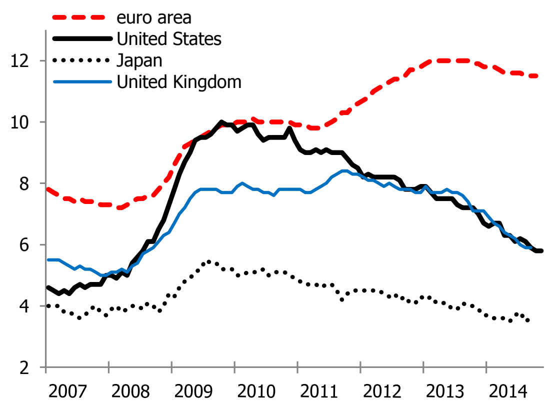
Source: IMF.

growth of the Chinese economy slowed down moderately, mainly due to the lower investments and weaker credit growth. However, the growth of these economies continues to be comparatively high compared to other countries. On the other hand, the economic activity in Russia continues to score low and slower growth as a result of tighter financial conditions and international sanctions. Because of the declining private consumption, Brazil's economy again went down, yet at a slightly slower pace compared with the previous quarter. The high-frequency survey indicators of economic activity - PMI[2], show that in the fourth quarter, the global growth is slower compared to the previous quarter. Thus, the global composite PMI dropped to 53 index points (55.1 index points in the third quarter), with lower values in the services sector and in the manufacturing industry. The data suggest further solid economic growth in the United States, while the growth in the euro area is estimated to slow down in the last quarter. In the next two years, the global growth is expected to accelerate gradually. Analyzing the developed economies, the accommodative monetary policies, favorable financial conditions, improving labor market conditions and slowing pace of fiscal consolidation are expected to stimulate their growth. The favorable movements in some developed economies are expected to have a positive effect on the growth of developing countries, which is still expected to be lower than the pre-crisis period, taking into account the structural changes, the macroeconomic imbalances and the general context of gradual normalization of monetary policies in developed economies.

The downward trend of global inflation that began in mid - 2014[3] continued in the two months of the fourth quarter. Thus, recent performance for the period October - November point to inflation of 2.9%, versus 3.3% in the previous quarter, which is the weakest growth recorded after 2009. Disinflation movements are present in all groups of countries. Thus, lower inflation rates were registered in the emerging economies and developing countries (4.9% on average in October and November

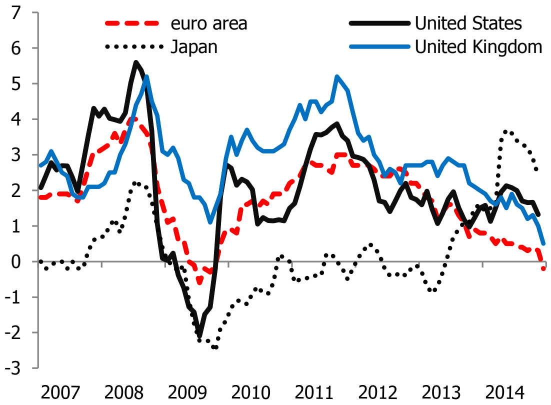
[2] PMI (Purchasing Managers Index) is based on surveys of a representative sample of companies from the manufacturing and service sectors, and are often used as high frequency indicators for the current and future economic activity.
[3] Source of data is the IMF's International Financial Statistics database.

Unemployment in advanced economies
(in percent; seasonally adjusted monthly data)



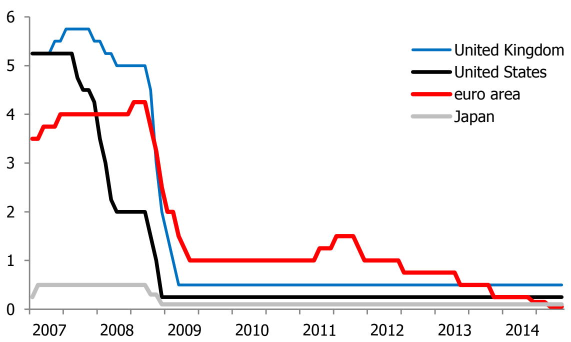
Source: Eurostat.

Inflation in advanced economies
(annual percentage changes; monthly data)



Source: Eurostat and national statistical offices.

Policy rates in advanced economies
(in %)



Source: Central banks.

versus 5.3% in the third quarter), while reduced inflation of 1.2% was recorded in the developed economies (1.5% in the third quarter). Such movements of inflation are largely determined by the energy prices on the world market, which began decreasing in the second half of the year.

In the third quarter, the euro area continued showing positive rates of economic growth[4], but they are still low in order to provide vigorous recovery of the economy. Namely, after the growth of 0.1% in the second quarter, in the third quarter, the growth marginally increased by 0.2% on a quarterly basis, which is the sixth consecutive quarter of positive, though weak GDP growth. However, the annual growth rate remains low, 0.8%, which is the level of the previous quarter. The quarterly growth is largely due to the strengthening of the private consumption, which made the largest positive contribution to the growth, given the positive changes in the aggregate income as a result of the labor market developments and lower inflation. In this context, the unemployment rate in the third quarter decreased by 0.1 percentage points to 11.5% compared to the second quarter. On the other hand, gross investments dropped for the second consecutive quarter, given the reduced business confidence and increased uncertainty. Public consumption also recorded moderate growth. Although net exports made a negative contribution to the growth, the export demand continued to increase, in part due to the depreciation of the euro in this period.

In the fourth quarter, the inflation in the euro area continued the two-and-a-half-year slowdown and reduced to 0.2% on an annual basis. Thus, it continued to move away from the ECB's inflation target of below but close to 2%. At the same time, this represents the lowest level reached after 2009. Observed through the main components, energy prices continue to register strong decline, which is in line with the significant decline in stock prices of oil these months. However, this decline was somewhat offset by changes in food prices, which after the fall in the previous quarter again registered a moderate increase, driven mainly by the depreciation of the euro. On the other hand, after

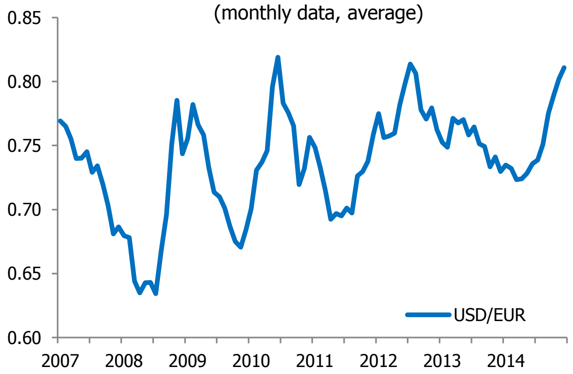
[4] According to ESA 2010.

several quarters of *status quo*, the core inflation slowed down moderately in this period, fully reflecting the fall in the prices of non-energy industrial goods.

The policy rates of the ECB, the Fed and the Bank of England remained unchanged in the last three months of 2014, at levels close to zero (0.05%, 0% to 0.25% and 0.5%, respectively). As for the non-monetary measures, the ECB started to implement the previously announced repurchase program of backed bonds denominated in euros issued by financial institutions from the euro area (CBPP3[5]) and asset-backed securities (ABSPP[6]). The second auction within the framework of the targeted long-term refinancing operations **(TLTRO[7]) was conducted in December, and another six are announced to be conducted by the end of June 2016.** These measures, which are primarily aimed at stimulating lending and encourage economic recovery, should also increase the balance sheets of the Eurosystem in order to reach the level of early 2012. At the meeting held in January 2015, the ECB announced the new extended program for purchase of financial assets in the euro area that provides direct purchase by the central bank of securities issued by private and public sector. Thus, besides the two programs of purchasing asset-backed securities and backed bonds issued by financial institutions in the euro area denominated in euro, which the ECB launched in the last quarter of 2014, the new program also includes purchase of securities issued by the member states of the euro area and relevant European institutions. The program is expected to be implemented in the period from March 2015 to September 2016 with an option to be extended until it ensures sustainable convergence of the rate of inflation in the euro area to the level of about 2% in the medium term. The program provides a monthly purchase of financial assets of Euro 60 billion (including the purchase of assets-backed securities and backed bonds issued by financial institutions in the euro area denominated in euros), bringing the total amount of the program to about Euro 1,000 billion. This program provides a further easing of the monetary policy by increasing the balance sheet of the central bank, aimed to support the process of economic recovery and the return of the

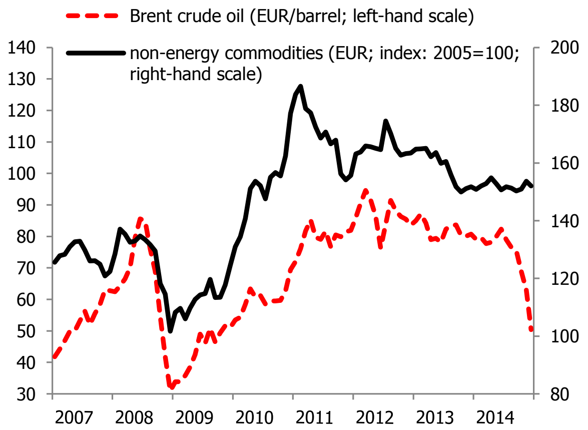
[5] CBPP3 - Covered Bond Purchase Programme 3;
[6] ABSPP - Asset-Backed Securities Purchase Programme;
[7] TLTRO - Targeted Longer-Term Refinancing Operations.

USD/EUR Exchange rate
(monthly data, average)



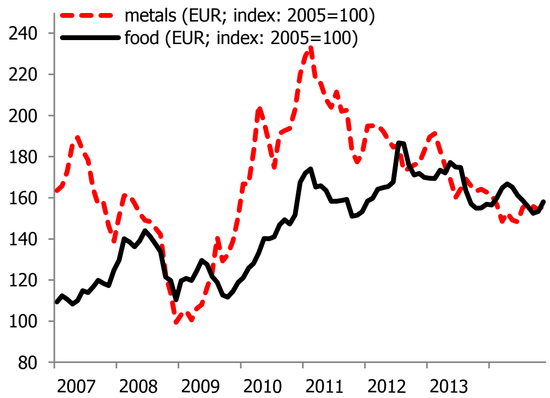
* Price of 1 USD in EUR.
Source: Eurostat.

Prices of crude oil and non-energy commodities
(monthly data)



Source: IMF monthly database.

Prices of food and metals
(monthly data)



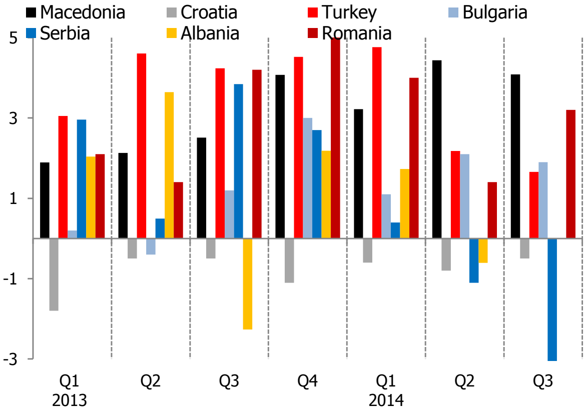
Source: IMF monthly database.

euro area inflation at a level consistent with the target level of about 2%. As for the Fed's non-standard measures, in the October meeting, the Federal Open Market Committee (FOMC) decided to terminate the purchase of mortgage bonds and long-term government bonds, putting an end of the third stage of quantitative easing program. It also retained the current practice to reinvest maturing debt in new assets in order to maintain favorable conditions of financing through solid level of Fed's balance sheet. Also, it was estimated that the policy rate will remain "appropriate for a considerable period of time." Moreover, the decision to increase the interest rate and to normalize gradually the monetary policy will take into account several indicators for the labor market conditions, inflationary pressures and expectations and financial market developments.

During the fourth quarter of 2014, the nominal exchange rate of the US Dollar against the Euro appreciated, but at slower pace. During October and November, the US Dollar appreciated at a rate of 1.8%, i.e. 1.6% on a monthly basis, and in December, it reduced to 1.1%. Compared to the same quarter of the previous year, the US Dollar registered a significant appreciation of 9%, which is the first increase of value of the US Dollar on an annual basis in the last two years. In December 2014, one US Dollar was exchanged for 0.81 euros, which is an appreciation of 11.1% compared to last year. The devaluation of the euro stems from the divergent estimates of the economic situation in the euro area, and the further monetary easing by the ECB, versus the expectations of a possible increase of the Fed's policy rate.

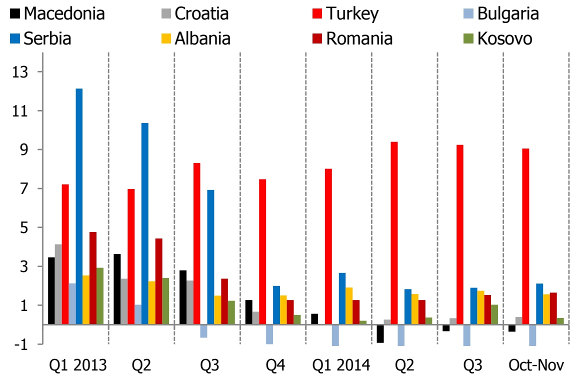
In the fourth quarter, there was a rough decrease in oil prices, expressed in euros. Thus, in this period, the price of crude oil "Brent" equaled Euro 60.7 per barrel, which is a quarterly drop of 21.1%. The decline in oil prices results primarily from the high supply that exceeds the demand for oil. Despite the conflict in Libya and Iraq, OPEC production remained within the current official target, amid increased supply by the United States. At the same time, oil demand remained weak, partly because of the slowdown of the industrial growth in China. **On the other hand, in the same period, the prices of non-**

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



Source: Eurostat and national statistical offices.

Inflation in countries from the region
(annual percentage changes)



Source: Eurostat and national statistical offices.

energy primary products[8] in euros registered a quarterly growth of 0.7%. The food prices slightly increased compared to the previous quarter [9] (0.9%), while the price of metals registered a quarterly decline of 1.7%. The unusually cold weather in the US, as well as the conflict between the two major producers of cereals, Russia and Ukraine, which affected production and trade, increased the price of cereals. The fall in metal prices is explained by the reduced global demand or economic slowdown in China and in some emerging economies.

In the third quarter, the economic activity of the region showed divergent movements. Namely, the economic activity of Turkey and Bulgaria slowed down annually, while Serbia and Croatia continued to register negative growth rates of GDP. The poor economic performance of Serbia primarily reflects the adverse weather or floods that hit the region. The lower economic growth in Turkey arises from the reduced investment activity, where net exports remain the main driver of growth, while the weaker performance of the Bulgarian economy reflects the worsened net exports, amid improved domestic demand. Serbia's GDP registered a rough decline as a result of the strong fall in the industrial output and the activity of the service sector. On the other hand, Romania's economy registered a rapid growth, the highest in the EU for the third quarter, driven by the improved investment climate, as well as the higher private consumption and improved net exports.

During October and November, the countries of the region mostly registered low rates of inflation, while in Bulgaria the deflation increased. The inflation rate decreased in Kosovo, Turkey and Albania, and a slight acceleration was observed in the growth of price levels in Serbia, Romania and Croatia. Low prices of food in Bulgaria continued the deflation in the first two months of the fourth quarter.

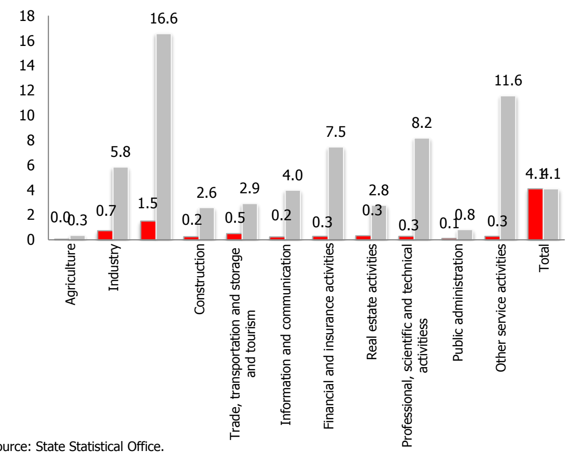
---

[8] The price index of non-energy primary products includes: prices of food, beverages, agricultural raw materials and metals.
[9] Expressed in US dollars, food prices registered a quarterly decline.

1.2. Domestic supply

The growth of domestic production continued in the third quarter of 2014, when a moderate quarterly GDP growth of 0.5% and annual growth of 4.1% was registered. Improved economic performances in the third quarter of 2014 were distributed among all sectors of activity, with the manufacturing industry being the largest generator of growth, while solid performances were registered in the activities in trade, transport and hotels and restaurants. Growth of value added was recorded in construction, but at significantly slower pace compared to the beginning of the year. Although it was assessed that the slowdown in construction activity is temporary, according to the results of the surveys, the situation in this sector is still not expected to change significantly in the fourth quarter.

Annual real growth rates of individual sectors of GDP in Q3.2014



Source: State Statistical Office.

In the third quarter of 2014, the domestic output continued growing and resulted in 0.5% and 4.1% higher GDP (seasonally adjusted) on both quarterly and annual basis, respectively[10]. Observing individual economic sectors, the manufacturing industry is the generator of the quarterly and the annual growth in the third quarter. Moreover, when it comes to the annual growth, favorable movements were registered in all economic sectors, and besides manufacturing industry, significant contribution to the growth of the total value added was made by the sectors of trade, transport and communication, and hotels and restaurants[11].

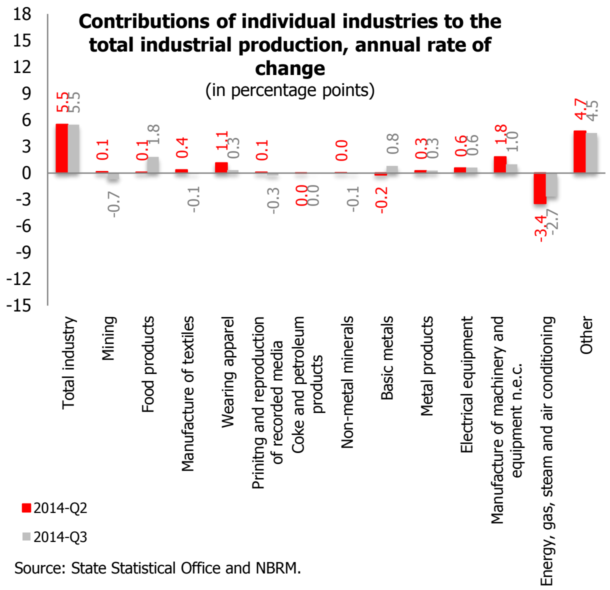
	annual growth rates, in %												
	Кв.1 2012	Кв.2 2012	Кв.3 2012	Кв.4 2012	***2012***	Кв.1 2013	Кв.2 2013	Кв.3 2013	Кв.4 2013	***2013***	Кв.1 2014	Кв.2 2014	Кв.3 2014
Agriculture	-16.4	-9.4	-10.8	-25.3	***-16.0***	16.0	7.3	1.7	14.3	***9.0***	3.2	9.2	0.3
Industry	-12.4	-7.8	-5.9	-1.0	***-6.7***	6.7	5.8	4.5	6.2	***5.8***	2.6	5.8	5.8
Manufacturing	-9.2	-3.4	0.2	7.0	***-1.2***	10.8	7.8	7.8	10.4	***9.2***	8.2	11.3	16.6
Construction	11.4	1.0	-10.2	-13.5	***-2.7***	5.8	4.0	8.9	5.7	***6.0***	9.3	0.5	2.6
Trade and transport	-9.9	3.8	19.7	17.4	***7.5***	10.6	5.7	3.4	-0.2	***4.5***	3.5	5.2	2.9
Information and communication	-16.9	-1.0	7.6	11.6	***-0.6***	10.4	10.7	9.2	10.0	***10.1***	2.3	5.1	4.0
Financial and insurance	25.3	21.0	17.1	7.9	***17.4***	2.6	1.1	0.5	3.6	***1.9***	4.2	3.5	7.5
Real estate activities	34.6	13.2	-14.9	-12.7	***2.4***	-10.4	-2.5	3.5	5.8	***-1.3***	4.8	4.1	2.8
Professional, scientific and technical activitiess	8.8	-2.4	-4.1	-2.9	***0.1***	-3.0	7.8	11.7	17.4	***7.6***	2.0	6.9	8.2
Public administration	0.9	1.8	2.8	4.0	***2.4***	2.0	1.5	1.0	0.4	***1.2***	0.6	0.6	0.8
Other service activities	1.0	-6.3	-10.9	-12.2	***-6.6***	-19.6	-7.5	10.5	22.0	***-1.0***	12.2	11.3	11.6
Gross Domestic Product	***-1.0***	***0.5***	***0.3***	***-1.6***	***-0.5***	***1.9***	***2.1***	***2.5***	***4.1***	***2.7***	***3.2***	***4.4***	***4.1***

	contributions to GDP growth (in p.p.)												
	Кв.1 2012	Кв.2 2012	Кв.3 2012	Кв.4 2012	***2012***	Кв.1 2013	Кв.2 2013	Кв.3 2013	Кв.4 2013	***2013***	Кв.1 2014	Кв.2 2014	Кв.3 2014
Agriculture	-1.0	-0.7	-1.1	-2.7	***-1.4***	0.9	0.5	0.2	1.2	***0.7***	0.2	0.7	0.0
Industry	-1.6	-1.1	-0.8	-0.1	***-0.9***	0.8	0.7	0.5	0.8	***0.7***	0.3	0.7	0.7
Manufacturing	-0.8	-0.3	0.0	0.6	***-0.1***	0.8	0.7	0.7	1.0	***0.8***	0.7	1.0	1.5
Construction	1.2	0.1	-1.0	-1.2	***-0.3***	0.7	0.4	0.8	0.5	***0.6***	1.1	0.0	0.2
Trade and transport	-1.5	0.6	2.7	2.5	***1.1***	1.5	0.9	0.6	0.0	***0.7***	0.5	0.9	0.5
Information and communication	-1.1	-0.1	0.4	0.5	***0.0***	0.5	0.5	0.5	0.5	***0.5***	0.1	0.3	0.2
Financial and insurance	0.7	0.7	0.5	0.3	***0.5***	0.1	0.0	0.0	0.1	***0.1***	0.2	0.1	0.3
Real estate activities	3.5	1.4	-2.0	-1.6	***0.3***	-1.4	-0.3	0.4	0.6	***-0.2***	0.6	0.5	0.3
Professional, scientific and technical activitiess	0.3	-0.1	-0.1	-0.1	***0.0***	-0.1	0.3	0.4	0.5	***0.3***	0.1	0.2	0.3
Public administration	0.1	0.2	0.3	0.5	***0.3***	0.3	0.2	0.1	0.0	***0.2***	0.1	0.1	0.1
Other service activities	0.0	-0.2	-0.3	-0.3	***-0.2***	-0.6	-0.2	0.2	0.4	***0.0***	0.3	0.3	0.3
Gross Domestic Product	***-1.0***	***0.5***	***0.3***	***-1.6***	***-0.5***	***1.9***	***2.1***	***2.5***	***4.1***	***2.7***	***3.2***	***4.4***	***4.1***

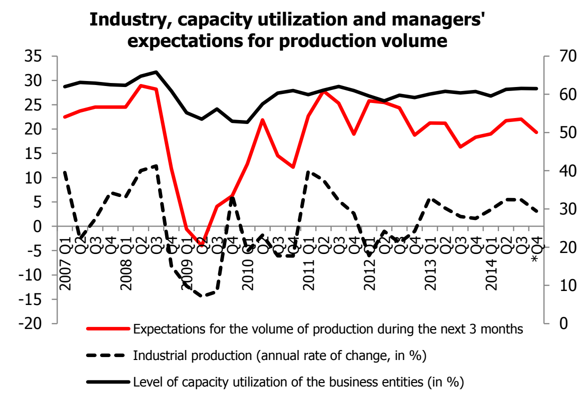
Source: State Statistical Office and NBRM calculations.

[10] The data on the movement of GDP and its components in the third quarter of 2014 that the SSO announced in December 2014 were compiled using the new method of calculating certain categories in order to achieve greater scope and application of the ESA 2010 methodology. Additionally, data by sector of economic activity are presented according to the NACE Rev.2 classification.

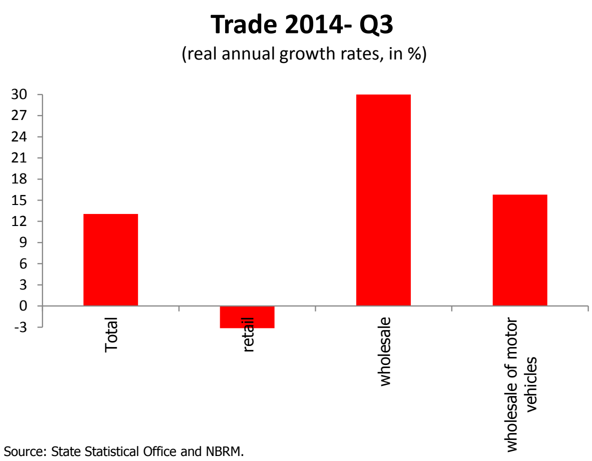
[11] Within the published GDP data, in the third quarter, the three activities: trade, transport and communications, and hotels and restaurants are published aggregately, i.e. it is impossible to isolate the individual growth of each of them.



Source: State Statistical Office and NBRM.



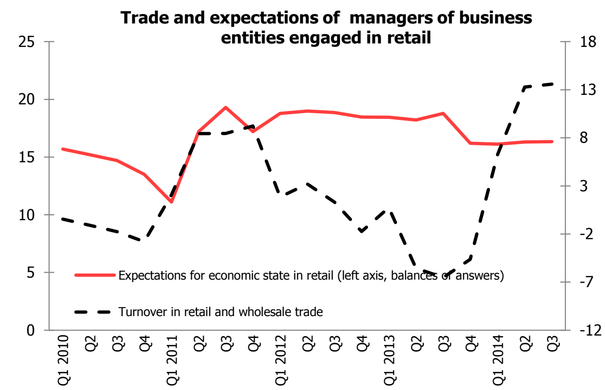
Source: State Statistical Office.
* average of expectations for 7 and 8 month of 2014



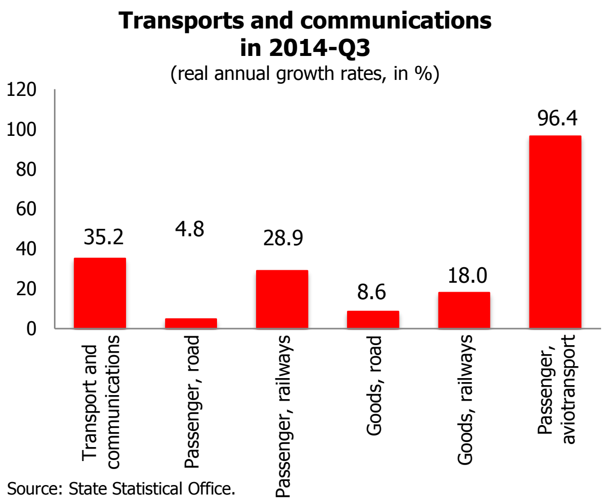
Source: State Statistical Office and NBRM.

The industrial sector continued registering favorable developments in the third quarter. Moreover, there is a certain slowdown of the quarterly growth, which however have not affected significantly the annual change in the value added, which in the third quarter remained at the level of the previous quarter. The manufacturing industry is the generator of the growth in the industry, where the improved performances are largely attributable to the activity of new export facilities, and growth has also been observed in some other facilities. The analysis of individual activities within the manufacturing industry refers to the production of motor vehicles, trailers and semi-trailers and the production of food products as activities that make the highest contribution to the annual growth of the manufacturing industry. Despite the good performances in the manufacturing industry, the sector of supply of electricity, gas, steam and air conditioning, and the mining sector made a negative contribution to the growth of the industrial output. The improved performance in the manufacturing industry is also confirmed in the **Business Tendency Survey in manufacturing industry**[12]. According to the Survey, the third quarter registered an improvement of the perceptions of corporate managers for the current economic situation compared to the preceding quarter. As for the limiting factors, corporate managers emphasize the lack of equipment, lack of skilled labor and uncertain economic surrounding as factors with more pronounced negative impact in the third versus the second quarter. **The results of the survey conducted in the first two months of the fourth quarter point to moderately less favorable movements compared with the third quarter.** Thus, the period October-November 2014 witnessed moderate deterioration of the assessments of the current economic situation of the facilities, and a slight decrease in the average capacity utilization. However, taking into account the growth of industrial output in the same period (an average annual growth of the industrial output index of 6.7% in the last two months of the year), the moderately worsened perceptions of corporate managers in this sector are probably based on temporary factors.

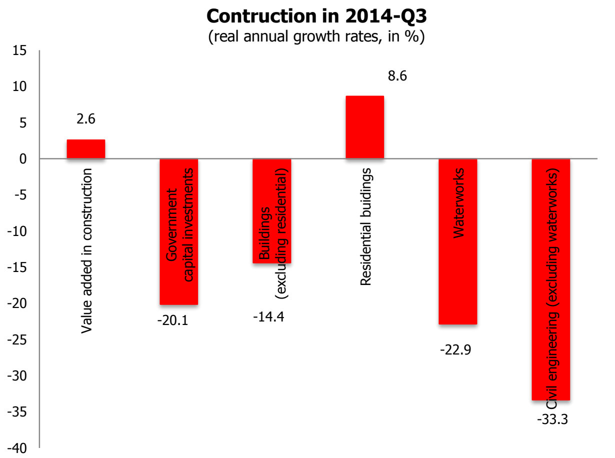
[12] Refers to the surveys conducted in the third quarter of 2014.



Source: State Statistical Office and NBRM.



Source: State Statistical Office.



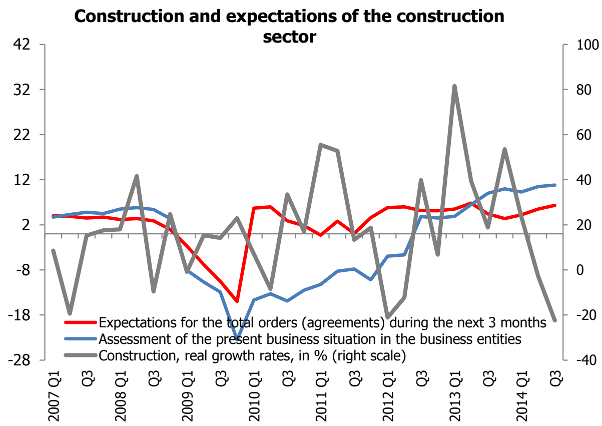
Source: State Statistical Office and Ministry of finance.

The situation in the trade sector in the third quarter is similar as in the previous quarter[13]. Thus, in this quarter, the growth reflects the increased turnover of the wholesale trade, with additional contribution to the growth being made by the trade in motor vehicles, which registered annual growth of turnover, despite the decline in the previous quarter. On the other hand, the turnover in retail trade still declines on an annual basis, but at a significantly slower pace. Poor performance in retail trade is to a certain extent confirmed by the results of the **Survey of Retail Trade Managers**[14]. Namely, in the third quarter, the assessments of managers of this sector about the current corporate business are moderately worse. Furthermore, the analysis of the survey results indicates the existence of several limiting factors whose negative impact is more pronounced compared to the second quarter of the year, with the dominance of increased competition. In terms of trends in retail trade, no significant improvement in the fourth quarter is expected, taking into account the deteriorating expectations of corporate managers in terms of the status of orders and selling prices.

In view of the developments in the sector of transport and communications, all indicators point to a continuation of the favorable developments from the second quarter. The highest growth was recorded in cargo aviation traffic, with significant growth rate in the road traffic.

In the third quarter, the value added in construction registered a moderate annual and quarterly growth. However, analyzed on average for the second and the third quarter, the growth is still significantly slower compared with the first quarter of the year. Analyzing the types of buildings, the annual growth could be explained by the growth of the construction of residential buildings. Besides housing activity, other construction activities in the

[13] The analysis of the trends in the trade is based on data on the trade turnover.
[14] SSO's Business Tendency Survey in retail trade for the third quarter of 2014. The balance of responses is the difference between weighted positive and negative responses of the 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.

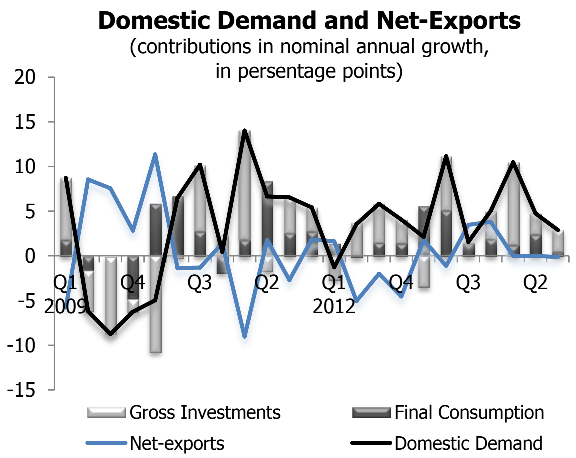


Source: State Statistical Office.

field of building construction, as well as activities in the field of civil engineering decreased compared to the same period last year. Although it was assessed that the slowdown in construction activity is temporary, according to the results of the **Business Tendency Survey in construction**[15], no significant changes are expected in this sector in the fourth quarter. Namely, although managers' perceptions about the current situation in this sector slightly improved, yet their expectations for the fourth quarter about the period of providing works, selling prices and total orders are less favorable compared to the previous quarter. The managers pointed to the increased financial costs, bad weather and lack of equipment and materials as factors that limit the growth of construction.

1.3. Aggregate demand

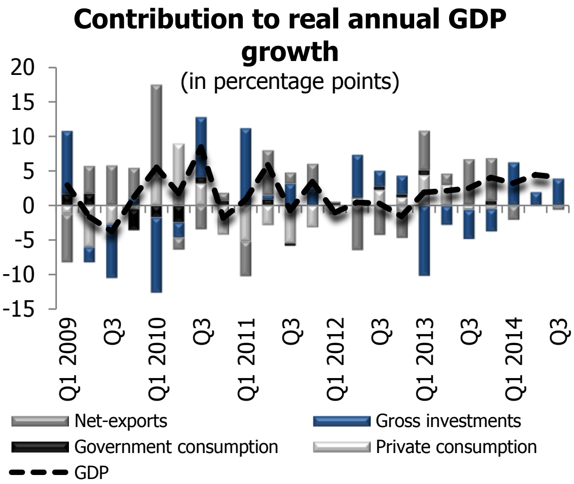
In terms of demand, the annual growth of gross domestic product of 4.1% in the third quarter of 2014 is explained by the concurrent growth of domestic demand and export activity. Within the domestic demand, the highest growth was recorded in gross investments (17%), which amid decline in the value of completed construction works, most probably reflects the increase in inventories and investments in machinery and equipment. Household consumption continued to increase in the third quarter of 2014 (by 2.5%), but at a slower pace compared to the previous quarter. The activity of new production facilities in the first half of the year and in the third quarter contributed to a significant growth in export activity, whereby exports grew by 15.4%. The higher domestic and export demand, amid high dependence of domestic production on imports, increased the imports by 14%. Despite the high growth of exports, net exports remained in the the negative zone, and compared with the previous quarter, the negative contribution of this category is moderately stronger.



Source: State Statistical Office and NBRM calculations.

Gross domestic product (GDP), in the third quarter of 2014, increased by 0.5% (seasonally adjusted) and by 4.1%, compared to the previous quarter and compared to the same period last year, respectively. Analyzing the demand, the solid annual GDP growth in the third quarter is a result of the export and domestic demand, partially offset by the increase in imports from abroad. Observing individual components, the export of goods and services registered a high growth as in the second quarter, which is largely due to the activity of the new production facilities. In the third quarter of the year, growth was registered in all domestic

[15] Refers to the surveys conducted in the third quarter of 2014.



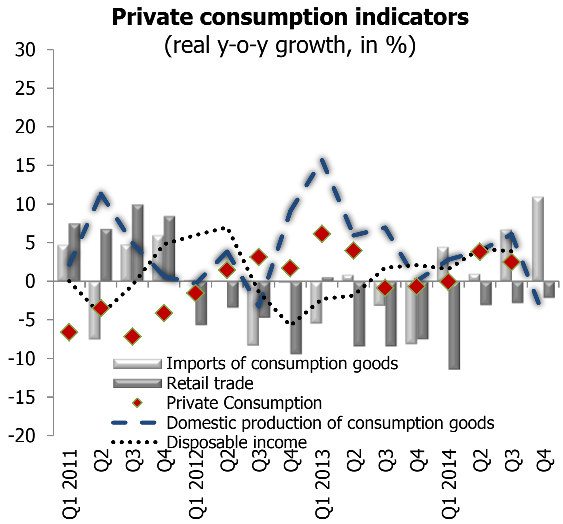
Source: State Statistical Office and NBRM calculations.

components of demand, with the exception of the public spending. Namely, the third quarter witnessed a significant acceleration of the growth of gross investments (both quarterly and annually), probably as a result of the growth of investments in machinery and equipment and inventories. Also, the favorable developments in the labor market and the growth of real wages provided further support for the annual growth of household consumption, despite the quarterly decline in this component of domestic demand. The public spending was the only component that went down annually. Increased domestic and export demand led to higher imports, but at slightly slower pace compared to the growth 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
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
Government consumption	2.2	0.8	3.7	3.1	2.4	4.4	-0.1	1.2	4.4	2.5	-1.6	0.1	-5.2
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	14.4	16.0	15.4
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	14.0
Gross capital formation	-0.4	27.7	8.9	8.7	10.2	-32.6	-9.8	-15.2	-9.6	-16.6	30.2	7.8	17.0
Domestic demand	*-0.7*	*6.6*	*4.5*	*3.7*	*3.5*	*-4.3*	*0.1*	*-4.0*	*-2.5*	*-2.6*	*5.3*	*4.2*	*4.5*
*Net exports**	*-1.0*	*54.6*	*36.8*	*28.6*	*26.3*	*-30.2*	*-9.4*	*-41.6*	*-28.8*	*-27.0*	*15.9*	*0.4*	*6.9*
GDP	**-1.0**	**0.5**	**0.3**	**-1.6**	**-0.5**	**1.9**	**2.1**	**2.5**	**4.1**	**2.7**	**3.2**	**4.4**	**4.1**

**decrease represents lower deficit*
Source: SSO and NBRM calculations.

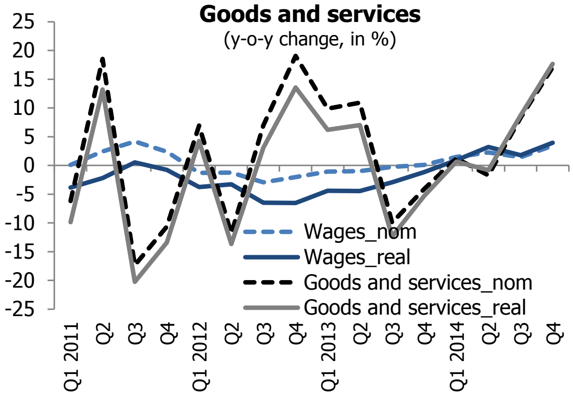


Source: State Statistical Office , Ministry of Finance and NBRM calculations.

1.3.1. Private consumption

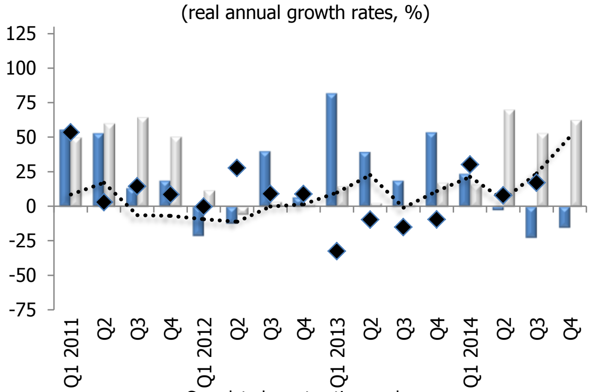
In the third quarter of 2014, private consumption registered a quarterly fall of 3.7% (seasonally adjusted). Unfavorable quarterly movement determined certain slowdown of the annual growth rate, and yet, in the third quarter, it registered a solid annual growth of household consumption of 2.5%. Moreover, same as the previous quarter, the annual growth of private consumption was supported by the growth of the disposable financial assets, given the growth in the most significant components of disposable income. Real growth in average wages paid for two quarters in a row, coupled with the higher employment growth increased the wage bill in the economy, although somewhat slower compared with the previous quarter. Moreover, the growth of pensions continued in the third quarter, with the higher inflows based on private transfers from abroad making additional positive contribution to the growth of household income. Besides the growth of the main components of households' disposable income, the higher consumption in the third quarter was also supported through the higher

Expenditures for Wages and salaries and Goods and services
(y-o-y change, in %)



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

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



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

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 third quarter. Thus, an annual growth was observed in the domestic production and the import of private consumption goods, as well as in the net income from VAT. On the other hand, the turnover in retail trade continued to decline in the third quarter, but at a further slowing pace.

The annual growth in the private consumption is expected to continue in the fourth quarter of the year according to the latest available data[16]. Namely, the increase in real wages, pensions and transfers leads to further growth of the total funds available to households in the fourth quarter. According to the lending data, in the period October-November, the growth of consumer loans to households is expected to continue in the last quarter of the year, which according to the Lending Survey[17], corresponds to the banks' expectations for easing the terms of lending and accelerating the demand for loans in this period. Analyzing the short-term indicators of private consumption, an accelerated annual growth was recorded in the net income from VAT, as well as in the import of consumer goods that also underpin the expectations for higher private consumption in the fourth quarter.

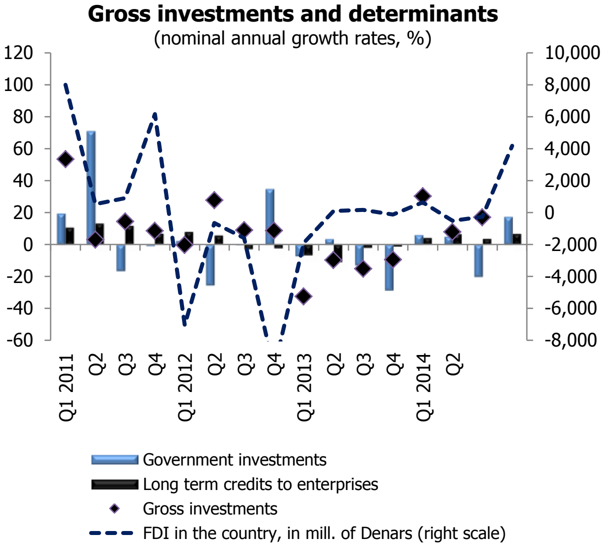
1.3.2. Public consumption

In the third quarter of 2014, public consumption dropped both quarterly (3%, seasonally adjusted) and annually (5.2%). The real annual decline stems from reduced health care expenditures[18]. On the other hand, the available data for October-November 2014 indicate higher public spending **in the fourth quarter of 2014,** given the higher costs for wages, and goods and services, as well as higher transfers for health care.

1.3.3. Investment consumption

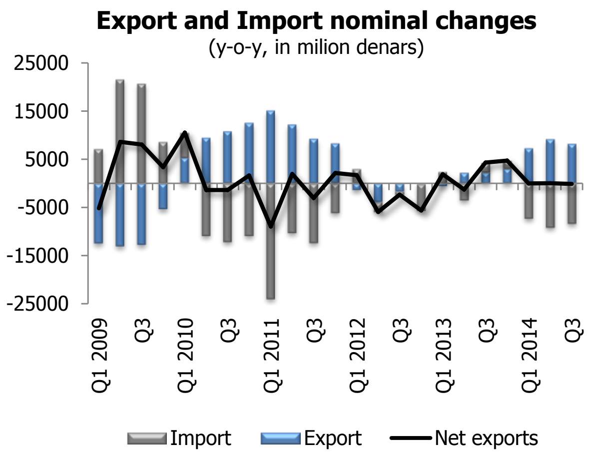
The favorable movements in gross investments continued in the third quarter

[16] Data on wages, private transfers and import of consumer goods are as of October, while other data are as of November.
[17] NBRM's Lending Survey conducted in September 2014.
[18] Most of these assets relate to expenditures for goods and services.



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

of 2014, reaching a quarterly growth of 10.5% (seasonally adjusted), while annually, gross investments increased by 17%. In the third quarter, the growth of gross investments could be explained by the increase in inventories, with some positive contribution of the investments in machinery and equipment to the growth, taking into account the double-digit growth in imports of capital goods. On the other hand, in the third quarter, the fall in the value of completed construction works accelerated, suggesting adverse movements in investments in construction. Some of the remaining short-term investment indicators also support the growth of investments in the third quarter. Thus, in the third quarter, growth was registered in the domestic production of investment goods, as well as in the corporate loans. Moreover, according to the results of the Lending Survey[19], significant part of the credit demanded by the corporate sector was aimed to finance investments. Additionally, banks emphasize that the growth in demand for loans by the corporate sector is due to the further moderate net easing of the terms of lending. Contrary to the favorable trends in the indicators for private investments, the third quarter registered a decline in government spending for capital investments, despite the increase in these expenses in the first half of the year.



Source: State Statistical Office .

In terms of the movement of investments in the last quarter of the year, most of the available short-term indicators of investment activity point to continuing growth[20]. Thus, the annual growth of imports of capital goods and domestic production of capital goods accelerated. Meanwhile, the period October-November registered boost of the annual growth of long-term bank lending to companies, with growth being registered in capital budget expenditures, despite the fall in the previous quarter. On the other hand, data on the value of completed construction works in October suggest further unfavorable movements in construction. Additionally, the results of the Business Tendency Survey in construction[21] point to absence of significant changes in the managers' expectations about the situation in the sector during the fourth quarter. Bearing this in mind,

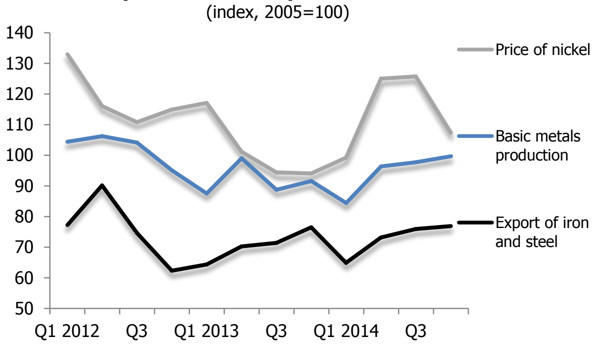
[19] NBRM's Lending Survey conducted in September 2014.
[20] Data on completed construction works, foreign direct investments and import of working capital are as of October, while other data are as of November.
[21] Refers to the surveys conducted in the third quarter of 2014.

in the fourth quarter, the support of the construction sector to the total investment demand will most likely be relatively weak.

1.3.4. Net external demand

The external sector trends in the third quarter are a continuation of the developments that marked the first half of the year. Thus, in the third quarter, the level of foreign trade was significantly higher compared with the previous year. The contribution of net exports to the growth remained in the negative zone. Real export of goods and services registered double-digit annual growth of 15.4%, while compared to the previous quarter, a certain slowdown of the growth pace was registered (quarterly growth of 0.4%, seasonally adjusted). The high annual growth almost entirely derives from the increased exports of new production facilities. Analyzed by product categories, in the third quarter, the export of machinery and equipment, and chemical products was the highest. The situation in the domestic metal industry, given the still weak global demand for metals, remains unfavorable. However, the third quarter shows significant slowdown in the rate of annual decline in exports of metals, which indicates possible stabilization of the metal industry in the coming period. Amid heavy import-dependence of the domestic production, the high annual growth of imports in the third quarter reflects the import of intermediate products. A slight decrease in imports of 2.8% (seasonally adjusted) was registered on a quarterly basis.

Iron and steel export, base metals production and price of nickel
(index, 2005=100)

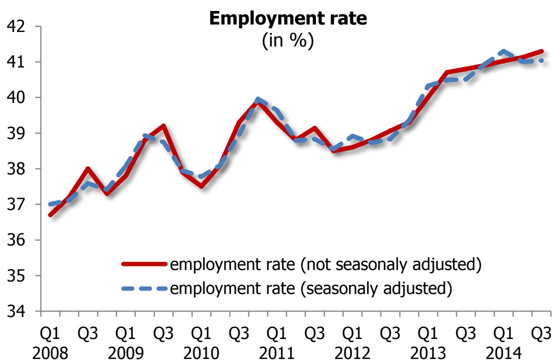


Source: State Statistical Office, IMF monthly database and NBRM calculations.

The data for the fourth quarter point to a continuation of favorable developments on the export side. Thus, in October and November 2014, there was a double-digit nominal annual growth of exports of goods, whereby during the year, the growth was driven by the new export facilities (growth in export of machinery, electrical equipment and chemical products), with certain positive contribution to the growth being made by the facilities in the traditional export sectors (moderate growth of exports of food and tobacco). **In the first two months of the fourth quarter, the imports also registered a nominal annual growth,** primarily due to increased import of raw materials by a major export facility, along with the growth of import of equipment and machinery. Observing the movement of net export demand, based on nominal data for October and November, certain narrowing of the trade deficit is expected for the fourth quarter, given the significantly faster growth in exports compared to the increase in imports.

1.4. Employment and wages

In the third quarter of 2014, the number of employees grew annually at an almost unchanged pace compared to the previous quarter. Thus, this indicator has been in the zone of positive annual changes for nine consecutive quarters . These developments correspond with the real sector performances, which are also favorable. For several consecutive years, the improvement of some of the key labor market indicators has been associated with the business of the new export facilities. Moreover, for a longer period, fiscal policy has been aimed towards accelerating economic activity and employment, through active employment measures, publicly funded infrastructure projects, as well as agriculture subsidizing policies. According to aggregate signals from business tendency surveys, the favorable labor market developments are expected to continue in the fourth quarter of the year.



Source: State Statistical Office, Labour Force Survey.

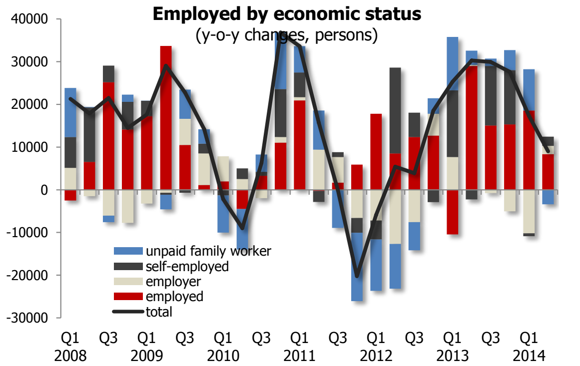
The number of employees registered an annual growth of 1.2%, a pace which is almost unchanged compared to the previous quarter, while the quarterly growth of 0.2%[22], after the quarterly decline in employment in the previous quarter, is a reversal to the zone of positive changes. The annual employment growth is mostly attributable to the transport, storage and communications sector, construction, as well as the sector of activities related to real estate and other business activities. In terms of economic status[23], the growth completely derives from the category of employees. These developments increased the employment rate by 0.5 percentage points annually, to 41.3%. The results of the Job Vacancy Survey confirm the positive developments in the employment[24]. Namely, the number of vacancies,

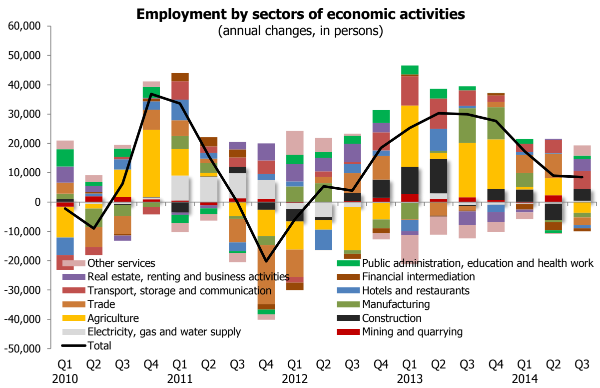
---

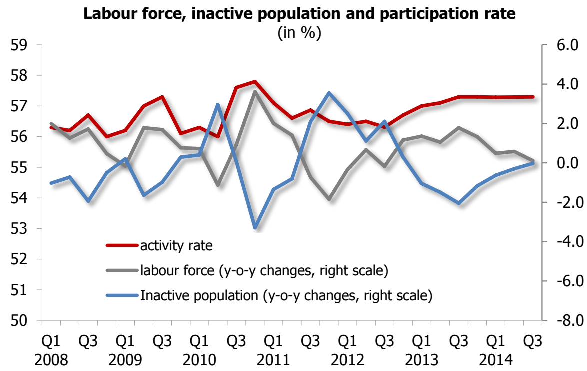
[22]The analysis of quarterly dynamics of employment, unemployment and total active population was made using seasonally adjusted data.

[23] 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).

[24] For the first time in 2012, the State Statistical Office began to conduct a Vacancy Survey as part of the labor market research.







Source: State Statistical Office, Labor Force Survey.

as another indicator of the movement of labor demand, increased annually by 51.5% in the third quarter, while the rate of vacancies rose by 0.2 percentage points, to 1.58%.

From a dynamic perspective, the annual performances of employment in the second and third quarter compared with the growth at the beginning of the year point to halving of the intensity of job creation. The slowdown is mostly associated with agriculture, manufacturing industry, as well as trade as sectors where the employment has been decreasing since the beginning of the year[25]. However, amid simultaneous acceleration of the activity in these sectors, the reduction in employment brings about increase of productivity, as an indicator of competitiveness. Namely, the operations of new facilities, increased capacity utilization, as well as policies that promote access to credit lines at subsidized rates earmarked for development projects could be indicated as factors that can explain the acceleration of last year's positive trend in productivity in the manufacturing sector. Additionally, the favorable turnaround in trade productivity at the beginning of the year most probably reflects the increased competition in line with the signals from the Business Tendency Survey in this sector. At the same time, the further strengthening of competitiveness in the agriculture is mostly associated with multiyear government policy of subsidizing production.

The prospects in terms of labor market developments remain favorable by the end of the year. The aggregated signals from business tendency surveys[26] suggest strengthening of the optimism regarding the employment for the next three months. This tendency corresponds to the positive developments in the domestic economy and the gradual recovery of the global economy.

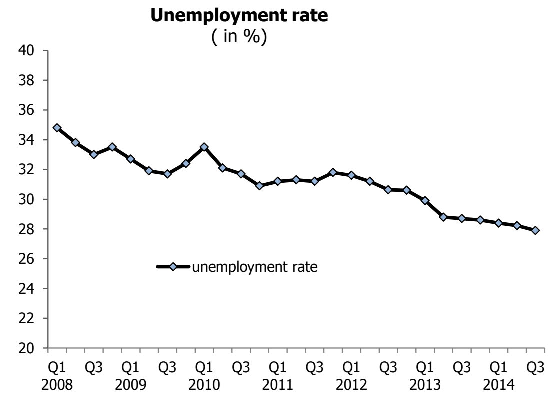
The labor supply registered no significant shifts in the third quarter. Thus, relative to the same period last year, the total

---

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.

[25] The trend, i.e. the quarterly changes are seasonally adjusted.

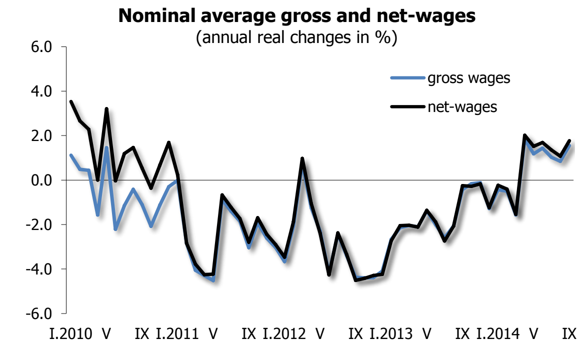
[26] Source: State Statistical Office, business tendency surveys in manufacturing industry (October 2014), construction (third quarter of 2014) and trade (third quarter of 2014).



Source: State Statistical Office, Labor Force Survey.

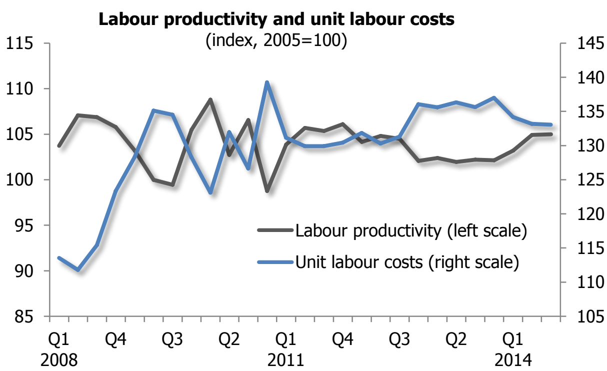
active population increased by merely 0.1%, which amid simultaneous but minor decline in the inactive population, caused an annual stagnation of the activity rate, which remained at 57.3%.

In the third quarter, the reduction of unemployment continued, amid further intensive growth of labor demand versus the growth of labor supply. Namely, the number of unemployed persons in the third quarter went down by 2.7% on an annual basis, which is an enhanced downward correction. Consequently, the unemployment rate fell by 0.8 percentage points annually, to 27.9%.



Source: State Statistical Office.

The average wages paid in the third quarter registered further intensification of the positive annual pace. Thus, in the third quarter, the nominal net and gross wages increased by 1.1% and 0.8%, respectively, on an annual basis. Wage growth was recorded in almost all sectors of activity, with the sector of professional, scientific and technical activities, and the construction sector being distinguished because of the intensity of their upward adjustment. On a quarterly basis, nominal net and gross wages are almost stagnating, amid larger number of sectors with downward adjustments in wages. **In the third quarter, despite the faster growth of annual nominal wages, the slower pace of reduction in the general price level brought about real annual growth of net and gross wages, but at a slower pace, i.e. growth of 1.4% and 1.1 %, respectively.** On the other hand, the stagnation of nominal wages on a quarterly basis, amid further minimal reduction of the consumer prices, brought about minor real wage growth of 0.1% on a quarterly basis.



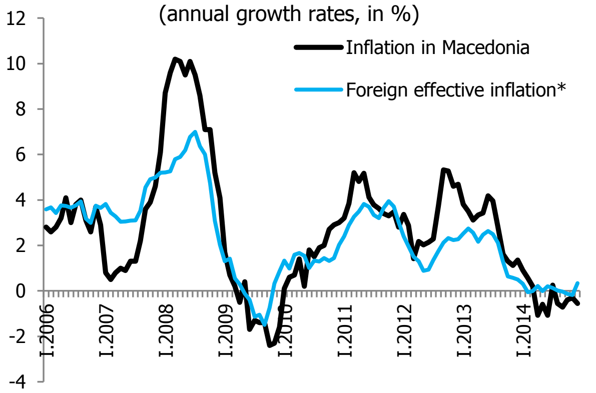
Source: State Statistical Office and NBRM calculations.

Labor productivity registered an annual growth of 2.7% in the third quarter, which is slightly slower pace than that registered in the previous quarter. The above results from the more intense annual growth of economic activity compared to the employment growth. Productivity increased, although minimally, on a quarterly basis, given the slightly faster growth of economic activity compared to the growth in the number of employees. **Unit labor costs registered an annual decline of 1.9%, but at a slightly slower pace than in the previous quarter.** The downward adjustment results from the faster growth of productivity compared to the growth of gross wages. The labor costs also registered minor quarterly downward adjustment.

1.5. Inflation

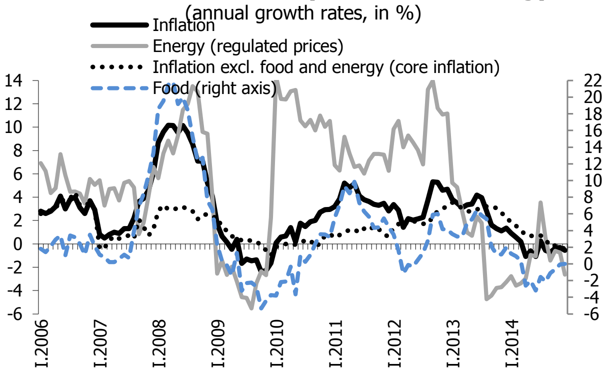
In the fourth quarter of 2014, domestic prices continued with the annual decline (of 0.4%) that started in the second quarter this year. However, unlike the previous quarter when the decline was driven by lower food prices, in the fourth quarter of the year, the negative contribution of prices of the energy component of inflation is the most significant, given the substantial drop in the price of crude oil on world markets. At the same time, the long-term component of inflation also registered a price reduction. On a quarterly basis, consumer prices slightly increased, mainly reflecting the seasonal rise of prices of some food products, and the bad weather in the second and the third quarter of the year. Producer price indices continued to decline on both annual and quarterly basis.

Domestic inflation and foreign effective inflation
(annual growth rates, in %)



* Foreign effective inflation is calculated as weighted sum of inflations in countries that are major trade partners with Macedonia.
Source: State statistical office, Eurostat and NBRM calculations.

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



Source: State statistical office and NBRM calculations.

The reduction in domestic consumer prices that started in the second quarter continued in the last quarter of the year when prices went down by 0.4% on an annual basis. Thus, the decline in consumer prices equaled 0.3% for the entire 2014, as forecast in the October cycle projections (expected inflation rate of around 0%). Analyzed by component, unlike the previous quarter when the fall in prices was driven by lower food prices, in the fourth quarter, the downward movement is explained by lower prices of all three components of inflation. The largest contribution was made by the energy component of inflation as a result of the lower prices of liquid fuels and lubricants, affected by the drop in the price of crude oil on world markets. Food prices continued to decline in the fourth quarter, but at a slower pace. Lower food prices result from the downward adjustment in the prices of unprocessed meat, oil and fats, as well as the category of sugar, jam, honey, chocolate, and confectionery products[27]. For the first time since the first quarter of 2010, the fourth quarter of 2014 also registered a decrease of the long-term component of inflation (price component without food and energy), given the lower prices of IT equipment. **Unlike domestic consumer prices, foreign effective**

[27] Solid global stocks and production of sugar in recent years, and the lower price of crude oil (which caused lower production of ethanol from sugar crops) contribute to the reduction in the price of sugar on the world markets.

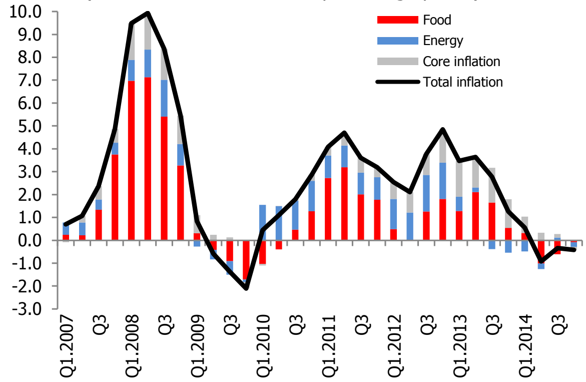
inflation[28] stagnated on an annual basis, i.e. the prices remained unchanged in the fourth quarter (0% in the previous quarter).

Price categories

	(annual growth rates, in %)										(contributions to annual growth rates, in p.p.)									
	2013				2013	2014				2014	2013				2013	2014				2014
	Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4	
Consumer price index - all items	**3.5**	**3.6**	**2.8**	**1.3**	**2.8**	**0.6**	**-0.9**	**-0.3**	**-0.4**	**-0.3**	**3.5**	**3.6**	**2.8**	**1.3**	**2.8**	**0.6**	**-0.9**	**-0.3**	**-0.4**	**-0.3**
Food	*3.4*	*5.6*	*4.4*	*1.4*	*3.7*	*0.8*	*-2.6*	*-1.6*	*-0.2*	*-0.9*	*1.3*	*2.1*	*1.7*	*0.5*	*1.4*	*0.3*	*-1.0*	*-0.6*	*-0.1*	*-0.3*
Energy	*4.3*	*1.3*	*-2.6*	*-3.6*	*-0.2*	*-3.3*	*-1.7*	*0.8*	*-1.4*	*-1.4*	*0.6*	*0.2*	*-0.4*	*-0.5*	*0.0*	*-0.5*	*-0.2*	*0.1*	*-0.2*	*-0.2*
Electricity	10.0	10.0	-1.0	-3.1	3.7	-3.1	-3.1	4.5	3.6	0.4	0.7	0.7	-0.1	-0.2	0.3	-0.2	-0.2	0.3	0.3	0.0
Heat energy	0.2	-10.3	-14.4	-16.3	-10.3	-12.3	-2.9	-8.2	-11.0	-8.7	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	0.0	-0.1	-0.1	-0.1
Fuels and lubricants	0.2	-6.7	-2.3	-4.2	-3.3	-4.3	-0.8	-2.2	-8.2	-3.9	0.0	-0.3	-0.1	-0.2	-0.1	-0.2	0.0	-0.1	-0.3	-0.2
Food and energy (volatile prices)	*3.6*	*4.4*	*2.4*	*0.0*	*2.6*	*-0.3*	*-2.4*	*-0.9*	*-0.5*	*-1.0*	*1.9*	*2.3*	*1.3*	*0.0*	*1.4*	*-0.2*	*-1.3*	*-0.5*	*-0.3*	*-0.5*
Core inflation (inflation excl. food and energy)	*3.3*	*2.8*	*3.2*	*2.7*	*3.0*	*1.5*	*0.7*	*0.3*	*-0.3*	*0.6*	*1.6*	*1.3*	*1.5*	*1.3*	*1.4*	*0.7*	*0.3*	*0.2*	*-0.1*	*0.3*

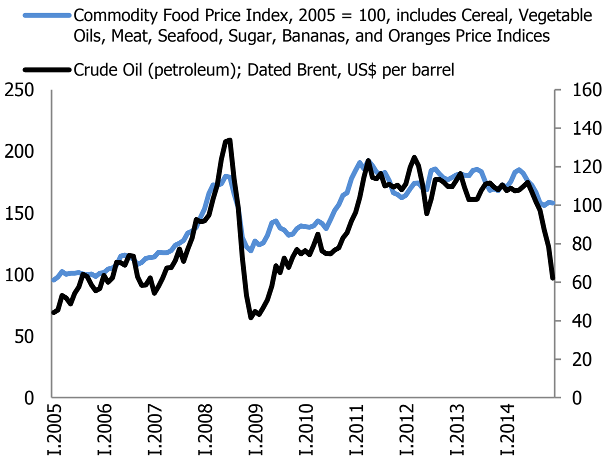
Volatile (food and energy) and long-term component of inflation

(contribution to inflation, in percentage points)



Source: State statistical office and NBRM calculations.

Crude oil and food prices



Source: IMF Primary Commodity Prices.

The minor acceleration of the annual decline in prices in the last quarter is due to the price of energy and long-term component, amid reduced negative contribution of the food prices. **The annual rate of long-term component of inflation was reduced from 0.3% in the third quarter to -0.3% in the fourth quarter, which is the first reduction of these prices in a period of four years** (since the first quarter of 2010). The downward path of core inflation largely reflects the changes in prices of pharmaceutical products, whose annual growth slowed down significantly in the fourth quarter, which also affected their contribution to core inflation. Additional contribution was made by the prices of vehicles and air traffic that decreased annually, compared to the previous quarter.

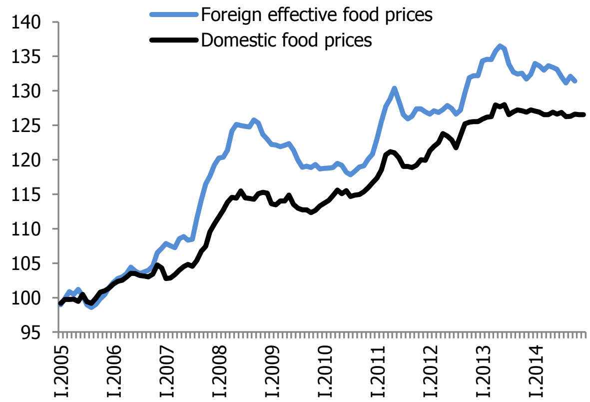
On a quarterly basis, consumer prices rose by 0.1% in the fourth quarter, **which reflects the movement of the food component of inflation, which in the last quarter of the year went up by 0.8% mainly reflecting the seasonal increase in the prices of unprocessed vegetables[29]**, partially offset by the fall of the prices of unprocessed fruits. Upward movements are registered in some other food products, which correspond to the increase in prices of some internationally traded primary food products, and to a certain extent, to the

[28]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.

[29]Heavy rains and generally bad weather in the second and third quarter this year, as well as the export of domestic agricultural products in Bulgaria and Greece increased the prices of vegetables.

Foreign effective food prices* and domestic food prices

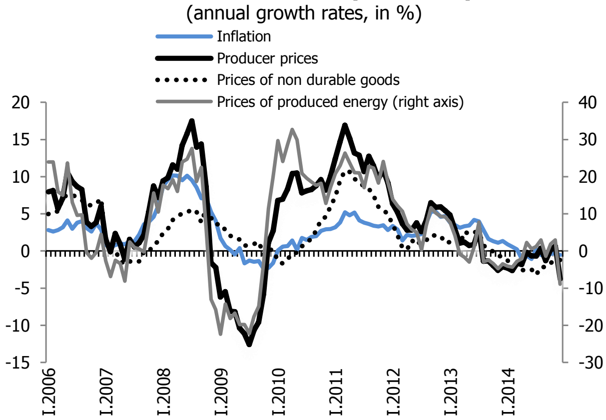
(indices, 2005 =100)



* Foreign effective food prices are calculated as weighted sum of food prices in countries that are major trade partners with Macedonia.
Source: State statistical office, Eurostat and NBRM calculations.

Inflation and industrial producer prices

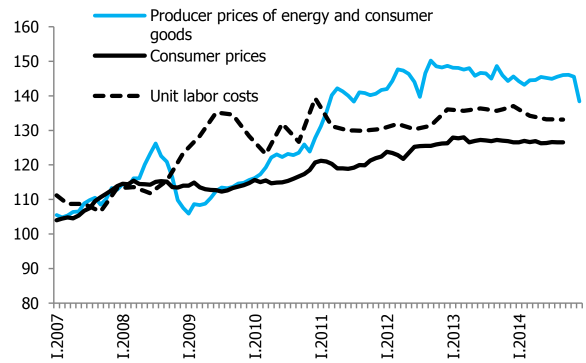
(annual growth rates, in %)



Source: State statistical office and NBRM calculations.

Factors affecting consumer prices

(indices, 2005=100)



Source: State statistical office and NBRM calculations.

movement of foreign effective food prices[30] that registered a significant slowdown in the fall. Small quarterly growth (of 0.1%) was registered in the long-term inflation, while the 2.1% lower prices of the energy[31] component largely offset the price increase of food and long-term inflation. **On the other hand, seasonally adjusted data indicate quarterly fall in consumer prices of 0.3%,** amid minor increase in the food component, and simultaneous drop in the prices of energy and long-term component of inflation.

In the fourth quarter of 2014, the change in producer prices in the domestic market remained in the negative zone for fifth consecutive quarter. Thus, the annual decline in producer prices equaled 1%, which compared to the previous quarter, is a moderate acceleration of the decline (0.5% in the previous quarter). The largest contribution to the annual decline was made by the lower producer prices of petroleum products and to a lesser extent, of food and clothing, with the higher prices of electricity, coal and lignite, and other non-metal mineral products acting in the opposite direction. **On a quarterly basis, producer prices also declined** (by 1.3%, while on a seasonally adjusted basis, they dropped by 1.1%), which mainly reflects the lower producer prices of petroleum products, with the increase in prices of electricity acting in opposite direction. **The movement of producer prices that affect domestic inflation component[32] indicates downward pressures.** The annual decline in these prices accelerated to 1.5% (despite the fall of 0.9% in the previous quarter), amid simultaneous quarterly fall of 1.4% versus the growth of 0.9% in the previous quarter (seasonally adjusted). Keeping these prices in the negative zone indicates lower inflationary pressures in the coming period.

Analyzing the movement of unit labor costs, their further decline, amid negative output gap[33], suggests absence of pressures on the prices of final products through this channel.

---

[30] Data on foreign effective food prices refer to the first two months of the quarter.
[31] The fall in the prices of the energy component is due to the lower prices of liquid fuels and lubricants, given the fall in the price of crude oil on world markets.
[32] Consumer goods (durable and non-durable) and energy.
[33] The NBRM's estimates show that domestic output is still below the potential level (negative output gap).

Box 1: Inflation Expectations Survey[34]

The 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 months[35]. Carlson and Parkin (1975) probability approach has been used for quantification of qualitative answers, which assumes that at a sufficiently large number of respondents, the expected change in prices is normally distributed among the population. The second question requires from the respondent to quantify precisely the expected average rate of change of prices in the next two years[36]. 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 December 2014[37]. **Given the further reduction in the inflation rate (as of November, the average inflation in the previous 12-month period equaled -0.1%[38], versus 0.3% in the previous 12-month period as of August 2014), the results from the December survey indicated lower inflation expectations compared with the previous quarter.** Thus, contrary to the September expectations for 0.3% inflation rate in the next 12-month period, in December, the respondents expected around 0% inflation in the next 12-month period. There are similar expectations with respect to different surveyed

[34] 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.

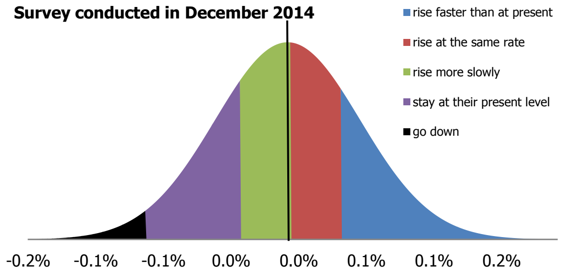
[35] The qualitative question of expectations reads as follows: "Compared with the past 12 months, how do you expect consumer prices to change in the next 12 months? a) will have a faster growth; b) will grow at the current pace; c) will grow at a slower pace; d) will remain almost unchanged; e) will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

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

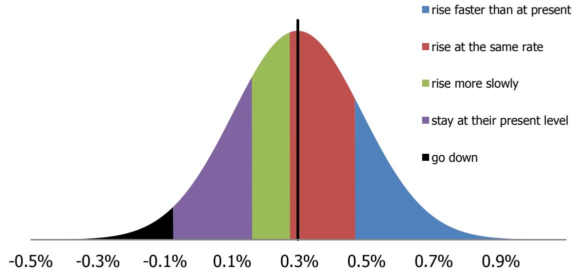
[37] Refers to the period December 2013 to November 2014. The percentage of responsiveness to the Survey conducted in December was 33.3%, which compared to the previous quarter, represents a decrease of responsiveness. Analyzed by groups of respondents, the financial institutions' responsiveness is 55.6%, followed by economic analysts with 41.2% and companies with 24.3%.

[38] 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.

Survey conducted in December 2014



Survey conducted in September 2014



groups (economic analysts, companies and financial institutions) who expect the rate of inflation in the next 12-month period to gravitate around 0%.

Lower inflation expectations can be confirmed through the answers of the quantitative question for the expected rate of inflation for 2015. Namely, in the period between the two surveys, the respondents' expectations for inflation for 2015 decreased by 0.5 percentage points, on average.

In December, respondents pointed to the movement of consumer prices in the domestic economy in the past period, as well as the reduction in the world price of crude oil, amid increased oil supply and low demand, as **factors that explain the lower inflation expectations**.

1.6. Balance of payments[39]

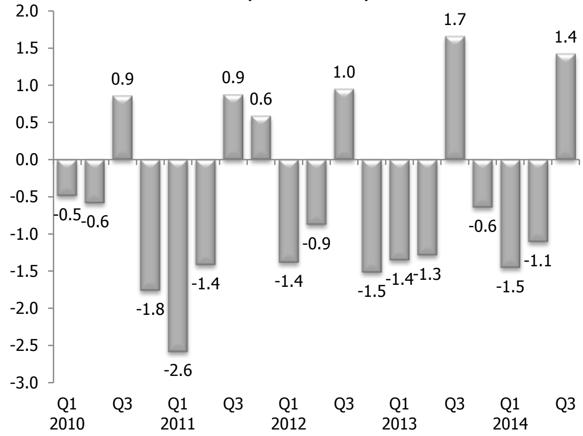
In the third quarter, the current and capital account of the balance of payments recorded a surplus. The improved performance in services and seasonally higher net inflows of private transfers significantly improved the balance of current and capital transactions on a quarterly basis. On an annual basis, the surplus moderately decreased given the decline in net inflows of secondary income and higher net outflows of primary income. The third quarter of the year was characterized by high net borrowing, i.e. inflows in the financial account. The growth of debt is due to the issuance of the third government Eurobond in the international financial markets, and the growth of net foreign direct investments. These developments have resulted in high accumulation of foreign reserves in the third quarter of the year.

1.6.1. Current account

In the third quarter of 2014, the current and capital account surplus totaled

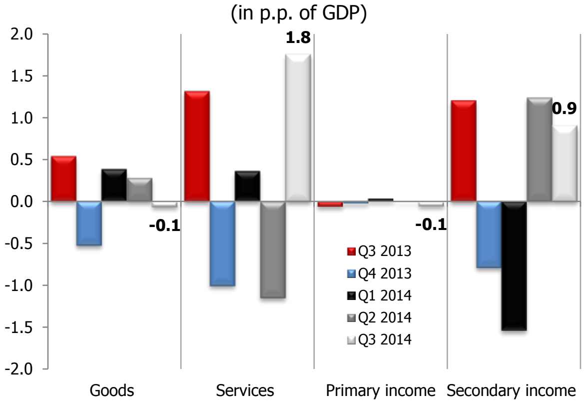
[39] Starting from the Quarterly Report, October 2014, the analysis of the movements in the balance of payments is based on data compiled under the Manual on the Balance of Payments and International Investment Position, sixth edition (IMF, 2009) (IMF, 1993). For more detailed information on the methodological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

Current and Capital account
(as % of GDP)



Source: NBRM.

Contribution of current account components in its quarterly change
(in p.p. of GDP)

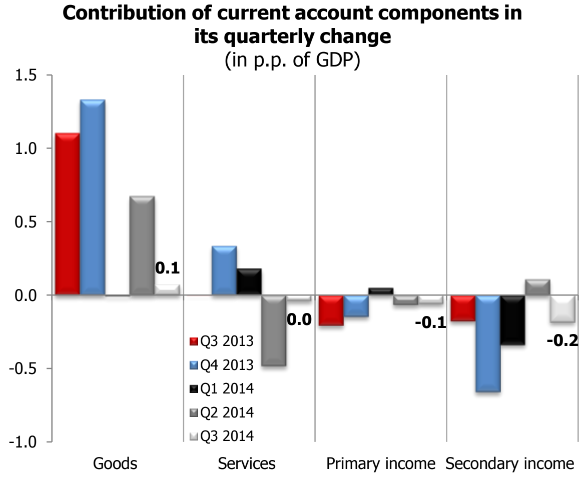


Source: NBRM.

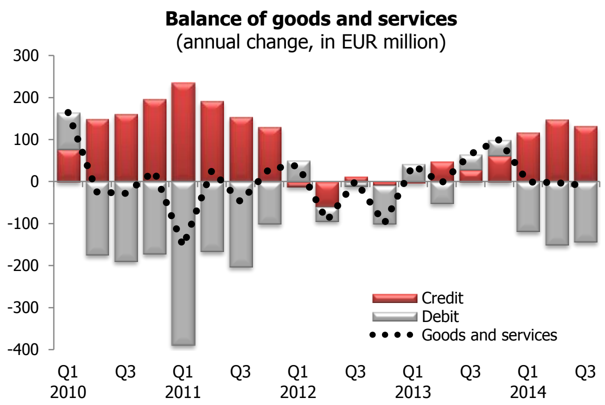
Euro 120.4 million or 1.4% of GDP[40]. The positive balance in the current and capital transactions is fully driven by the improved current account performances, i.e. the surplus of Euro 120.6 million. Compared with the previous quarter when it registered deficit of 1.1% of GDP, the current account significantly improved by 2.6 percentage points of GDP. ***The positive quarterly change is due to the higher trade surplus in services and higher net inflows of secondary income.*** Services performance substantially improved (1.8 percentage points of GDP) due to a mix of seasonal factors, such as the increased travel and transportation services, and specific factors surrounding construction services, where the improvements are due to the base effect from the previous quarter, i.e. the high import of services during the second quarter[41]. In addition, the usual seasonal increase in the foreign assets purchased in the currency exchange market, which is an approximation of private transfers in cash, led to higher net inflows of secondary income (0.9 percentage points of GDP), despite the decrease in net inflows in the government sector, due to lower cash inflows based on the EU Instrument for Pre-Accession Assistance (IPA). The other two components of the current account have not registered major changes compared to the previous quarter. Namely, the trade balance in goods slightly expanded on a quarterly basis, with moderate growth in both the export and the import components, while higher outflows in the primary income led to higher net outflows in the overall category.

Analyzed on annual basis, the current and capital account surplus recorded a slight narrowing of 0.2 percentage points of GDP, entirely caused by the lower positive balance in the current account of the balance of payments. The annual change is driven by the deterioration in the secondary and primary income, while the performance in the balance of goods and services, the lower share of net inflows in

[40] The calculations use the projected amount for the nominal GDP.
[41] The high outflow in construction services during the second quarter was due to the advances paid for construction works on highway construction projects. This transaction was simultaneously recorded in the financial account, as net incurrence of liabilities on the basis of loans earmarked for financing road infrastructure, in the same amount as in the services, so that the net effect on the balance of payments in the respective period is neutral.



Source: NBRM.



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

secondary income in GDP (0.2 percentage points) is due to the annual reduction of inflows in the government sector, without significant annual changes in other sectors of the economy[42]. The annual change in primary income (0.1 percentage points of GDP) driven by the lower inflows based on employee compensations deteriorated the current account. On the other hand, the trade balance in goods and services recorded a small positive annual change, driven by the slight narrowing of the trade deficit (by 0.1 percentage points of GDP), amid unchanged services balance compared to the third quarter of previous year. In terms of trade balance, high growth rates were observed in the export and the import component of foreign trade. The acceleration of the export growth is due to the higher non-energy exports, particularly pronounced among investment categories. Non-energy component is the prime generator of the annual growth on the import side, with especially high contribution of the import of row materials for the industry. **According to the latest balance of payments data, in October 2014, the current and capital account recorded a surplus of Euro 15.3 million,** which is not typical for this month of the year, when the current account usually registers deficit. As expected, the annual analysis indicates improved performance in the current and capital transactions, driven by the higher surplus in the balance of services and higher net inflows of secondary income. The change in the sub-balance of services was caused by the higher exports of construction services[43], while in the secondary income, both the government sector and other sectors reported an annual growth of net inflows.

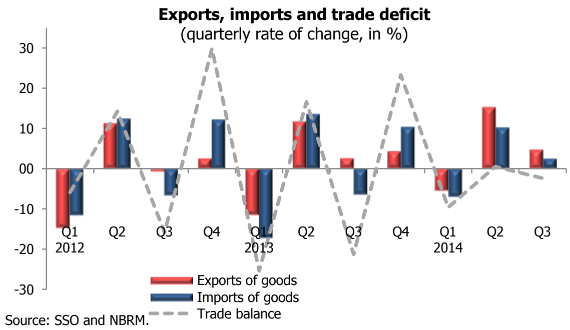
---

[42] Secondary income of other sectors of the economy includes 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.

[43] High export of construction services made during October 2014 was caused by the completed construction works related to highway constructions by domestic companies, on behalf of a foreign contractor.

Box 2: Foreign trade of goods and movement of the Nominal and the Real Effective Exchange Rate (NEER and REER)[44]

In the third quarter of 2014, the foreign trade of goods amounted to Euro 2,384 million (28.2% of GDP), which is an increase of 3.4% compared to the previous quarter.

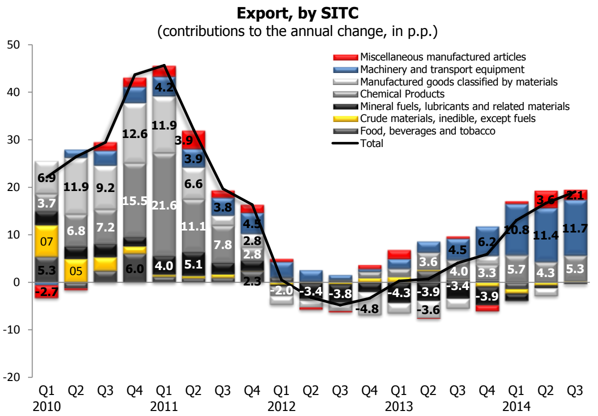


Source: SSO and NBRM.
** Negative change in the trade balance represents contraction of the deficit.*

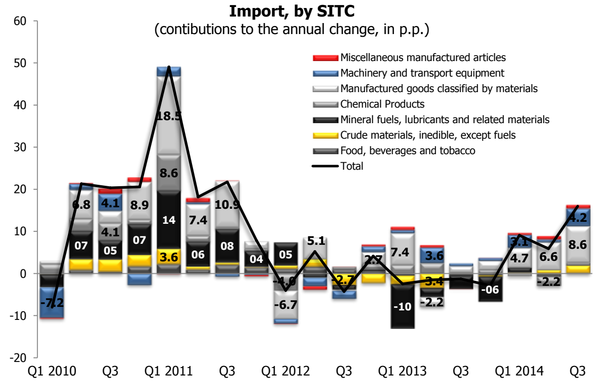
On a quarterly basis, growth was observed in the export and the import component. The 4.7% quarterly growth of export of goods reflects the growing export of machinery and equipment, metal products, and the impact of seasonal factors, through export of vegetables and fruits and clothing and footwear. Imports recorded a quarterly growth of 2.5%, mostly reflecting the import of iron and steel, energy, and higher import of raw materials for the new export facilities, versus the strong decline in imports of raw materials for the textile industry. In such conditions, **the foreign trade deficit in goods narrowed by 2.4% compared to the previous quarter. This narrowing is caused by the reduced non-energy deficit, while the negative energy balance further expanded.**

The annual analysis shows a significant enhancement of foreign trade in the third quarter (17.2%), driven by the rapid growth of its two components. **Exports continued to increase rapidly and reached an annual growth rate of 19.1%, the highest in the past three years.** Making dominant and growing contribution to the export growth, the export activity of the new foreign facilities remains a major generator of positive performances. The rise in export of clothing and food provided small impetus to the annual growth. On the other hand, after a period of greater downward pressure on the export growth, in this quarter, the energy imports have almost neutral impact. **Improved export performances affected the imports side, which increased significantly and registered an annual growth of 16%.** Increased import of goods in the third quarter confirms the high import dependence of the Macedonian export, amid increased investment activity and higher value added. Thus, imports of the new industrial facilities increased significantly, with the non-ferrous metals, machinery and transport equipment being categories that contributed the most to the annual growth. Imports also increased within the metal manufacturing industry, where for the first time after five consecutive quarters of negative growth rates, growth was recorded in imports of iron and steel annually, with the import of metal ore making additional contribution. Imports of energy marginally increased, influenced by the high annual growth of imported electricity, driven by the higher quantity of import of this fuel amid reduced domestic production. On the other hand, imports of oil derivatives made a small negative contribution, which largely reflects the second-round price effect of the dramatic decline in the world stock prices of oil. **Such trends of the foreign trade components expanded the trade deficit by 9.4% on an annual basis.** Observing the individual balances, the main driver of these changes is the deteriorated non-energy balance, with minimum expansion of the energy deficit.

[44] 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.

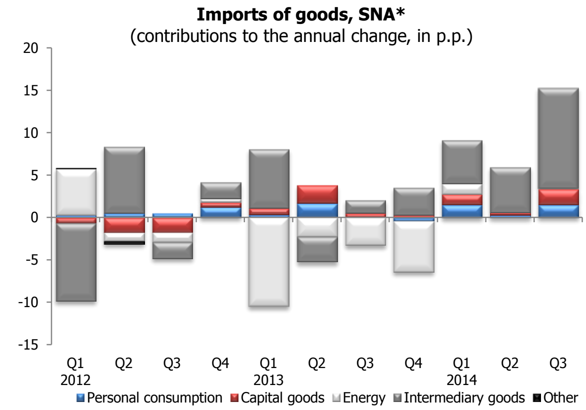


Source: SSO and NBRM.

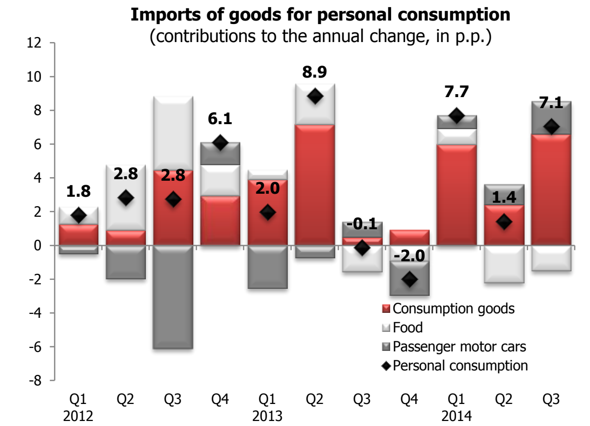


Source: SSO and NBRM.

The analysis of the import of goods under the System of National Accounts (SNA) indicates that in the third quarter, the intermediate products remain a category with dominant contribution to the annual growth of imports. Imports of capital goods and private consumption goods slightly increased, with an almost neutral effect of the energy imports. Analyzing individual components of the imports of private consumer goods, the increase is primarily due to the import of consumer goods, coupled with imports of passenger vehicles, amid negative contribution of the private consumption food. In general, the annual growth of imports for private consumption remains moderate, indicating the absence of significant pressures on private consumption through this channel.



* Classification: System of national accounts (SNA).
Source: NBRM.

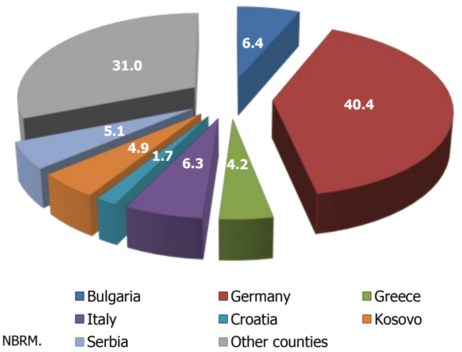


Source: NBRM.

The latest available data on foreign trade indicate continuation of trends in the trade components during October and November. Exports of goods increased by 19.1% compared to the same period last year, as a result of the higher export of the new industrial facilities, amid a decline in export of iron and steel. The import of goods registered an annual growth (of 10%), yet slower compared to the same period last year, mainly due to import of raw materials for the new facilities, with the lower import of energy and chemical products acting in the opposite direction.

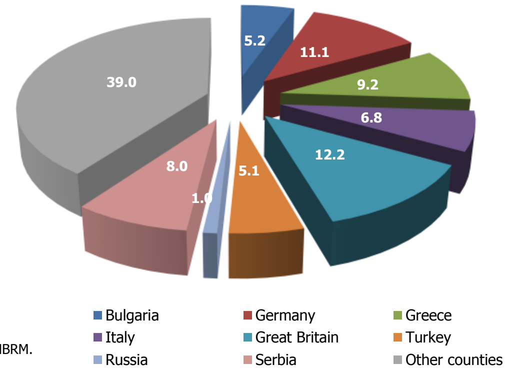
The foreign trade analysis by country shows that in the third quarter of 2014 the European Union was our major trading partner (making up 68.1% of total trade). Observed from the exports side, the exports to Germany, as a market to which the export activity of the new facilities is largely targeted, remain the main driver of the annual growth. Other EU countries that contribute to the export growth include Belgium, Italy and Greece, with additional positive momentum from the exports to Taiwan[45] and to the United States. The annual growth in imports primarily reflects the increased imports of platinum from the UK, coupled with higher imports from Romania and Germany[46]. The increase in imports also resulted from the annual growth of imports from Russia, Ukraine[47] and Turkey, amid a decline of energy imports from Greece. Analyzing balances, the annual expansion of the trade deficit is due to the deepening of negative balance in trade with the Western Balkans, given the expansion of the deficit with Serbia and the narrowing of the surplus with Kosovo, as well as the higher deficit with Ukraine and Russia . On the other hand, the trade deficit with the EU member states narrowed annually, under the influence of the high trade surplus with Germany[48] and the lower deficit with Greece, which was significantly offset through the deterioration of the trade balance with the United Kingdom and Romania[49].

Export of goods, by countries in the third quarter of 2014 (share, in %)



Source: NBRM.

Import of goods, by countries in the third quarter of 2014 (share, in %)

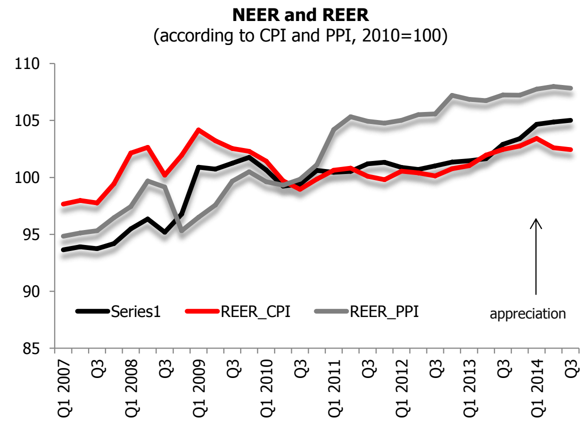


Source: NBRM.

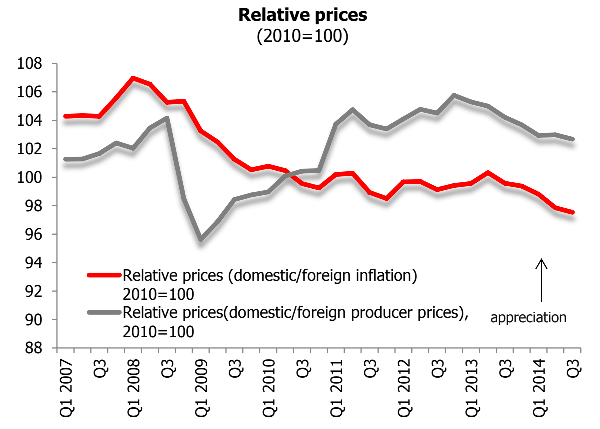
The movement of price competitiveness indicators in the third quarter indicates a slight improvement of the competitiveness of the national economy, compared with the previous quarter. The REER deflated by consumer prices depreciated by 0.2%, while the REER deflated by producer prices depreciated by 0.1% on a quarterly basis. These positive performances indicate favorable price ratio, i.e. quarterly decline in relative prices (0.3%) according to both price indices. The movement of Denar nominal effective exchange rate acted in the opposite direction, registering a quarterly growth of 0.2%, due to the depreciation of the Serbian dinar and the Ukrainian hryvnia, amid appreciation of the British pound and the US dollar. The latest data on price competitiveness indicators in the period from October to November, suggest deterioration compared to the third quarter. REER deflated by producer prices appreciated (by 1.1%), due to the appreciation of NEER (of 0.7%) and the concurrent increase in relative prices (0.4%). REER deflated by consumer

[45] The share of Taiwan's exports in total exports is very low (1.7% in the third quarter), but the exports to this economy made a significant contribution to the export growth in this quarter, due to the intensified export activity of the metal manufacturing industry.
[46] The changes are due to the increased imports of iron and steel, oil derivatives and machinery and equipment from Romania, coupled with the higher imports from Germany by the new foreign facilities.
[47] The annual growth in the imports from Russia is due to the import of inorganic chemical products, coupled with the higher import of iron and steel from Ukraine.
[48] The Macedonian economy registered the highest surplus in the trade with Germany, which is continuously increasing for two years on an annual basis.
[49]Annual expansion of the negative trade balance with Great Britain, and deficit with Romania, despite the small surplus registered the same period last year.

prices moderately appreciated (by 0.4%), with the lesser intensity of change being due to slower growth in domestic prices relative to foreign prices.

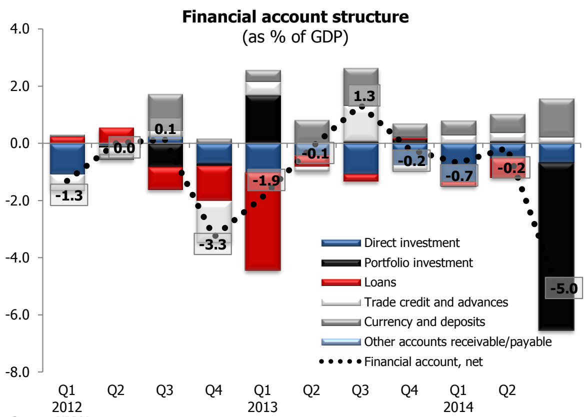


Source:NBRM.



Source:NBRM.

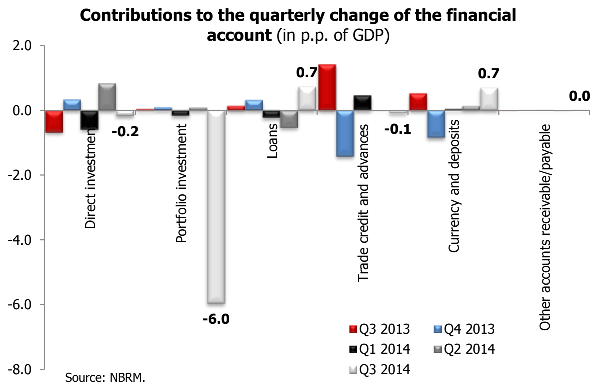
1.6.2. Financial account

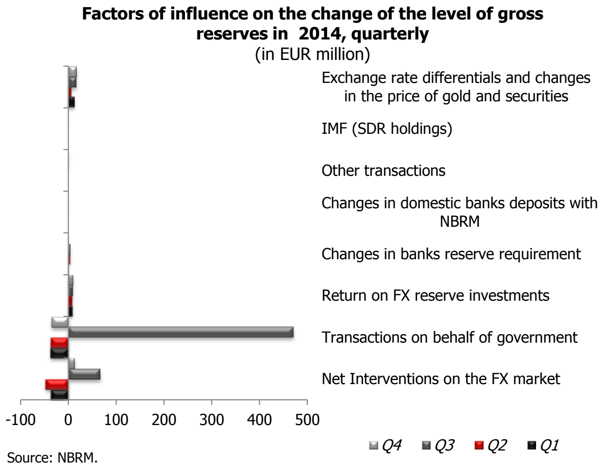


Source: NBRM.

The third quarter of the year was marked by high inflows in the financial account from net external liabilities worth Euro 419.7 million, or 5 percentage points of GDP. *The portfolio investments and foreign direct investments are major sources of these flows, with significantly higher share of the portfolio investments as a result of the issuance of the third Eurobond by the government*[50]*.* The net effect of FDIs in the financial account is again due to the debt component of direct investments, i.e. FDIs in the form of loans from parent companies, with significantly smaller contribution of equity. On the other hand, in the third quarter, high dividend payments reduced reinvested earnings. Dividends paid in the first three quarters of 2014, reached a record high, collectively. On the other hand, the other components registered a rise in net lending, mainly driven by the increase in net assets in the category of currency and deposits, primarily in other sectors and in depository institutions. *Significant quarterly change was caused by higher portfolio investments as a result of the government borrowing in the international financial markets, with additional positive contribution from the positive performance of foreign direct investments.* The increase in FDIs largely reflects the growth of

[50] In July, the government issued the third Eurobond in the international financial markets in the amount of Euro 500 million.





net liabilities in the form of debt, or increased funding of foreign-owned companies through borrowing from their parent entities. The change in financial loans i.e. the net lending acted conversely to the changes in these categories, as opposed to the net borrowing during the second quarter, which was a change largely caused by differences in short-term loans[51]. Net long-term loans register no major changes. However, the sector-by-sector analysis indicates moderate incurrence of net liabilities of depository corporations and government[52], amid significant reduction of debt of other sectors compared to the previous quarter[53]. A quarterly increase in net assets was also recorded in currency and deposits, driven by the increase in foreign assets of depository institutions.

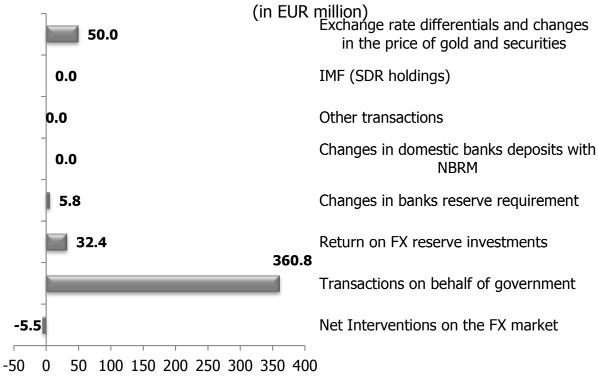
The annual analysis of financial account indicates significant net borrowing of 6.3 percentage points of GDP, compared to the third quarter of last year, when it registered net lending to the rest of the world. The annual change was predominantly driven by the performance in portfolio investments, with additional contribution of trade loans and advances, where the net lending abroad was significantly lower compared with the same period last year. On the other hand, foreign direct investments declined on an annual basis as a result of lower non-debit component[54]. The annual changes in loans acted in the same direction, registering net lending abroad, versus the net debt in the same period last year, which was a change caused by changes in both short-term and long-term financial loans. The category of currency and deposits registered no major changes on an annual basis. **The financial account of the balance of payments in October recorded net lending abroad of Euro 19.4 million.** Performances in the financial component are largely driven by the further

[51] During the second quarter, one domestic bank made short-term borrowing from the parent bank. The loan was earmarked for overcoming liquidity problems associated with the payment of dividend of a major foreign-owned company.
[52] In July 2014, the government borrowed from the World Bank by withdrawing funds from the Second Programmatic Competitiveness Development Policy Loan (Official Gazette of the Republic of Macedonia No. 28 of 6 February 2014) in the amount of Euro 36.4 million.
[53] During the second quarter of the year, other sectors borrowed higher amounts in order to finance long-term infrastructure projects of public interest.
[54] The negative change is predominantly caused by reinvested earnings, whose decline reflects significantly higher dividend payments in the third quarter of the year.

growth of net assets in currencies and deposits with other sectors and the reduction of net liabilities in loans. Despite the performance of these categories, in October, the net liabilities were incurred on the basis of trade loans and advances.

As of 30 September 2014, the gross foreign reserves were valued at Euro 2,435 million, which is a quarterly increase of Euro 562 million. The principal factor for the positive change are transactions on behalf of the government, mostly as a result of foreign currency inflows from the Euro-bond coupled with the net purchase of foreign currency in the foreign exchange market by the NBRM. *According to the latest available data, at the end of 2014, the foreign reserves amounted to Euro 2,436 million*, which is by Euro 443.5 million more compared to the end of 2013. The growth of foreign reserves is mostly due to the net inflows of funds from transactions on behalf of the government, with additional positive contribution of exchange rate differentials and changes in the price of gold and returns from foreign reserves. On the other hand, in this period, the net sales by the NBRM in the foreign exchange market acted toward reducing the foreign reserves.

Factors of influence on the change of the level of gross reserves in 2014
(in EUR million)



Source: NBRM.

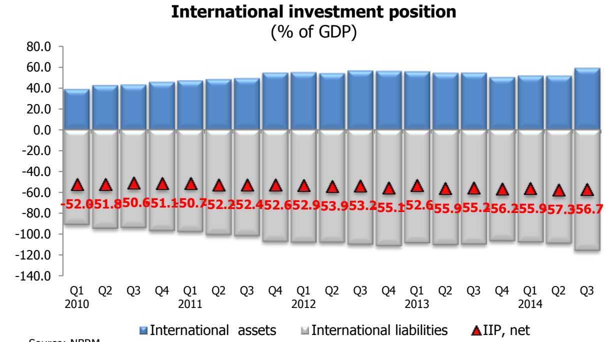
1.6.3. International investment position[55] *and gross external debt*

At the end of the third quarter of 2014, **the negative international investment position of the Republic of Macedonia amounted to Euro 4,794 million or 56.7% of GDP**[56]**.** *Compared to the previous quarter, net liabilities to the rest of the world decreased by*

---

[55] 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_za_promenite_vo_platniot_bilans_megunarodnata_investiciska_pozicija_i_nadvoresniot_dolg_koisto_proizleguvaat_od_primenata_na_novite_megunarodni_statisticki_standardi.pdf).

[56] The calculations use the projected amount for the nominal GDP.



Source: NBRM.

Euro 51.5 million, or 0.6 percentage points of GDP. The narrowing of the negative investment position[57] of the country is due to the **faster growth of international assets** (14.4%) **compared to the growth of international liabilities** (6.3%). *In terms of structure, a positive feature* of the international investment position of the Republic of Macedonia is the dominance of liabilities based on foreign direct investments. *Analyzed by sector, the quarterly decrease in negative net liabilities is due to the growth of net assets of the central bank and the somewhat smaller contribution from the reduction of net liabilities of depository corporations.* The high growth in foreign reserves in the third quarter is a pivotal factor for the growth of net assets of the central bank, while the higher assets of deposit corporations compared to the second quarter narrowed the negative international investment position in this sector of the economy. On the other hand, the net debt position of the government deteriorated on a quarterly basis, mainly due to the increase in liabilities based on portfolio investments[58], and as a result of higher long-term loan liabilities[59]. Increasing negative IIP of other sectors continued in the third quarter, again driven by the growth of net liabilities on direct investments.

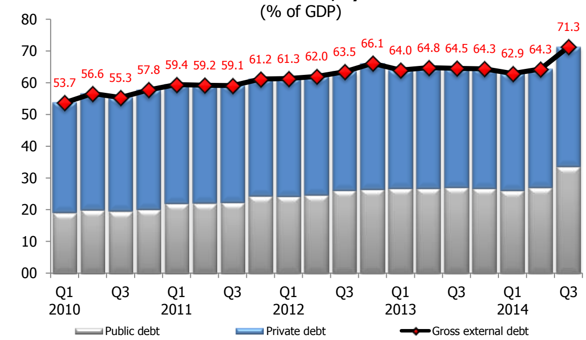
	Q3 2013	Q2 2014	Q3 2014	*quarterly change*			*annual change*		
		in EUR million		*difference*	*contribution*	*in %*	*difference*	*contribution*	*in %*
IIP, net	**-4,479.1**	**-4,845.5**	**-4,794.0**	**51.5**	**-1.1**	**-1.1**	**-314.8**	**7.0**	**7.0**
Government, net	-1,582.4	-1,556.3	-2,095.1	-538.8	11.1	34.6	-512.7	11.4	32.4
Central bank, net	1,991.5	1,799.1	2,360.3	561.2	-11.6	31.2	368.8	-8.2	18.5
Deposit-taking corporations, net	-561.8	-602.0	-524.0	78.0	-1.6	-13.0	37.9	-0.8	-6.7
Other sectors, net	-4,326.4	-4,486.4	-4,535.2	-48.8	1.0	1.1	-208.8	4.7	4.8

[57] 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.

[58] In July 2014, the government issued the third Eurobond in the international financial markets in the amount of Euro 500 million, which resulted in an increase in the government liabilities on investment portfolio, but also caused a high accumulation of foreign reserves..

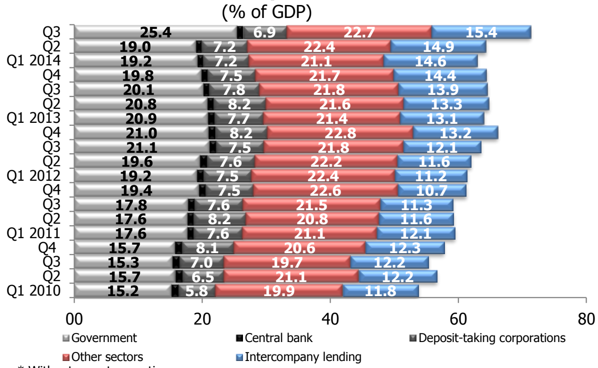
[59] In July 2014, the government borrowed from the World Bank by withdrawing funds from the Second Programmatic Competitiveness Development Policy Loan.

Gross external debt, by debtors
(% of GDP)



* Without repo-transactions.
Source: NBRM.

Gross external debt, by institutional sectors
(% of GDP)



* Without repo-transactions.
Source: NBRM.

The annual increase of net debt position of the economy continued in the third quarter of 2014, given the simultaneous increase of both international liabilities (of 10%) and international assets (of 13%). Compared to the same period last year, **the negative IIP increased by Euro 314.8 million, or by 1.4 percentage points of GDP.** *The sector-by-sector analysis indicates that the expansion of the negative IIP gap is due to the higher net liabilities of the government and other sectors.* The change in the government was solely caused by the growth of liabilities on debt portfolio investments, while the higher net liabilities of other sectors are due to the increase in liabilities to foreign direct investors and long-term loan liabilities, amid annual increase in assets in the form of trade credits and advances. On the other hand, the change in the central bank and the depository corporations corresponded to the quarterly shifts. Accordingly, net assets of the central bank registered significant annual growth due to the higher foreign reserves, while depository corporations reduced their net liabilities by lowering long-term financial loan liabilities, and currency and deposits.

At the end of the third quarter of 2014, gross external debt amounted to Euro 6,334.8 million[60]. Excluding repo transactions of the central bank, the gross external debt totals Euro 6,029.9 million, or 71.3% of GDP[61].

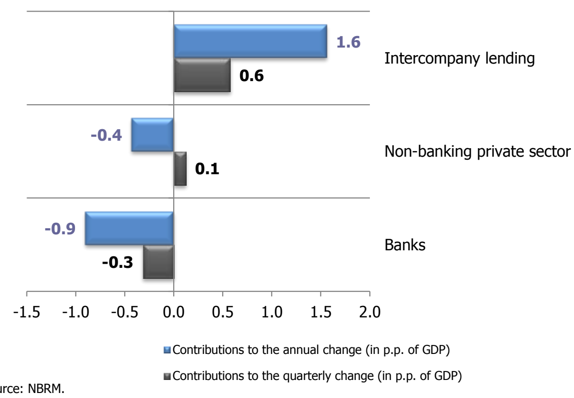
Compared to the previous quarter, the gross external debt of the country increased by Euro 589.9 million, or 7 percentage points of GDP, as a result of the higher external debt of the public sector and to a lesser extent, of the private sector. Quarterly growth of public debt mostly stems from the intensive 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 on long-term financial loans registered with the central government and the public companies. However, it is important to note that the more dynamic growth of public debt is a result of the government external borrowing. Namely, given the favorable conditions in the financial markets, the government borrowed in order to finance repayments of debt that falls due next year. The

[60] Or 74.9% of GDP.

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

moderate increase in private debt is due to the increased liabilities to foreign direct investors, with simultaneous decline in the liabilities of the banking sector on the basis of short-term loans.

Changes in private sector debt



Source: NBRM.

The gross external debt increased strongly on an annual basis, as well. Compared with the third quarter of 2013, the debt rose by Euro 796.5 million. Analyzing its share in GDP, the gross external debt increased by 6.8 percentage points of GDP due to the increased private debt (by 6.5 percentage points of GDP) coupled with a moderate increase in the public debt (of 0.2 percentage points of GDP) annually. Main factors of the annual change in the public debt include higher external debt of the central government in the form of long-term debt securities, as well as the growing debt of public companies through long-term financial loans. The external debt of the private sector increased annually, mainly due to the higher liabilities to foreign direct investors, amid reduction of the banks' liabilities, caused by reduced long-term financial loan liabilities and short-term liabilities on currency and deposits.

The analysis of the dynamics of external debt[62] indicates annual deterioration in all solvency indicators in the third quarter. Notwithstanding such developments, the external indebtedness indicators of the domestic economy generally 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. On the other hand, liquidity indicators suggest a favorable external position, with significant annual

[62] 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.

improvement in all indicators and full coverage of liabilities based on short-term debt with residual maturity with the foreign reserves. The net external debt, as an additional indicator of the dynamics of the external indebtedness of the economy in the third quarter of 2014 amounted to Euro 1,772 million or 20.9% of GDP. Compared to the previous quarter, this indicator shows a more favorable debt position, due to the reduction of the net external debt by 0.3 percentage points of GDP.

Indicators for external indebtness	***Solvency***				***Liquidity***		
	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
31.03.2011	3.12	144.2	62.8	16.8	1.64	1.14	25.9
30.06.2011	3.12	143.6	62.6	16.8	1.59	1.09	25.8
30.09.2011	3.12	143.4	62.5	16.8	1.64	1.09	25.3
31.12.2011	3.12	148.4	64.6	16.8	1.78	1.18	25.2
31.03.2012	2.92	131.6	62.7	13.1	1.70	1.02	26.1
30.06.2012	2.92	133.1	63.4	13.1	1.63	1.01	26.4
30.09.2012	2.92	136.3	64.9	13.1	1.72	1.06	25.3
31.12.2012	2.92	141.9	67.6	13.1	1.64	1.03	26.7
31.03.2013	2.51	136.8	67.0	15.8	1.68	1.20	25.6
30.06.2013	2.51	138.5	67.8	15.8	1.48	1.05	26.2
30.09.2013	2.51	138.0	67.6	15.8	1.66	1.15	23.8
31.12.2013	2.51	137.6	67.4	15.8	1.64	1.08	23.3
31.03.2014	3.40	134.4	66.1	19.2	1.41	0.95	25.8
30.06.2014	3.40	137.3	67.6	19.2	1.34	0.90	25.8
30.09.2014	3.40	152.2	74.9	19.2	1.75	1.17	23.0
Moderate indebtedness criterion	*12 - 20%*	*165 - 275%*	*30 - 50%*	*18 - 30%*		*1.00*	

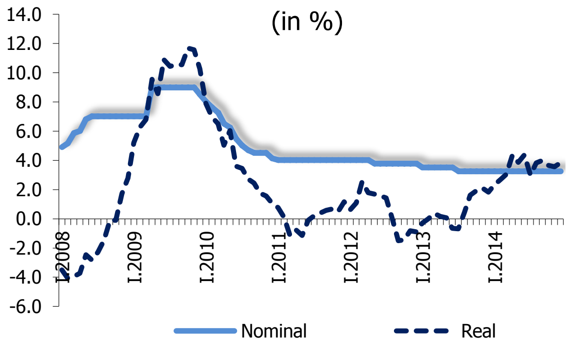
*The moderate indebtness criterion is accordng to the World bank's methodology of calculationg indebtness indicators, which implies 3-year moving averages of GDP and exports of goods and services in the calculation of the indicators.
In compliance with "External debt statistics: Guide for compilers and users," published by the IMF.
*According to the "Greenspan-Guidotti rule", a country should maintain full coverage of short-term debt at remaining maturity with gross foreign reserves.
Source: NBRM.

II. Monetary policy

During the fourth quarter of 2014, the NBRM preserved the policy rate at 3.25%. This decision was based on the latest macroeconomic projections of October and the recent performances of the key macroeconomic and financial indicators. The analyzes showed that the economy continues to recover at a solid

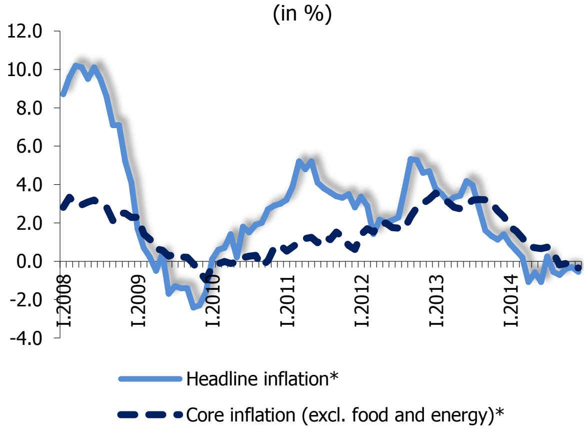
pace, in part supported by domestic bank lending, amid further maintenance of an adequate level of foreign reserves and absence of inflationary pressures. Considering these developments, it was assessed yet again that there is a suitable environment for sustainable recovery of the private sector even without additional monetary stimulus. In the period ahead, the NBRM will be mainly focused on monitoring the achievement of the projected path of foreign reserves and foreign exchange market developments and will adjust the monetary policy accordingly. Same as before, risks to the macroeconomic scenario from the external environment remain unfavorable and have been additionally highlighted by the deteriorated outlook for the economic growth in the euro area and by the persistent geopolitical tensions. The last ECB's measure taken in January 2015, which means a significant quantitative easing through the purchase of government and private securities, mitigates the adverse risks to the growth of the European economy. However, it takes time to perceive the extent to which this policy will transmit to the real sector of the economy of the euro area. In such environment, the NBRM will continue to monitor closely the situation for the purposes of timely and appropriate adjustment of monetary policy.

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



Source: NBRM.

Inflation
(in %)



*Current month/same month of the previous year.
Source: SSO

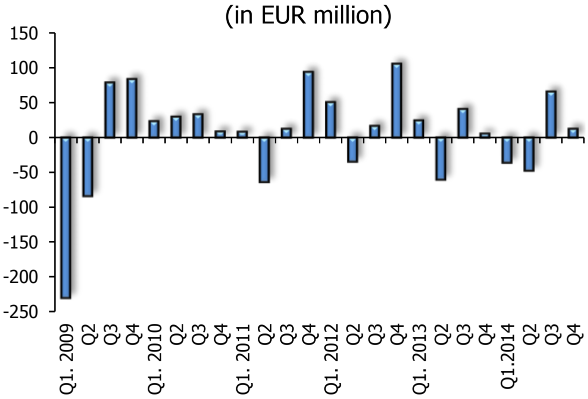
Based on the regular assessment of recent macroeconomic and financial developments, at the meetings held during the fourth quarter[63] of 2014, the NBRM's Operational Monetary Policy Committee decided to preserve the CB bill interest rate at the level of 3.25%. The NBRM's October projections showed no significant changes in the findings about the environment for conducting monetary policy and risks compared to the previous assessments. Thus, the new projection predicts solid economic and credit growth in the absence of price pressures and balance of payments position that provides growth and further maintenance of foreign reserves at the adequate level. The macroeconomic scenario remains accompanied by risks, which are still mainly exogenous and are associated with the potential changes in the pace of recovery of the global economic growth, as well as with the movements in the prices of primary products in world markets. In this period, there have been some changes that indicate certain deterioration of the global environment. This primarily refers to the euro area, which in the third quarter showed slower than expected economic growth. The ECB does not perceive such slower performances as temporary, and therefore, in the most recent December projections it made a significant

[63]During the quarter, the NBRM's Operational Monetary Policy Committee held three sessions on 14 October 2014, 11 November 2014, and 9 December 2014, when it reassessed the monetary policy setup.

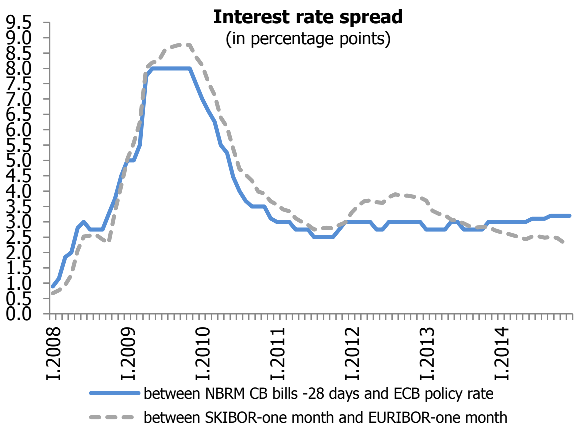
downward adjustment of the forecasts for the economic growth in the period 2014-2016. These developments further pronounce the risks from the external environment for the period ahead. The latest performances in key macroeconomic indicators in the fourth quarter generally do not deviate much from the projected dynamics. In the fourth quarter, the NBRM purchased net foreign currency (of Euro 12.4 million for the entire quarter), with a relatively high purchase of foreign currency being made in December. Thus, changes in foreign reserves in the fourth quarter slightly improved compared to the October projections, with adequacy ratios remaining in the safe area. The inflation continued to decline moderately during the fourth quarter, averaging -0.4% on an annual basis. The fall of annual inflation reflects lower prices of food and energy, while the core inflation made a negative contribution. Namely, starting from September, changes in core inflation aim towards its annual reduction, which comes after a longer period of continuous maintenance of the core inflation in the area of positive growth. However, the reduction is moderate, and in the fourth quarter, the core inflation reduced by 0.3% on average, on an annual basis. Inflationary performances follow the October projection. The economic activity continued accelerating in the third quarter, but at slightly slower pace, as projected in October. Banks continued to support the private sector through further growth in lending. The dynamics of bank lending as of the fourth quarter exceeds the October projection, indicating more stable expectations and knock-on effects of the past monetary easing on credit activity. Most of the loans in the last quarter were made to the corporate sector, with further growth of loans to households. In such conditions, **it was assessed that in the economy conditions have been created for a sustained recovery of the private sector, i.e. there is no need for additional monetary stimulus. Hence, it was assessed yet again that the support of the monetary policy measures for the domestic economy is sufficient. Leaving the zone of accommodative monetary policy in the period ahead will depend on the changes in the external position of the economy and the effects on foreign reserves.**

Following the cut in interest rates in September, in the fourth quarter, the ECB kept the policy rate unchanged. In this period, the ECB launched the programs of outright purchase of asset-backed securities, and purchase of secured bonds issued by

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

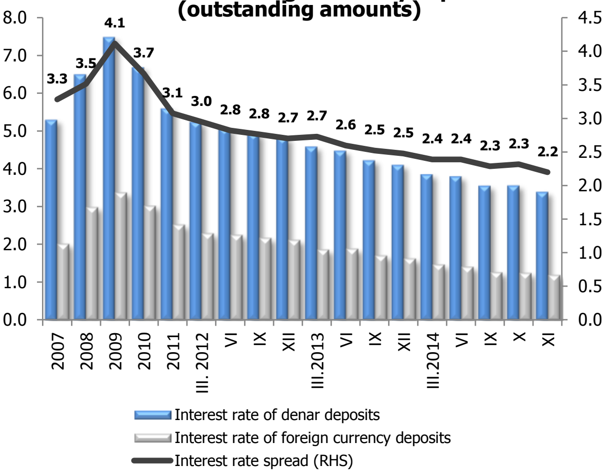


Source:NBRM

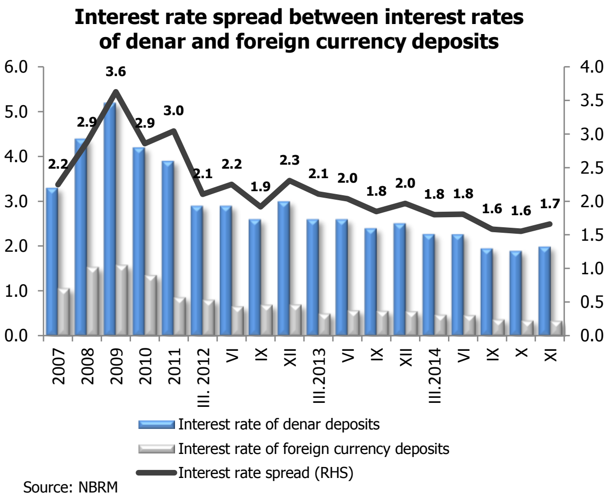


Source: NBRM, ECB (www.ecb.int) and De Nederlandsche Bank (www.statistics.dnb.nl).

Interest rate spread between interest rates of denar and foreign currency deposits (outstanding amounts)



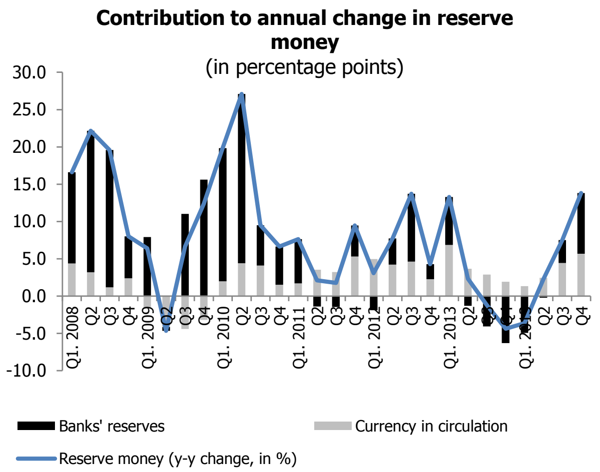
Source: NBRM



Source: NBRM

financial institutions in the euro area denominated in euros, which are to be operational in the next two years. These non-standard monetary measures are taken in environment of low inflation, low inflation expectations and risk of deflation, weak economic growth and decelerated monetary and credit dynamics in the euro area. With these programs, complemented with targeted long-term refinancing operations to support lending to the private sector (in effect since September), the ECB aims to improve the transmission mechanism of the monetary policy and to encourage lending, thus ensuring further easing of monetary conditions in the euro area. During the last quarter of 2014, the ECB and the NBRM policy rates remained at the level of September, whereby the interest rate spread between the interest rate on CB bills and the ECB policy rate registered no changes, remaining at 3.2 percentage points. Short-term interest rates in the domestic and the European financial market registered a moderate decline, which was more intense in SKIBOR[64]. These developments moderately narrowed the interest rate difference between the one-month SKIBOR and one-month EURIBOR to 2.2 percentage points in December, versus 2.5 percentage points in September.

2.1 Banks' liquidity and Interbank Money Market developments



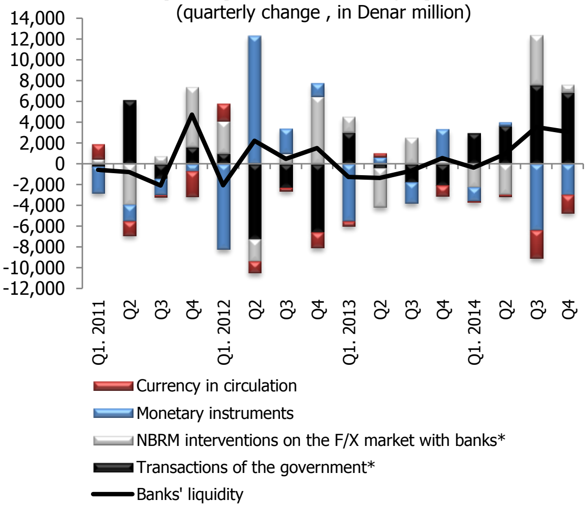
Source: NBRM

During the fourth quarter of 2014, bank liquidity increased by Denar 3,061 million, compared to the end of the third quarter. Thus, in December, the balances of banks' accounts with the NBRM[65] stood at Denar 19,908 million. In December, reserve money[66] increased by 13.8% annually, compared to September 2014, when they registered an annual growth of 7.5%.

During the fourth quarter of 2014, the autonomous factors contributed to creation of net liquidity of Denar 6,043 million. Among them, government transactions made the largest contribution to the increasing

[64] Interbank interest rate calculated on the basis of quotations for selling unsecured Denar deposits of reference banks
[65] Refers to Denar accounts of banks required to allocate reserve requirement.
[66] Includes reserve requirement in foreign currency.

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



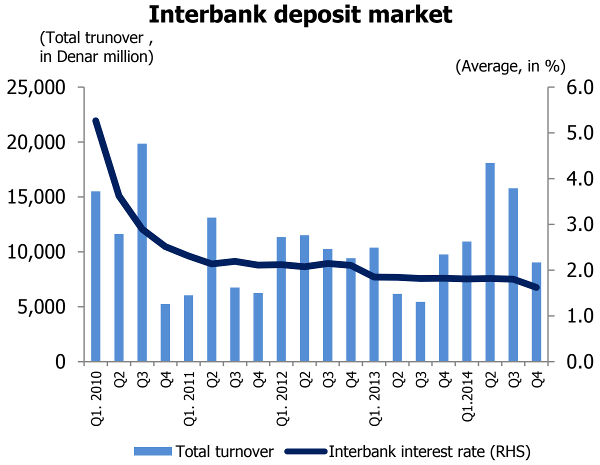
*Positive change- liquidity creation, negative change- liquidity withdrawal .
Source: NBRM

liquidity of Denar 6,865 million. According to the NBRM's net purchase of foreign currency in the foreign exchange market, the NBRM's foreign currency transactions with market makers also acted towards creating liquidity in the amount of 758 million. On the other hand, currency in circulation acted towards withdrawing liquidity (of Denar 1,726 million).

In the fourth quarter, the NBRM's monetary instruments contributed to withdrawal of net liquidity of Denar 2,983 million. Given the further stable level of CB bills, the change in the total monetary instruments in this period arises solely from changes in the NBRM's deposit facility. In the fourth quarter, three CB bill auctions were held with volume tender and fixed interest rate of 3.25%, where the NBRM determined the supply of CB bills at the level of the due amount. Thus, CB bills had a neutral effect on the level of liquidity in the banking system. At the auctions held in the fourth quarter, the demand was higher than the offered amount of CB bills. The demand was also higher with respect to the potential, with certain banks being required to allocate funds in seven-day deposit facility with the NBRM[67]. Under these conditions and amid active use of this instrument for short-term liquidity management by banks, the seven-day deposit facility increased by Denar 2,963 million on a quarterly basis. The overnight deposit facility rose insignificantly by Denar 20 million compared to the previous quarter. As a result, in the fourth quarter, net liquidity was withdrawn from the banking sector through the deposit facility in the total amount of Denar 2,983 million. In October, the NBRM decided to cut interest rates on overnight and seven-day deposit facility, from 0.75% to 0.50% and from 1.25% to 1%[68], respectively. During the fourth quarter of 2014, banks allocated excess liquid assets over the reserve requirement of 0.6% on average (which is

[67]The banks' obligation to allocate funds in seven-day deposit facility of the NBRM stems from the Methodology for determining the potential demand for CB bills, which the NBRM adopted in November 2013. For the method of determining the potential demand for CB bills see the Decision on CB bills, (Official Gazette of the Republic of Macedonia No. 166/13).
[68]Except for the seven-day deposit facility the banks are obliged to allocate in case the CB bill auctions require amount higher than the potential[68], at 0% interest rate (see Decision on CB bills, Official Gazette of the Republic of Macedonia No. 166 / 13 and Decision on deposit facility, Official Gazette of the Republic of Macedonia No. 49/12, 18/13, 50/13 and 166/13).

Interbank deposit market



Source: NBRM

at the level of the average of the previous quarter).

In the fourth quarter of 2014, the interbank deposit market (unsecured segment) reported a total turnover of Denar 9,032 million, which is by 42.8% less compared to the third quarter of 2014. In the third quarter of 2014, compared to the fourth quarter last year, the activity at the interbank money market decreased by 7.5%. Analyzed by maturity segments, in the fourth quarter, intraday transactions had a dominant share in the total turnover in the interbank money market, making up 90% of the total transactions, followed by transactions of up to seven days, with share of 10%. The interbank interest rate on overnight transactions (MKDONIA) averaged 1.62% in the fourth quarter (1.80% on average in the third quarter). The interbank interest rate (MBKS) averaged 1.61%, in the fourth quarter (1.86% on average, in the previous quarter)[69]. In the fourth quarter of 2014, transactions executed on **the secondary money market** (transactions in government bonds, repo transactions and transactions in treasury bills) totaled Denar 2,628 million, which is by 2.5 times more compared to the previous quarter. Moreover, in the last quarter, the secondary money market registered repo transactions, transactions in government bonds and transactions in treasury bills (constituting 42.4%, 42.4% and 15.2%, respectively, in the total amount traded) unlike the previous quarter when repo transactions dominated (with a share of 99.8%), with only a marginal contribution of the transactions in treasury bills.

2.2. Monetary and credit aggregates

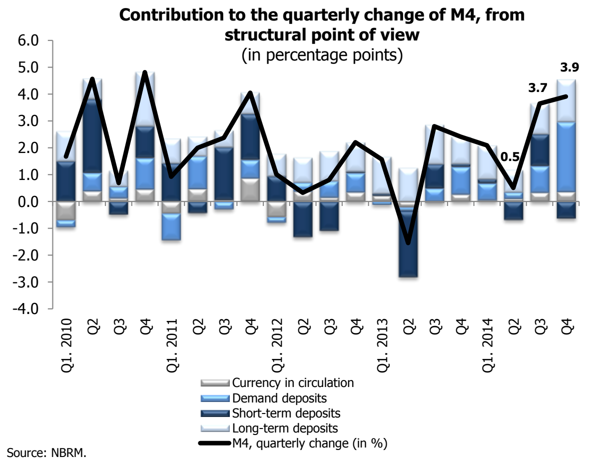
In the last quarter of 2014, the broad money M4 registered a moderate acceleration of the quarterly growth rate. The further expansion of money supply is the result of fundamental and seasonal factors as perceived through the analysis of the structure of the quarterly growth. Thus, most of the recorded flows are due to the increase of liquid assets (currency in circulation and demand deposits), reflecting the increased demand for liquid assets on the eve of the New Year and Christmas holidays. A significant positive contribution was also made by long-term deposits, amid reduction in short-term deposits. Observed by sector, there is a further solid growth of household and corporate deposits.

[69] The cut of interest rates in the interbank deposit market corresponds with the cut of interest rates on deposit facility by the NBRM in October.

These developments were further supported by the intensive financial support of the domestic banks to the private sector. Against the backdrop of continuous recovery of the real sector, the fourth quarter of 2014 witnessed significant acceleration in the overall lending activity, especially to the corporate sector. Annually, at the end of December, total loans increased by 10% (9.4% in September).

2.2.1. Monetary aggregates

In the last quarter of 2014, the broad money M4 further expanded, at moderately accelerated pace compared to the previous quarter. Thus, the quarterly growth rate of this monetary aggregate equaled 3.9% at the end of December (3.7% in September). Such money supply developments are due to seasonal and fundamental factors, given the accelerating economic growth since the beginning of the year. **Analyzing the structure**, the quarterly growth is largely due to the faster increase in the most liquid assets (currency in circulation and demand deposits) which account for 76% of the quarterly growth (36% in the previous quarter). Such developments are explained by the usual seasonal increase in the demand for liquid assets at the end of the year on the eve of the New Year and Christmas holidays. Long-term deposits register further positive contribution to the overall growth, while short-term deposits tend to reduce money supply (despite their positive contribution in the third quarter). Analyzing the currency structure, the quarterly growth is solely due to the intense increase of the Denar deposits (with demand deposits)[70] amid reduction of the foreign currency deposits. Given the further denarization of deposit base, at the end of December, the share of foreign currency deposits in M4 moderately decreased to 37.3% from 39.1% in September. **On an annual basis,** the broad money registered accelerated growth rate, reaching 10.5% at the end of 2014 (8.9% in the previous quarter).



Source: NBRM.

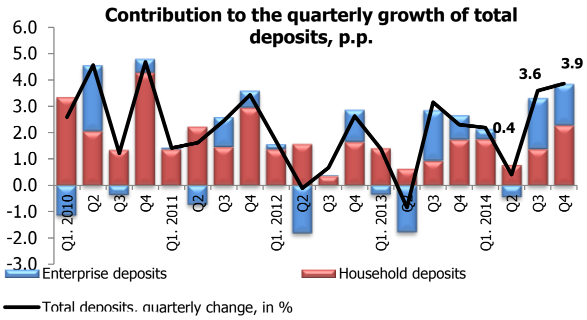
Total deposits

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

Source: NBRM.

The growth of deposit potential of domestic banks continued during the last quarter of 2014 at moderately accelerated pace compared to the previous quarter. Thus, at the end of December, the quarterly

[70] The aggregate and sector-by-sector analysis of total deposits refers to total deposits, including demand deposit. Denar deposits are also analyzed with included demand deposits.

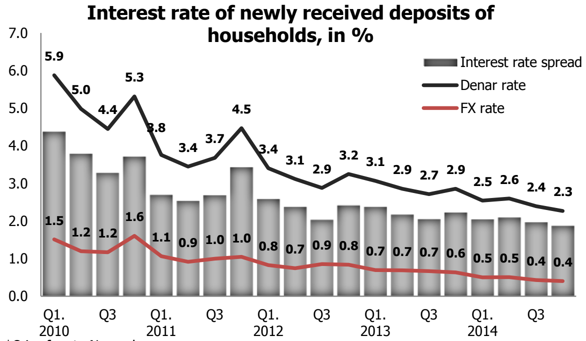


Source: NBRM.

Household deposits

	2013 Q1	Q2	Q3	Q4	2014 Q1	Q2	Q3	Q4
quarterly change, in %								
Total household deposits	2.0	0.9	1.3	2.4	2.4	1.1	1.9	3.2
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
Denar deposits	1.2	0.8	0.8	1.1	1.2	0.7	0.9	1.1
FX deposits	0.8	-0.1	0.6	0.3	0.7	0.2	0.9	0.2
Short-term deposits	0.2	-0.4	-0.2	-0.2	0.2	-0.2	0.2	-0.2
Long-term deposits	1.8	1.1	1.6	1.6	1.7	1.1	1.5	1.4

Source: NBRM.



*Q4 refers to November.
Source: NBRM.

Enterprise deposits

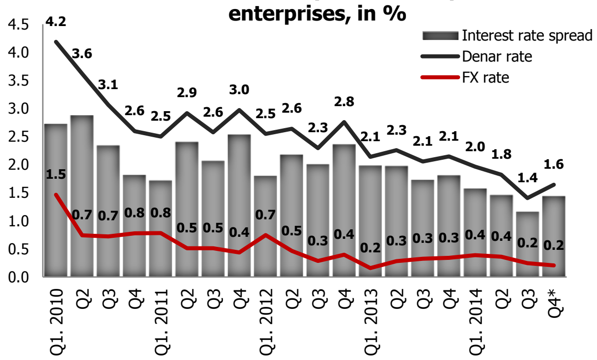
	2013 Q1	Q2	Q3	Q4	2014 Q1	Q2	Q3	Q4
quarterly change, in %								
Total household deposits	-1.5	-7.8	9.1	4.1	1.7	-2.0	8.8	6.8
contribution to quarterly change of total deposits, in p.p.								
Deposit money	-1.4	1.3	2.9	1.9	1.1	0.2	3.3	7.6
Denar deposits	0.1	-1.3	2.6	1.6	0.2	-1.8	2.8	1.3
FX deposits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

Source: NBRM.

growth rate of total deposits equaled 3.9% (3.6% in September). Structural sector-by-sector analysis shows a larger contribution of household deposits to the total growth, followed by the corporate deposits (share of 59% and 41% respectively, of the total growth). **In the fourth quarter, the growth rate of total household deposits accelerated by 3.2% quarterly, against the 1.9% increase in the third quarter.** Higher performance in this period may in part be attributable to the favorable labor market developments and the rise of nominal wages, in part driven by the nominal increases of wages of the public sector employees in October. The further growth of household deposits was also supported by payment of bonuses and other wage benefits typical for the end of the year. Structurally analyzed, the quarterly growth largely results from the increase in demand deposits (accounting for 59% of the growth), with the long-term deposits acting in this direction (with a share of 46%). Contrary to the performance in the third quarter when short-term deposits constituted about 10% of the quarterly growth rate, in the fourth quarter they dropped on a quarterly basis. Observing by currency, the quarterly growth of household deposits is predominantly driven by increased Denar deposits, making up about 95% of the growth. Foreign currency deposits registered a minor quarterly growth unlike the previous quarter, when given the seasonally higher inflows of private transfers, the household foreign currency deposits significantly increased. The analysis of interest rates on newly received deposits in the period October-November indicates generally stable developments in the yields on the newly received Denar and foreign currency savings of the households. Amid minimal decline in the interest rate on newly received Denar deposits and unchanged interest rate on foreign currency savings, the interest rate spread between them slightly narrowed. **On an annual basis,** total household deposits rose by 8.9% in December (8.0% in September).

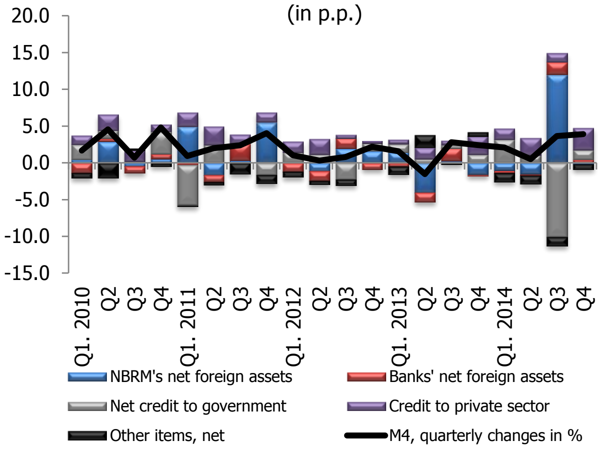
After the intense growth in the previous quarter, the quarterly growth rate of total corporate deposits moderately slowed down from 8.8% in September to 6.8% at the end of December. However, this period witnessed relatively high flows of corporate deposits that, except for the solid performance of the real economy, are also supported by the more intense credit support from the banking system to this segment of the economy. According to the analysis of the structure of corporate deposits, the

Interest rate of newly received deposits of enterprises, in %



*Q4 refers to November. Source: NBRM.

Quarterly growth of M4 and contributions to growth, from balance sheet point of view



Source: NBRM.

quarterly growth is due to the increase in demand deposits and long-term deposits while short-term deposits acted towards reducing the total corporate deposits (unlike the positive contribution in the previous quarter). Observing by currency, the total quarterly increase is solely due to the growth of Denar deposits, amid reduction in foreign currency deposits (unlike the positive contribution in the previous quarter). Analyzing the interest rates, in the period October-November, yields on the newly received Denar deposits increased (by 0.2 percentage points), compared to the decrease in the previous quarter (of 0.4 percentage points). The interest rate on newly received foreign currency deposits stabilized compared to September, with the interest rate spread between the yields on the newly received Denar and foreign currency corporate deposits slightly expanded. **On an annual basis,** in the last quarter, total corporate deposits registered an accelerated growth rate of 15.7%, versus 12.9% in September.

Analyzing the structure of the money supply with respect to the balance sheet, loans to private sector have made the greatest positive contribution to the quarterly monetary growth, followed by the net government loans. On the other hand, the NBRM net foreign currency assets made a small contribution to the reduction of the money supply, contrary to its intense growth recorded in the previous quarter[71].

2.2.2. Lending activity

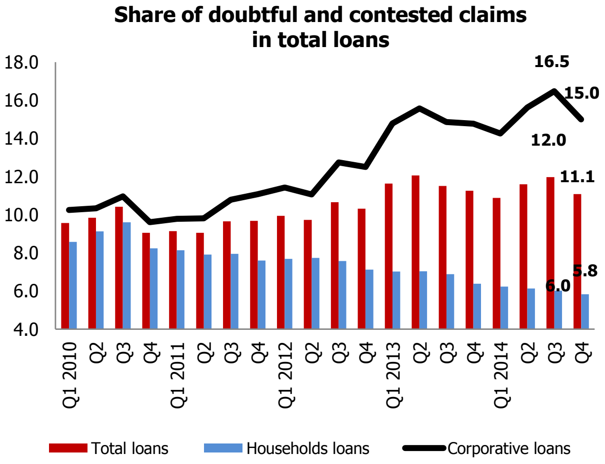
In the last quarter of 2014, the credit support of domestic banks to the private sector significantly accelerated, and the quarterly growth rate equaled 3.6% at the end of December (1.4% in the previous quarter). Such acceleration of the quarterly growth pace of total credits in part arises from the low base effect, taking into account that in the third quarter there was poorer credit performance compared with the previous three quarters. Yet, excluding this effect, in the last three months of 2014, there were high credit flows that represent the most intense quarterly support for the real

Total credits of private sector

	2013				2014			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	
quarterly change, in %								
Total credits of private sector	0.7	1.9	0.6	3.0	1.8	2.9	1.4	3.6
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
Foreign currency credits	0.3	0.3	-0.8	0.1	0.2	0.1	0.1	0.5
Short-term credits	-0.1	0.6	-0.4	0.7	0.7	0.4	0.0	1.7
Long-term credits	-0.6	0.6	1.6	2.3	1.2	1.3	0.9	2.4
Households	0.4	1.4	1.0	1.2	0.9	1.6	1.2	1.0
Corporations	0.3	0.5	-0.4	1.9	0.9	1.2	0.2	2.6

Source: NBRM.

[71] High growth in the NBRM net foreign assets in the third quarter is explained by the inflows of the Eurobond issued by the government in July.

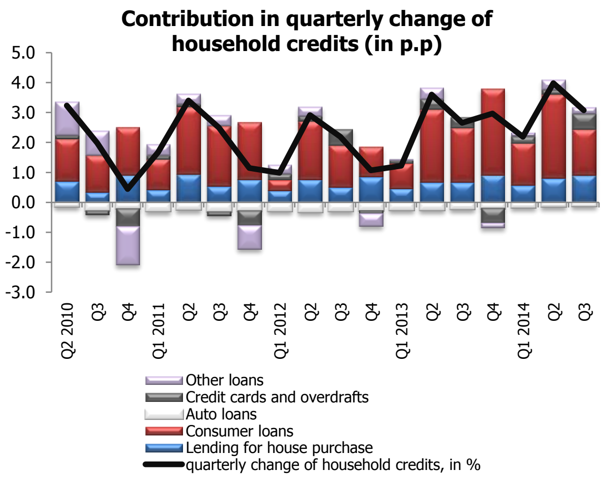


Source: NBRM.

Total credits of households

	2013				2014			
	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
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
Foreign currency credits	-0.1	-0.1	-0.1	0.0	0.0	0.1	0.0	0.1
Short-term credits	0.1	0.4	0.3	-0.6	0.2	0.3	0.4	-0.4
Long-term credits	0.9	2.7	2.1	3.8	1.8	3.5	2.5	2.8

Source: NBRM.



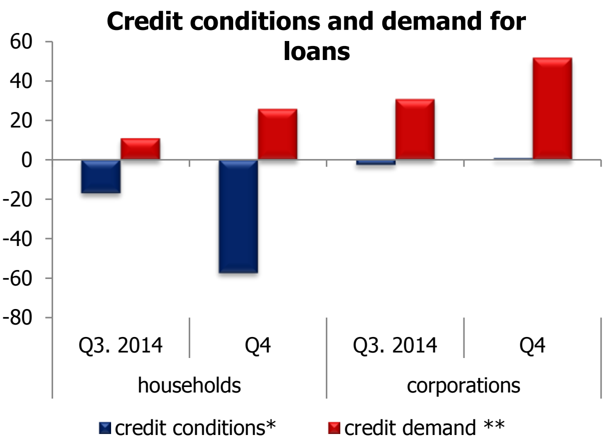
*Total loans to households do not include loans to self-employed individuals
Source: NBRM.

economy since the onset of the crisis. The sector-by-sector analysis shows that there is an adequate support for the two most important segments of the domestic economy, particularly the corporate sector. Thus, despite the weaker performance in the previous quarter, in the last quarter, corporate loans accounted for 72% of the total quarterly growth. On an annual basis, corporate loans make up half of the growth of the total loans (about 36% in 2013), which in part reflects the continuation of economic growth from the beginning of the year. Additionally, these results may suggest increasing appetite of banks to take risks given the improved risk perception in this segment. These findings are corroborated through the dynamics of non-performing loans. Thus, in the fourth quarter, the doubtful and contested claims significantly decreased, and the share of non-performing loans in total loans reduced to 11.1% at the end of December. Such performances in total doubtful and contested claims are dominantly driven by the reduction in non-performing loans to the corporate sector.

The analysis of maturity structure of the quarterly growth of total loans indicate a greater contribution of long-term loans (accounting for 68% of the total growth), with a positive contribution of short-term loans (compared to the decrease in the previous quarter). According to the currency structure, the total quarterly increase in loans is still mainly due to the growth of Denar loans, amid moderate growth of foreign currency loans. The higher propensity of private sector to borrow in local currency corresponds with the intensive denarization of the deposit base in the last quarter of 2014, and this tendency is evident on an annual basis as well. Given the greater performance of total deposits compared to the growth of total loans, there is a slight decrease in the utilization of the deposit potential for lending to the private sector, for the second consecutive quarter. Thus, at the end of December, the loan/deposit ratio equaled 89.3% (89.6% at the end of September). **On an annual basis,** lending activity has registered an accelerated growth rate, reaching 10% at the end of the year (9.4% in the previous quarter).

Banks' lending to the household sector recorded a moderate slowdown in the fourth quarter of 2014 compared with the performance in the previous quarter, when at the end of December, the quarterly growth rate reduced to 2.4% (2.9% at the end of September). Thus, after two quarters of greater focus on the household sector, in the fourth quarter, only about 28% of total banks' loans were granted to this sector. Analyzing individual types of loans, the quarterly increase is still a result of the growth in consumer and housing loans that constituted 71% and 41% of the total growth, respectively, while car loans continued to decline. Retention of favorable performances in this sector, according to the latest Lending Survey[72], is a combined effect of the positive trends in the supply and the demand for loans. Thus, the last quarter registered significant easing of the conditions for lending for all types of loans to households, with a moderate increase in their demand. According to the analysis of the maturity structure, the total quarterly growth of loans to households is completely attributable to the growth of long-term loans, with a reduction in the short-term loans (despite the positive contribution in the previous quarter). Observing the currency structure, the quarterly growth is mainly due to the increased Denar credits, with a small positive contribution of foreign currency loans. There was a moderate **annual** slowdown in the growth rate of loans to households, and at the end of December, the total loans to households increased by 11.8% (12.3% in September).

After the slowdown in the third quarter, in the last three months of 2014, the quarterly growth rate of corporate loans significantly accelerated from 0.3% in the third quarter to 4.5% in the fourth quarter. Credit flows in this period represent the most intense support of banks to this sector since the onset of the crisis, which may suggest a gradual strengthening of the confidence of the banking system in the creditworthiness of companies and their risk profile. Thus, 72% and 50% of the quarterly and annual growth, respectively, are due to the increase in corporate loans. In addition to solid performance of the domestic economy and recovery of the private sector, such movements could in part be explained by the appropriate environment created by the monetary policy measures, including the non-standard measure to encourage lending to net exporters and producers of electricity. Thus, in the October - November period, the banks granted new Denar 247 million,



*negative net-percentage - easing of credit standards;
*positive net-percentage - tightening of credit standards;
**negative net-percentage - decrease in credit demand;
**positive net-percentage - increase in credit demand

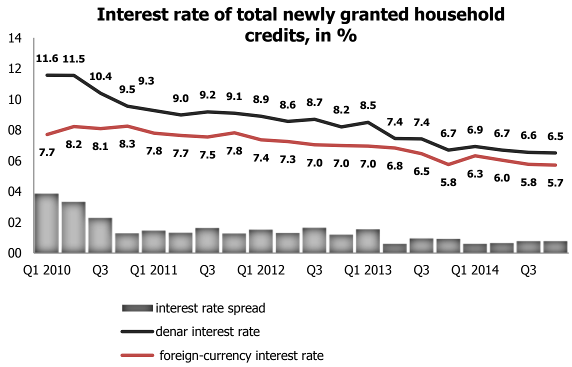
Source: Bank lending survey, NBRM.

Total credits of corporations

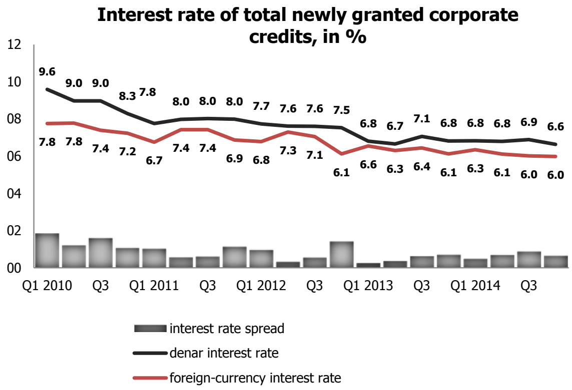
	2013				2014			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	
quarterly change, in %								
Total credits of corporations	0.5	0.9	-0.7	3.2	1.5	2.0	0.3	4.5
Contribution in quarterly change of corporation credits (in p.p)								
Denar credits	-0.1	0.2	0.5	3.0	1.2	1.9	0.1	3.7
Foreign currency credits	0.5	0.7	-1.2	0.2	0.3	0.2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

Source: NBRM.

[72] For more detailed information see the Lending Survey at http://nbrm.mk/?ItemID=F7AC78DEE498764FBAF39049F726CE3C.



*Q4 refers to the end of November
Source: NBRM.



*Q4 refers to the end of November
Source: NBRM.

thus exceeding the cumulative support provided under this measure in the third quarter (Denar 212 million for the July – September period). Also, there is a more intense use of funds from the credit line of EIB 4 (in a total amount of Euro 20.9 million) compared with the disbursements in the previous quarter (Euro 10.9 million). Approximately 80% of these funds are investment loans to support SMEs. According to the latest Lending Survey, the favorable trends in corporate lending are mostly explained by the positive movements on the demand side, which shows significant intensification of the demand for all types of loans. On the supply side, most of the banks consider the lending conditions unchanged compared to the previous survey, with expectations for their significant easing in the next three months. The analysis of maturity structure of the quarterly growth in corporate loans indicates positive contribution of short-term and long-term corporate loans. However, most of the growth is still due to the increase in short-term loans, which also accounts for the annual growth in 2014. In terms of currency structure, the cumulative growth in corporate loans is predominantly determined by the growth of Denar loans (accounting for 82% of total quarterly growth), followed by the foreign currency loans. **On an annual basis,** corporate loans rose by 8.6% in December (7.2% in September).

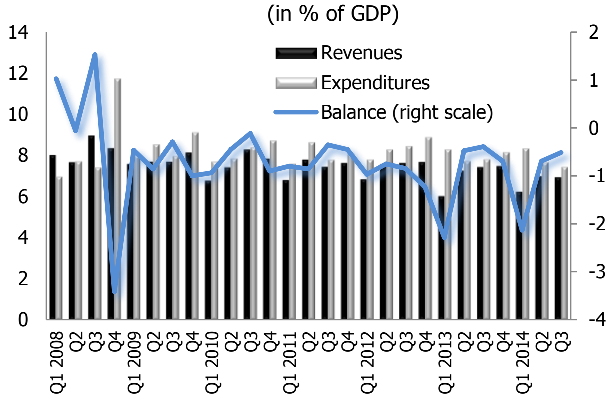
The cost analysis of newly granted and total household and corporate loans indicates generally stable movements in their interest rates in the period October-November. Thus, compared to September, there is a minor easing of the terms of lending to households (both newly granted and total loans). Analyzing corporate loans, there is a decrease in the interest rate on the newly granted Denar loans (of 0.3 percentage points) and unchanged interest rates on foreign currency loans. Interest rates on total corporate loans remain stable.

III. Public finances

During the third quarter of 2014, the Budget of the Republic of Macedonia (central budget and budgets of funds) registered lower generation of total revenues on an annual basis, accompanied by moderately weaker execution of budget expenditures. The weaker performances of total revenues can primarily

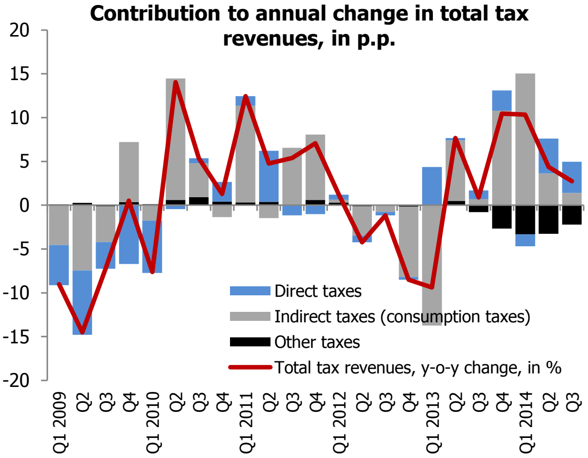
be explained by the base effects[73] in non-tax revenues. Tax revenues continued to grow in the third quarter, while the period October-November brought significant intensification of their growth. The growth of tax revenues in the period October-November was driven by indirect taxes, primarily due to the growing generation of revenue based on VAT, unlike the previous two quarters when direct taxes made greater contribution to the growth. Along with the growth in income, the period October-November registered an increased execution of budget expenditures, given the growth in the current and capital expenditures. Under these circumstances, in the third quarter and the period October-November, the state budget continued to register budget deficit, and since the beginning of the year through November, 97.6% of the projected budget deficit for 2014 was realized, in accordance with the Budget Revision for 2014.

Budget revenues and expenditure
(in % of GDP)



Source: NBRM's calcilations.

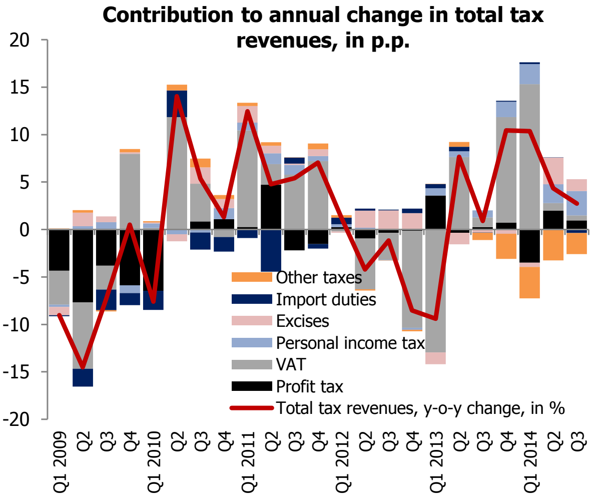
Contribution to annual change in total tax revenues, in p.p.



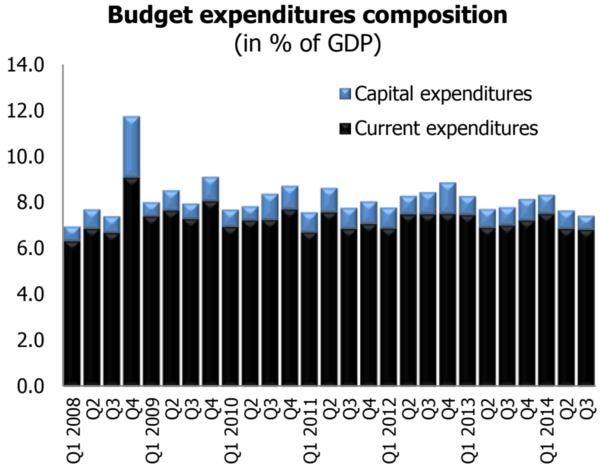
Source: Ministry of Finance.

Total revenues in the Budget of the Republic of Macedonia[74] in the third quarter of 2014 made up 6.9% of GDP[75], which is a weaker performance compared to the same quarter of the previous year (7.4% of GDP). Observed through the relative changes, total revenues in the third quarter went down by 2.6% on an annual basis. These changes in total revenues are primarily driven by the intense reduction of non-tax revenues (40.9% annually), largely reflecting the high base effect from the same period last year which registered inflows of concessions for offering services of the fourth generation of mobile telephony (4G). Tax revenues continued to grow during the third quarter, but at a slower pace compared to the previous quarter (2.7% versus 4.4% annual growth in the previous quarter). The growth of total tax revenues in the third quarter was largely driven by higher execution of direct taxes, given the increase in personal income tax and corporate tax. Moreover, the performance of the personal income tax further improved and accelerated annually, which made it the tax rate with the greatest single contribution to the growth of total revenues in the third quarter. Such trends in personal income tax correspond with the favorable labor market, where the beginning of the year registered continuous employment growth on an annual basis, followed by growth of nominal gross wages. Total indirect taxes in the third quarter were also increasing, but at a slower pace compared to the previous

[73]In July 2013, there were increased non-tax inflows based on concessions for rendering 4G services. Such movements were typical for 2014, thus causing base effects in the dynamics of non-tax revenues.
[74] Central budget and budgets of funds.
[75] The analysis uses GDP as projected by the NBRM.



Source: Ministry of Finance.



Source: NBRM's calculations.

quarter. Among them, VAT revenues and excise tax slowed down, while import duties declined on an annual basis. Total social contributions continued to grow at a moderately slower pace compared to the previous quarter (3.6% versus 4.4% in the second quarter), amid increased collection in all subcategories.

In the third quarter of the year, total budget expenditures equaled 7.4% of GDP, which is somewhat lower performance of budget expenditures compared to the same period last year (7.8% of GDP). In nominal terms, budget expenditures decreased by 0.6% annually, compared with the growth of 3.5% in the previous quarter. Analyzing by expenditure category, the decline in total expenditures in the third quarter is solely due to the reduced performance of **capital expenditures** (by 20.4% on an annual basis). These developments have reduced the share of capital expenditures in GDP (to 0.6%) and in total expenditures (to 8.1%) compared to the same period last year. On the other hand, **current expenses** continued to grow during the third quarter, but at a slower pace compared to the previous quarter (annual growth of 1.6% in the third quarter versus 3.5% in the second quarter). The growth of current expenses was mainly driven by the category of goods and services, which in the third quarter rose by 8.3% on an annual basis, compared to the decline of 1.7% in the previous quarter. In the third quarter, other categories of current expenses (wages and compensations, transfers and interest payments) reported slower growth rates, meaning a lower contribution of each of these categories to the growth of current expenses compared with the previous quarter.

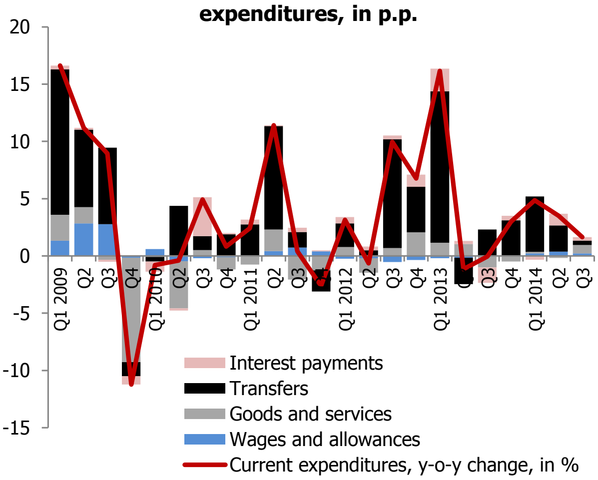
The third quarter of 2014 registered a budget deficit of Denar 2,696 million, or 0.5% of GDP[76] (0.7% of GDP in the second quarter). In terms of funding, in this period there were high inflows of external borrowing in the net amounted of Denar 30,954 million. Most of the borrowing was made in July when the third Eurobond was issued[77] in the international capital

---

[76]Using GDP as projected by the Ministry of Finance, in the third quarter and in the second quarter, the budget deficit equaled 0.5% and 0.7% of GDP, respectively.

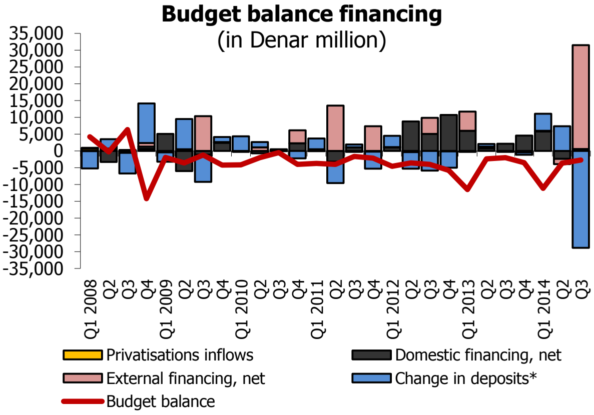
[77]The value of the Eurobond issued is Euro 500 million, with maturity of 7 years and rate of return of 4.25%, i.e. an interest rate of 3.975% per year.

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



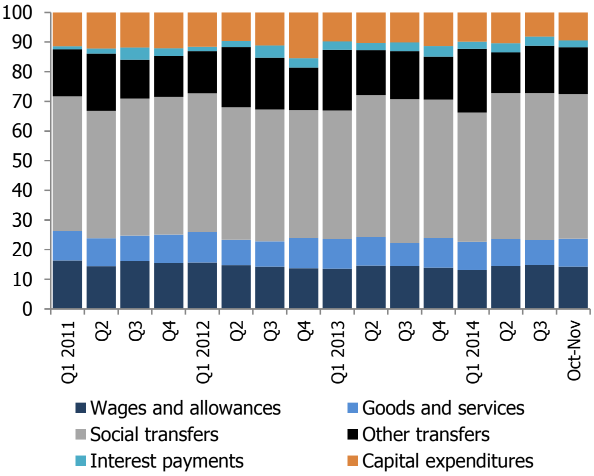
Source: Ministry of Finance.

Budget balance financing
(in Denar million)



* Positive change- deposits withdrawal; negative change-deposits accumulation.
Source: Ministry of finance of the Republic of Macedonia.

Share in total expenditures, in %

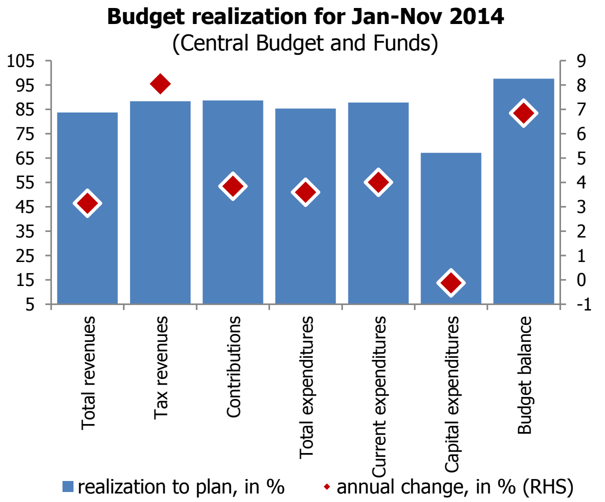


Source: Ministry of Finance.

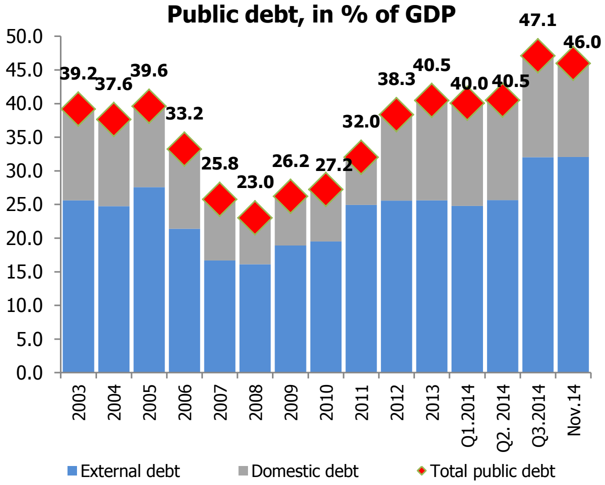
market, thus registering an inflow of Euro 491 million. Additional inflows of Euro 36.4 million were generated through the withdrawal of funds from the Competitiveness Development Policy Loan funded by the World Bank. Based on borrowing in the domestic market, the third quarter registered net inflows in the amount of Denar 584 million. In this period, the inflows in the Budget exceeded the outflows, allowing accumulation of deposits on the Government's account with the NBRM.

In the October-November 2014, budget revenues were higher by 10.4% on an annual basis, mainly due to higher performance of tax revenues (19.2% on an annual basis). Moreover, in the period from October to November, contrary to the third quarter, the growth of tax revenues was largely driven by higher collection of indirect taxes, which especially refers to VAT revenues, which represented an item with the largest single contribution to the growth of total revenues this period. Growth was observed in excise duties, while inflows from import duties continued to decline on an annual basis, although at slower pace compared with the third quarter. Positive changes in direct taxes, which were typical almost throughout the year, continued in this period, when they further strengthened their relevance to the growth of the total revenues. This especially refers to inflows from the income tax, which registered a high growth and increased contribution to the growth of total budget revenues compared with the first three quarters of the year, which is probably associated with the high amount of dividends paid. Revenues from social contributions also continued to increase on an annual basis, given the growth in all subcategories. **The period October-November registered increased execution of budget expenditures, which were higher by 7.8% on an annual basis.** Such dynamics of total expenditures is largely driven by the increased execution of current expenses, primarily in the part of social transfers, followed by the increase in the contribution of expenditures for goods and services. In this period, the capital cost increased after their decline in the third quarter. **The period October-November registered a budget deficit of Denar 1,671 million (or 0.3% of GDP[78]).** In this period, the budget deficit was

[78]Also, 0.3% of GDP according to the GDP projection of the Ministry of Finance.



* With respect to Supplementary Budget plan for 2014.
Source: Ministry of Finance.



Source: NBRM's calculations based on data from the Ministry of Finance.

funded through the withdrawal of a portion of government deposits with the NBRM, while domestic borrowing was used for outflows, which meant reducing government liabilities based on government securities.

As of November, the budget execution shows execution of 83.8% of budget revenues and 85.3% of budget expenditures projected in the Budget of the Republic of Macedonia. The budget deficit for the period January- November equaled 3.7% of GDP on a cumulative basis[79] , which, pursuant to the adopted Budget of the Republic of Macedonia for 2014, is about 97.6% of the projected budget deficit for 2014.

The total public debt[80] as of 30 November 2014 accounts for 46% of GDP[81], which compared to the end of the previous year is an increase of 5.5 percentage points of GDP. The growth of total public debt in this period is predominantly driven by the growing national debt[82], mainly as a result of the government borrowing in the international capital market through the issuance of the third Eurobond in July. Consequently, the structure of the total public debt recorded higher share of external debt, at a time when domestic borrowing moderately reduced compared to the end of the previous year.

---

[79] 3.6% of GDP, using the GDP projection of the Ministry of Finance.

[80] The public debt is defined under the Law on Public Debt (Official Gazette of the Republic of Macedonia No.165/14) , according to which public debt 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.

[81] Using GDP projected by the Ministry of Finance, at the end of November, the total public debt accounted for 45.5% of GDP.

[82] The government debt is defined under the Law on Public Debt (Official Gazette of the Republic of Macedonia No.165/14) , according to which government debt is the sum of financial liabilities incurred through the borrowings of the Republic of Macedonia, public institutions incorporated by the Republic of Macedonia and municipalities, municipalities within the city of Skopje and the city of Skopje, excluding the debt of public enterprises and trade companies in full or dominant ownership of the state, municipalities and of the National Bank of the Republic of Macedonia.

Budget of the Republic of Macedonia (central budget and budgets of funds)

	Budget for 2014	Supplementary Budget for 2014	Q1	Q2	Q3	Oct-Nov	Y-o-Y changes , 2014 period over the same period of the previous year, in %				Contribution to annual change, 2014 period over the same period of the previous year, in p.p.			
	planned, in Denar million	planned, in Denar million	realized, in Denar million				Q1	Q2	Q3	Oct-Nov	Q1	Q2	Q3	Oct-Nov
TOTAL BUDGET REVENUES	**158,243**	**155,554**	**32,291**	**36,259**	**36,016**	**25,736**	**7.9**	**0.4**	**-2.6**	**10.4**	**7.9**	**0.4**	**-2.6**	**10.4**
Revenues base on taxes and contributio	133,859	131,376	28,704	32,081	32,146	23,072	8.4	4.6	3.4	12.9	7.4	3.9	2.9	11.3
Tax revenues	87,222	85,189	18,216	20,887	20,745	15,380	10.4	4.4	2.7	19.2	5.7	2.4	1.5	10.6
Contributions	45,153	44,703	10,211	10,891	11,052	7,510	5.1	4.4	3.6	1.8	1.6	1.3	1.0	0.6
Non-tax revenues	14,973	14,697	2,591	2,433	2,645	1,942	-0.3	14.0	-40.9	9.6	0.0	0.8	-5.0	0.7
Capital revenues	5,290	4,177	181	1,046	348	127	-39.5	-57.5	18.8	-35.5	-0.4	-3.9	0.1	-0.3
Donations from abroad	3,521	4,504	612	534	766	474	34.2	-29.0	-24.0	-42.1	0.5	-0.6	-0.7	-1.5
Revenues of recovered loans	600	800	203	165	111	121	103.0	52.8	-13.3	44.0	0.3	0.2	0.0	0.2
TOTAL BUDGET EXPENDITURES	**176,514**	**175,157**	**43,428**	**39,880**	**38,712**	**27,407**	**5.0**	**3.5**	**-0.6**	**7.8**	**5.0**	**3.5**	**-0.6**	**7.8**
Current expenditures	154,137	154,073	39,120	35,741	35,565	24,827	4.9	3.5	1.6	6.9	4.4	3.1	1.5	6.3
Capital expenditures	22,377	21,084	4,308	4,139	3,147	2,580	6.5	4.0	-20.4	16.6	0.6	0.4	-2.1	1.4
BUDGET DEFICIT / SURPLUS	**-18,271**	**-19,603**	**-11,137**	**-3,621**	**-2,696**	**-1,671**	**-2.5**	**51.4**	**37.5**	**-21.6**				
Financing	18,271	19,603	11,137	3,621	2,696	1,671								
Inflow	**29,131**	**30,463**	**12,006**	**7,444**	**5,175**	**2,451**								
Revenues based on privatisation	0	440	310	130	0	9								
Foreign loans	5,276	36,449	994	908	33,301	632								
Deposits	13,915	-12,676	4,791	7,391	-28,842	7,446								
Treasury bills	9,840	6,150	5,642	-985	706	-5,638								
Sale of shares	100	100	269	0	10	2								
Outflow	**10,860**	**10,860**	**869**	**3,823**	**2,479**	**780**								
Repayment of principal	10,860	10,860	869	3,823	2,479	780								
External debt	9,133	9,133	737	2,503	2,347	648								
Domestic debt	1,727	1,727	132	1,320	132	132								

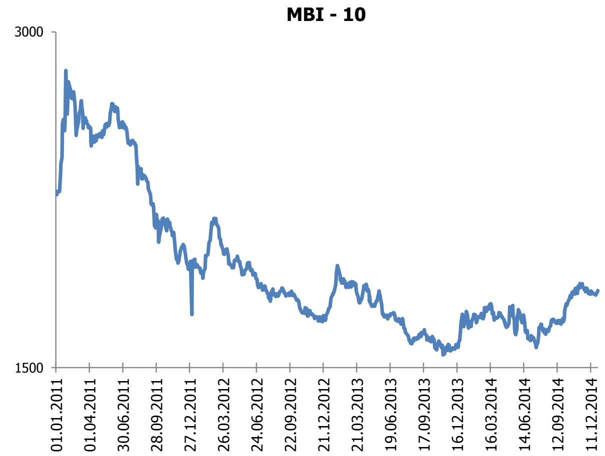
Source: Ministry of Finance.

IV. Stock exchange indices and real estate prices

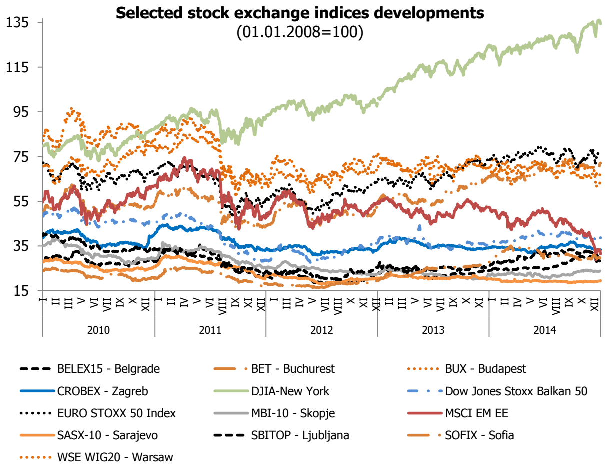
The Macedonian Stock Exchange Index MBI-10[83] continued to increase in the fourth quarter of 2014, which corresponds to the improved economic performance and expectations for further positive developments in the domestic economy. The value of bond index (OMB) also increased. The fourth quarter of 2014 witnessed lower trading in most of the exchanges in the region, leading to a decline in the indices of most regional markets. Real estate prices in the domestic market began decreasing, in consistence with the developments of the underlying factors.

During the fourth quarter of 2014, the value of the Macedonian Stock Exchange Index MBI-10 continued with the increase (7.6%) that started in the third quarter, despite its decrease in the first half of the year. Analyzing the pace, in the fourth quarter, the stock exchange index registered various

[83] On 15 December 2014, the MBI-10 index was revised, and as of 30 December 2015, the index includes the following companies: Alkaloid AD Skopje; Replek AD Skopje; Granit AD Skopje; Komercijalna Bank AD Skopje; Makpetrol AD Skopje; Stopanska Bank AD Bitola; Macedonian Telecom AD Skopje; Makedonijaturist AD Skopje; Tutunska Bank AD Skopje; Skopski Pazar AD Skopje.

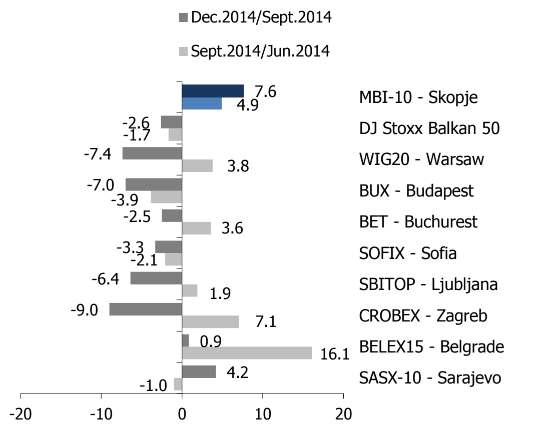


Source: Macedonian Stock Exchange Skopje



Source: National stock exchanges.

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



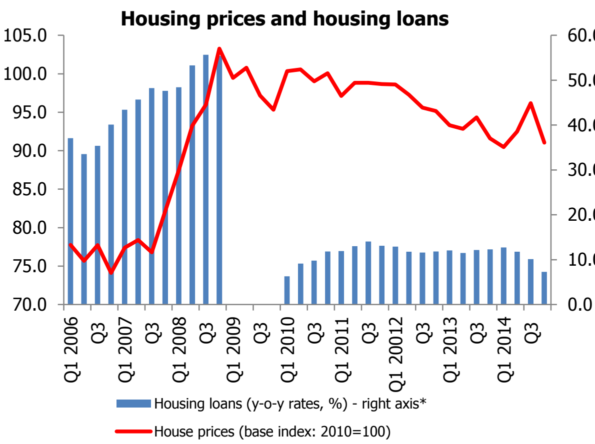
Source: national stock exchanges.

periods of movement. In October and November, the stock exchange index was increasing, while in December it registered a slight downward adjustment. However, at the end of the quarter, the index stood at 1844,2, thus exceeding the level at the end of the third quarter. Factors that contributed to the growth of the index include improved economic performance and expectations for further positive developments in the domestic economy. However, taking into account the historical data that indicate the sensitivity of the index, given the insufficient interest of domestic investors and absence of foreign institutional investors, it is still difficult to determine whether the increase of the stock exchange index will continue in the coming year or it is a temporary trend. The total stock exchange turnover increased by 8.4 times compared to the previous quarter, mainly due to the turnover through public offering of shares of one company during October[84]. Turnover from traditional trading also went up, but at a moderate pace compared to the total stock exchange turnover (30%). The value of bond index (OMB) also increased by 2.8% at the end of December 2014, compared to the end of September 2014.

During the fourth quarter of 2014, most regional stock indexes went down. Thus, the value of stock indices of the stock exchanges in Belgrade, Zagreb, Warsaw, Bucharest and Ljubljana went down. Increased downward shifts in these indices partly reflect the specific local factors[85] (reduced trading volume, reduced presence of foreign institutional investors). Political crisis in Greece, along with forecasts for slow recovery of the economy of the euro area are factors that had an adverse effects on the developments in the European stock markets, and hence, might have had certain negative impact on the stock markets in the region. The value of the stock index increased only in the stock market in Sarajevo under the influence of local factors and the stock market in Belgrade, where the index continued to grow as in the third quarter, but at a substantially slower pace of growth.

In the fourth quart of 2014, there was a reduction in the prices of flats, i.e.

[84] In October, one company traded more than 13 million shares in a public offering for the needs of business financing.
[85] http://wire.seenews.com/



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

house price index[86] decreased by 5.3% on a quarterly basis (quarterly growth of 4% in the previous quarter) and a decline of 0.6% on an annual basis (annual growth of 2% in the third quarter). This price trend corresponds with the perceptions for temporary nature of the increase registered in the previous two quarters amid continued growth in the supply in the real estate market in the past few years. Namely, the cumulative value of the buildings[87] constructed in the period 2011 - 2014[88] is higher by 72.4% compared with the period 2007 - 2010, and similar dynamic is shown by the data on licenses for building construction. Analyzing the demand for apartments, the continuous solid growth of housing loans in the fourth quarter points to further boost of the demand, a trend that is typical for the entire 2014.

V. Analytical appendices

Box 1: Impact of the movement of world oil prices on the trade balance

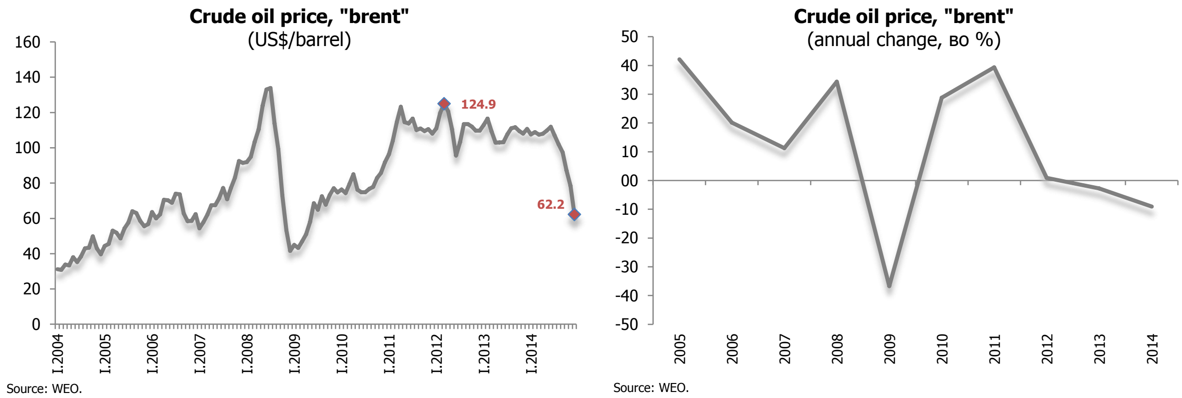
A key feature of the global crude oil market in 2014 was the sharp decline in the price of this fuel. Observed through the average annual prices, the downward correction in the oil price began in 2013. However, those changes were moderate (average annual decline of 2.8%), and the price level was continuously maintained above 100 US dollars per barrel. These price levels were typical for the first eight months of 2014, and since September, the price declined below 100 US dollars per barrel, followed by a sharp and strong downward correction. The price of crude oil was positioned at 62.2 US dollars per barrel in December 2014, which compared with the highest oil prices in the post-crisis period of 124.9 US dollars per barrel in March 2012, is a drop of 50.2%. This robust correction in the price of crude oil is associated with the higher supply that significantly exceeds the demand for oil. On the supply side, despite the conflict in Libya and Iraq, OPEC production remained within the current official target given the increased supply by the United States as well. Namely, the increased production of the United States, although not necessarily export of crude oil, results in substantially lower imports, thus contributing to the creation of excess supply in the world market. In any case, the decisive factor for the latest price movements is the OPEC's decision to leave the policy of maintaining oil prices at artificially high level (100 US dollars per barrel) and preserving production quotas unchanged[89]. This decision is likely to ensure excess supply of crude oil in the coming period. At the same time, oil demand remains weak due to reduced global economic activity, with the slowdown in industrial growth in China playing an important role. However, one should bear in mind

---

[86] 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.
[87] Source: Index of construction costs for new residential buildings, SSO.
[88] Data for 2014 is as of the third quarter of 2014.
[89] Norges Bank, Monetary Policy Report, 4/2014.

that uncertainty about future movements in world oil prices and the possibility of sudden changes in this category are high, given that they not always reflect market fundamentals, but may be associated with geopolitical tensions (which in part explains the current movements).

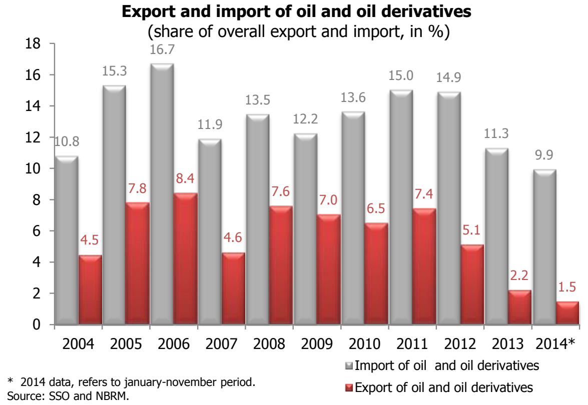
Chart 1

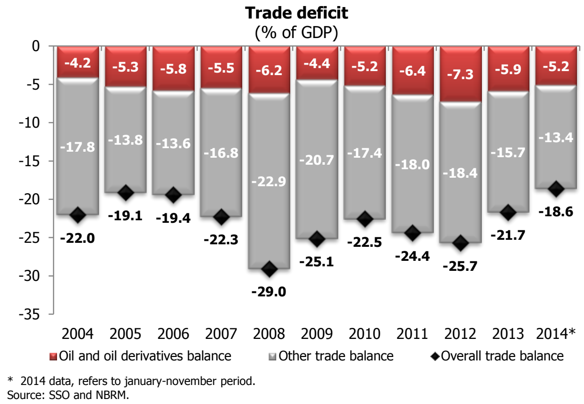


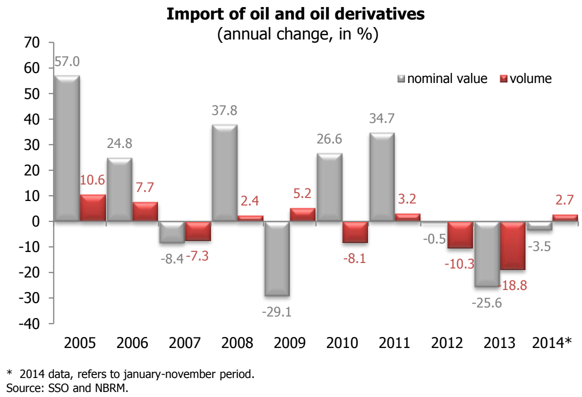
Unlike the petroleum exporting countries, which are hit by the unfavorable fall in the price of crude oil, the oil importing economies has seen positive effects through several channels - increased disposable household income, lower production costs, improved external position, lower inflation pressures. However, besides the positive effects in the importing countries, they could suffer adverse implications from the sharp decline in oil prices, manifested through the so-called bad deflation, given the downward adjustments of long-term inflation expectations, as well as the fiscal short-term effects, due to the lower tax revenues. These findings are valid for the Macedonian economy, which is characterized by high import dependence of the domestic energy consumption. The share of imports of oil and oil derivatives in total imports of goods in the past ten years is about 13%, or about 8% of GDP. Within the import structure, imports of crude oil dominated for a long period with about 84% of the imports of this type of energy. This situation gradually changed in 2011 and 2012, in favor of higher imports of oil derivatives, and since the beginning of 2013, the import of crude oil completely halted. The changed structure of imports of oil and oil derivatives influenced the quantities of export of oil derivatives[90]. Thus, the export component of imports of oil and oil derivatives reduced from around 30% to around 11% in the last two years. With respect to the balances, trade deficit in oil and oil derivatives accounts for about 25% of the total trade balance of goods.

[90] In the last two years, the export of oil derivatives also includes the imported slightly refined derivatives.

Chart 2







The effects of the drop of world oil prices on the trade balance of the Macedonian economy are confirmed by the foreign trade data for the last two years, and considering the projections for world oil prices, it is likely that these favorable trends will continue and become more pronounced in the coming period. As of November 2014, the trade deficit made up 18.6% of GDP, which compared to the same period last year, was lower by 1.2 percentage points of GDP, and to a lesser extent (0.2 percentage points of GDP) is due to the narrowing of the trade deficit of oil and oil derivatives, as a nominal effect of the fall in the oil price.

In order to quantify the impact of lower oil prices on the improvement of the trade deficit for the period January-November 2014, this box presents three simple simulations. They represent a counterfactual analysis that shows the trade deficit under assumption that imported and exported quantities of oil derivatives in 2014 would be valued at constant prices, from the period before the fall of oil prices[91]. Thus, we apply three different averages of import prices of oil and oil derivatives to the actual quantities imported in 2014[92]: 1)

---

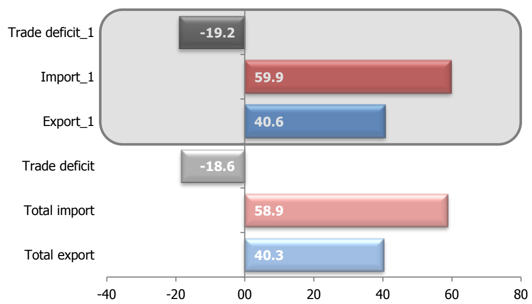
[91] In the next period, it could be that the positive effects of lower oil prices on the trade deficit are even more pronounced, given that in the period January-November 2014, in the last three months, oil prices were below 100 US dollars per barrel and in the other months, they were almost at the historical average after the crisis.

[92] Import oil prices implicitly derive from the nominal value of imports and exports and the quantities. The structural change within this category, transition to import of only oil derivatives, the price association is lower than before and there is some delay in the transmission of the effect of global markets on import (domestic) prices. Also, one needs to consider that the effect on world oil prices in the domestic economy is a mix of

average import price for 2012, 2) average import price for 2013 and 3) average import price for 2012 and 2013. **In summary, the results indicate higher trade deficit in these simulations, as expected, ranging from 0.4 to 0.6 percentage points of GDP in 2014.** In the first simulation, when applying the average oil price in 2012, the trade deficit would equal 19.2% of GDP, which is 0.6 percentage points of GDP higher than the factual, given the higher imports and exports by 1 percentage point and 0.4 percentage points of GDP, respectively. In the second simulation, when applying the average price in 2013, the negative trade balance would equal 19% of GDP, or 0.4 percentage points of GDP, lower than the currently registered for 2014. The result of the third simulation, when applying the average price for 2012 and 2013, shows that the trade deficit would be by 0.5 percentage points of GDP higher than the actual one, i.e. 19.1% of GDP.

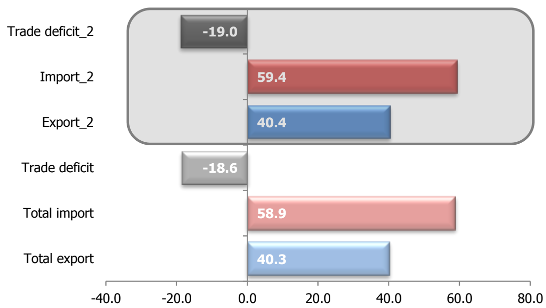
Chart 3

Crude oil price impact on trade deficit - Simulation 1
(% of GDP)



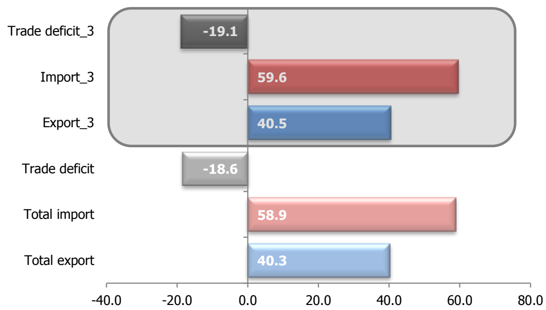
* 2014 data, refers to january-november period.
Source: NBRM.

Crude oil price impact on trade deficit - Simulation 2
(% of GDP)



* 2014 data, refers to january-november period.
Source: NBRM.

Crude oil price impact on trade deficit - Simulation 3
(% of GDP)



* 2014 data, refers to january-november period.
Source: NBRM.

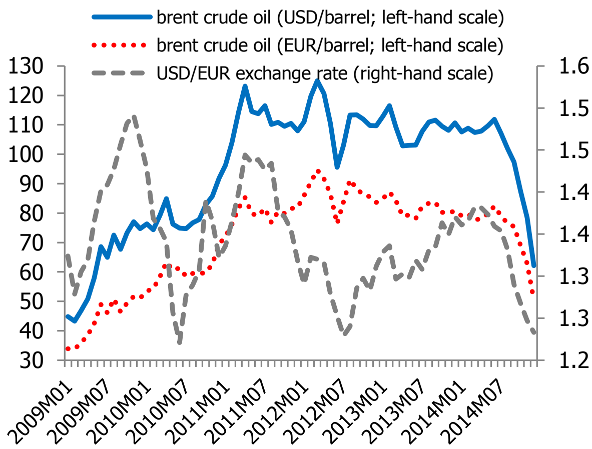
the price movement expressed in US dollars and the US dollar/euro exchange rate, i.e. the change of the US dollar against the euro.

Box 2: Indirect effects of oil prices on inflation

Since the second half of 2013, there is a trend of decrease in the annual growth of domestic prices, and during most of 2014, the annual rate of inflation was in the negative zone. The analysis of factors of this dynamics of domestic prices shows that the main reason behind these changes are the global price movements, primarily changes in world prices of some primary products, i.e. the prices of food and energy. This is expected, given the high import dependence of the domestic economy and the great weight of the food and energy components in the consumer price index. **However, despite the slowdown in headline inflation, a steady downward trend was registered in core inflation, as measured by consumer prices that exclude the energy and food prices.** In late 2014, core inflation entered the zone of negative annual changes for the first time in four years. Structurally speaking, the greatest contribution to the downward trajectory of core inflation is made by prices of clothing and footwear, prices of restaurant and hotel services, as well as the prices of products for apartment maintenance[93]. However, the downward adjustment of core inflation is partly due to the so-called indirect effects of declining prices of global primary products. In other words, these are second-round effects of the fall in food and energy prices, which mean lower input costs for other products and services and potential reduction of their prices and thus possibility for lower final prices.

This box focuses on the assessment of the spillover effects of changes in energy prices on core inflation. These are usually regarded as effects likely to materialized, given that the energy sources occur as input in most of the products and services. As mentioned above, energy prices in the recent period have generally been adjusted downwards. Following the strong increase in the period 2009-2011, the oil price was decreased slightly and gravitated around 110 US dollars per barrel by mid-2014. However, expressed in euros[94], oil prices decreased roughly during this period, given the appreciation of the euro against the US dollar. In mid-2014, there was a sharp downward correction of oil prices, and in January 2015, it fell below 50 US dollar per barrel. The effects of this decline in the price of oil prices on domestic prices, were, to some extent, limited due to the weakening of the euro against the US dollar (see Chart A).

Chart A: Evolution of oil prices and the USD/EUR exchange rate
(EUR; USD; monthly data)



Sources: IMF Primary Commodity Prices, ECB and NBRM calculations.

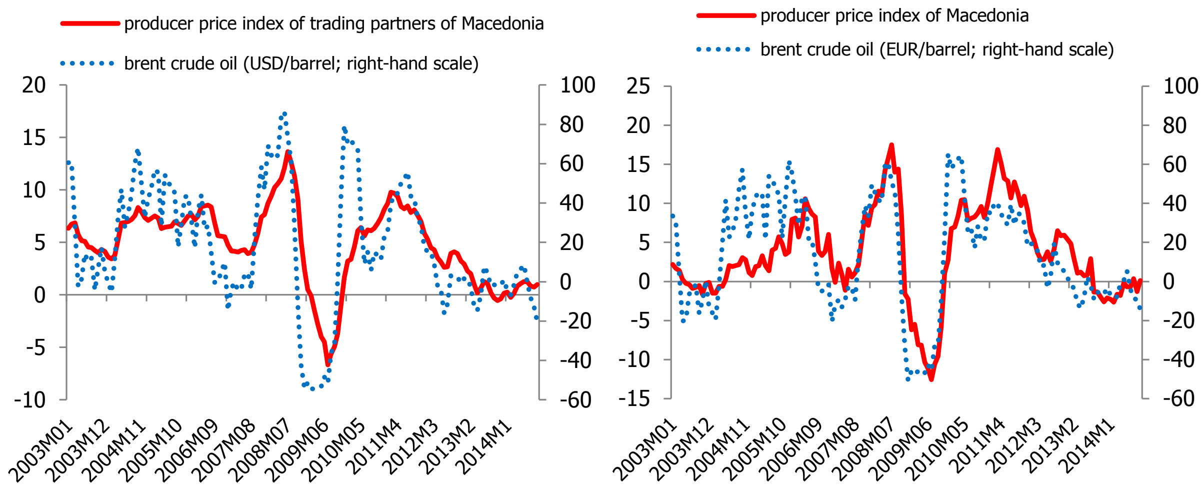
Unlike the direct effects of changes in oil prices through the impact of energy component on the inflation, indirect effects refer to the impact of changes in oil prices through the production costs. Such indirect effects are quite obvious in the case of transport services, where fuels are major costs. However, they are most likely present in case of production of relatively high oil, or more generally, high-energy intensive consumer products and services, such as some pharmaceutical products and some materials used for maintenance and repair of household appliances. Also, given the important role of imports in the field of production, changes in oil prices

[93] The effect of lower prices of footwear was the greatest due to the high base effect from early 2013, when prices of footwear rose, which in part reflects the method of measuring the prices of this category within the index.
[94] 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.

have additional indirect effects on domestic inflation through their impact on producer prices of the economies of trading partners. Chart B shows strong or clear common movement of oil prices and producer prices. Producer prices of trading partners of Macedonia that form the import prices of Macedonia and the Macedonian producer prices for the domestic economy tend to follow the movement of oil prices with certain time lag.

Chart B: Movement of oil price and producer prices[95]

(annual % changer; monthly data)



Source: IMF (primary commodity prices), the ECB, Eurostat, national statistical offices of the trading partners of Macedonia, SSO and NBRM's calculations.

In this box, the assessment of the presence of indirect effects of changes in oil price on core inflation is made using data-oriented method, i.e. it focuses on those categories of consumer prices without energy and food, which are more exposed to the movement of oil price[96]**.** To determine the relationship, a relatively simple (and partial) ARDL model (Autoregressive Distributed Lag Model) is assessed for each of the 69 individual categories of consumer prices for the period 2003-2014:

$$CPI_{i,t}^{qoq} = f(CPI_{i,t-1}^{qoq}, OIL_t^{qoq} : OIL_{t-4}^{qoq})$$

where *CPI* refers to the quarterly change of the seasonally adjusted component *i* in period *t*, and *OIL* refers to the quarterly change in the oil price in euro from period *t* to period *t-4*.[97]

Chart B shows the movement of aggregate consumer price index that consists of

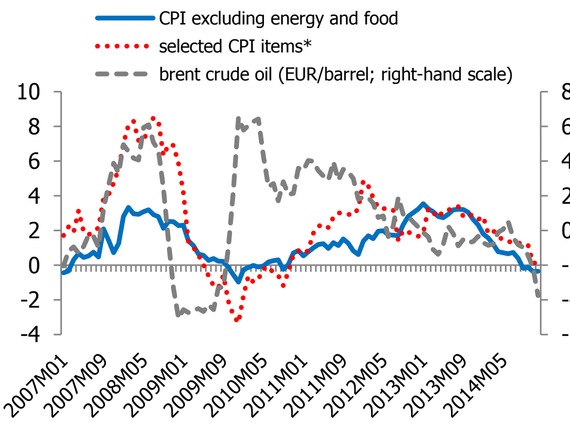
[95] The calculation of producer prices of trade partners of Macedonia is derived from the weighted sum of producer price indices of countries that are major partners of the Republic of Macedonia. Weight structure is based on the normalized share of the total foreign trade in the period 2010-2012. The calculation of this indicator includes: Germany, Greece, Serbia, Bulgaria, Italy, Russia, Great Britain, Turkey, Croatia, Slovenia, Switzerland, Romania, Ukraine, Austria and the United States.

[96] The ECB's methodology has been used. For more details also see the box: Indirect effects of oil price developments on euro area inflation, Monthly Bulletin, ECB, Frankfurt am Main, December 2014.

[97] Thanks to the joint movements of producer prices in world markets, this methodology might also include the impact of other prices of products such as food and industrial raw materials.

categories considered to have a statistically significant effect on past changes in the oil price[98]. These categories' weight is about 19% in the core component of inflation. Moreover, about 10% of the total decline of 3.6 percentage points of the core inflation rate in the last two years (the inflation fell from 3.3% in December 2012 to -0.3% in December 2014), can be explained by oil price sensitive categories. Thus, the chart shows that the downward trend in core inflation since the beginning of 2013 was followed by the downward trend of these selected oil price sensitive categories.

Chart C: Evolution of oil prices, CPI excluding energy and food and selected CPI components
(annual percentage changes, monthly data)



Sources: SSO, IMF Primary Commodity Prices and NBRM calculations.
*These CPI components have a high sensitivity to oil price movements.

In summary, despite the significant and immediately noticeable direct downward effect of the recent reduction in oil prices on the energy component of inflation, downward impact could also be expected on other components via the so-called indirect or second-round effects. Indirect effects, similar to the direct effects, in general, should be temporary and associated with the period of adjustment to the changes in oil prices. Hence, they should not affect the inflation on a permanent or long-term basis. Of course, an important requirement for this to materialize is such temporary movements not to be transmitted in the long-term inflation expectations and thus, not to have lasting impact on the determination of wages and prices in the economy. Our assessments show relatively small transmission effect of the fall in oil prices. However, one should bear in mind that the decline in world oil prices began in September last year. Any continuation of this trend in 2015, as well as the existence of certain time lag with which these changes are incorporated into the domestic prices indicates that there is a possibility for major effects through this channel on core inflation in the period ahead.

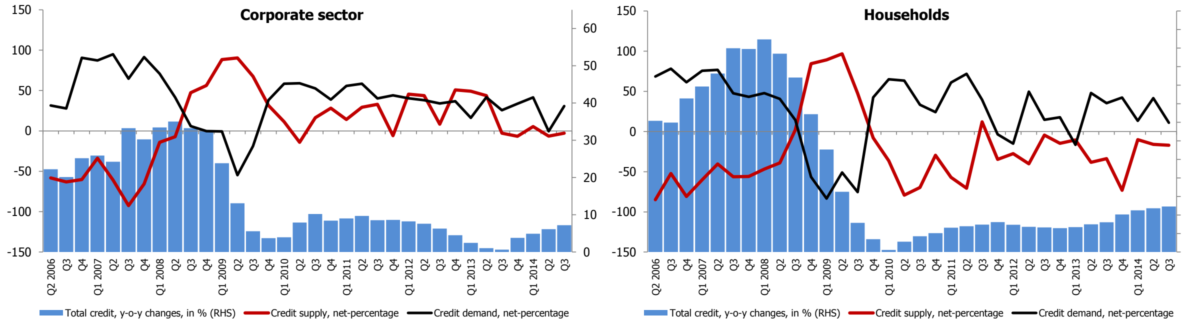
Box 3: Credit supply and demand as factors affecting credit growth: Analysis based on Lending Surveys of the NBRM

This box analyzes the changes in credit supply and credit demand as factors that influence the dynamics of credit activity of domestic banks. The distinction between these two factors is important for the conduct of monetary policy because depending on whether they are predominantly driven by factors on the supply side or by factors on the demand side, changes in credit activity may have different effects on economic activity and impose a need for a variety of monetary measures, which is especially true for periods of large shocks and crises. **However, the relative importance of these two factors for the lending in practice is difficult to**

[98] The selected categories include: Clothing materials (0311), Materials for the maintenance and repair of the dwelling (0431), Repair of household appliances (0533), Motor cars (0711), Passenger transport by road (0732), Radio and television sets, video players/recorders and the like (0911), Repair of audio-visual, photographic and information processing equipment (0915), Catering services (1110), Hairdressing services and other services for personal care (1211), Jewelry, clocks and watches (1231). These categories are selected based on their relationship to the movement in the oil price.

accurately isolate and evaluate because they are statistically immeasurable categories. The statistical indicators to monitor changes in the credit market, such as the volume of loans granted and their price, i.e. interest rate, simultaneously include the effect of both changes on the supply side and changes in the demand for loans. Therefore, to analyze the individual influence of these two factors, the literature commonly presents alternative sources of information, mostly regular surveys of central banks on the domestic banking sector. In this context, **for the purposes of our analysis, we use the information from the Lending Survey[99]**, which the NBRM conducts on a quarterly basis among the domestic banking sector since July 2006. We use the banks' estimates of changes in the lending terms as an indicator for changes in the supply of credit in our analysis, and original answers for the credit demand[100]. The analysis covers the period from Q2 2006 to Q3 2014, which includes two different phases of the functioning of the credit market, a phase of expansive and a phase of restrained credit growth. We particularly analyze changes in the household credit market versus corporate credit market, so as to identify any differences in the dimensioning of credit cycles by sector under the influence of these two factors.

Chart 1 Credit supply, credit demand and changes in total credits, by sector



Source: NBRM

During the pre-crisis period and the period of acute phase of the global crisis, our analysis shows synchronized impact of factors on the supply side and the factors on the side of demand for loans in the dimensioning of banks' lending. Thus, the period from the second quarter of 2006 until around the third quarter of 2008 is a period of expansive growth of lending in the domestic economy to both households and corporate sector. This is the period in which banks report strong growth of credit demand amid simultaneous and continuous loosening of lending terms to both sectors. The escalation of the global economic crisis and its spillover into the domestic economy in late 2008 ended the expansive credit cycle in the domestic banking sector. At the end of 2009, the annual rate of growth of loans was reduced to 3.5%, compared to 35% average annual growth in the period before the crisis. The adjustment was rapid and intense and according to the survey answers, it was again a combined effect of the limited supply and reduced demand for loans. Thus, the acute phase of the global crisis (in the last quarter of 2008 until around the third quarter of 2009 in our analysis) is marked by significant tightening of the banks' terms of lending, at averagely

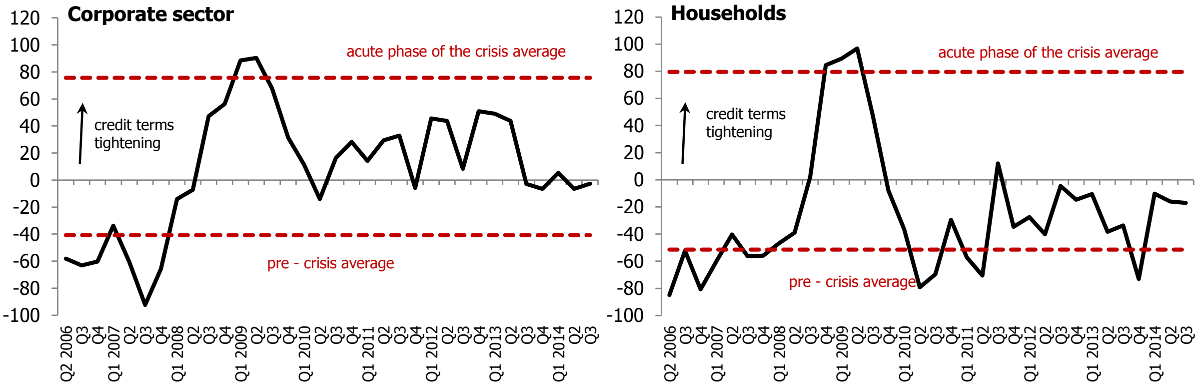
[99] The survey contains information on the banks' assessment of changes in credit supply and credit demand within the relevant quarter, as well as the factors that moved these changes. Overall results for all the questions of the survey are based on net percentages calculated as the difference of the optimistic and pessimistic assessments of banks. For more details about the Lending Survey also visit: http://www.nbrm.mk/?ItemID=F7AC78DEE498764FBAF39049F726CE3C

[100] Negative net percentage in lending terms implies easing of the terms, while positive net percentage implies tightening of the terms of lending. In terms of demand, negative net percentage implies a decrease, while positive net percentage implies increase in credit demand.

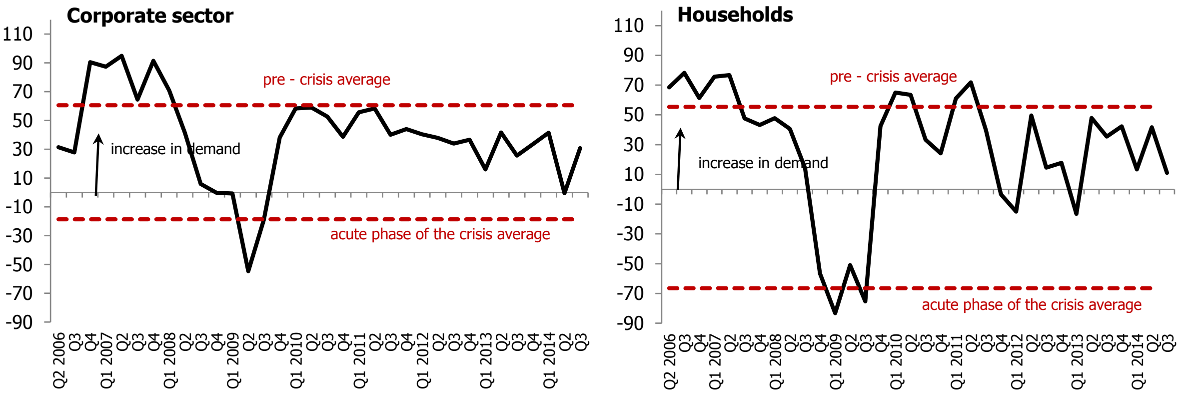
similar pace to the households and to the corporate sector. In terms of demand, there is a decrease in the appetite of both sectors for borrowing, but at averagely much faster pace in the household sector. These developments suggest a general increase in risk aversion caused by the global crisis. This particularly came to the fore through the sharp transition from relaxed to expressly restrictive credit policy to households and to the corporate sector. In the private sector, it is visible through the significantly decreased propensity for taking on new loan liabilities, particularly for the household sector, suggesting greater sensitivity of this sector to negative external shock. **So, for these two subperiods, there is synchronized impact of the supply and demand for loans aimed to stimulate credit growth in the pre-crisis period and restrained lending activity during the acute phase of the crisis.**

Chart 2 Credit supply and demand, by sector

Credit supply



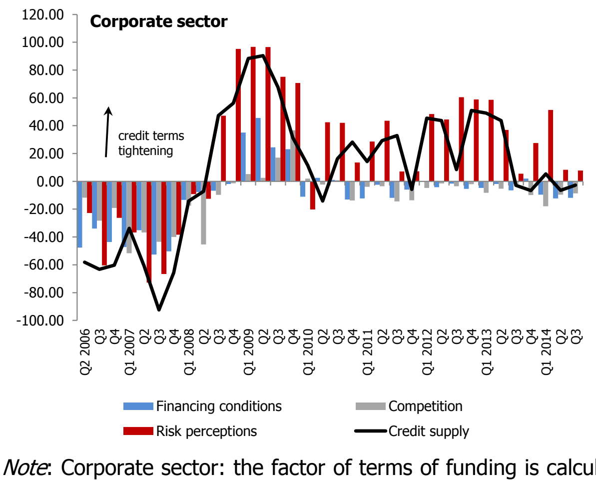
Credit demand

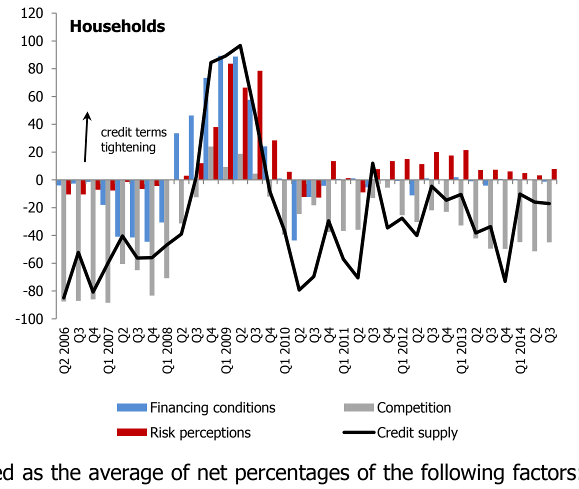


Note: the average for the pre-crisis period includes the period from Q2 2006 to Q3 2008. The average for the critical period of the crisis includes the period from Q4 2008 to Q3 2009.
Source: NBRM

Contrary to these movements, **the period after the acute phase of the crisis witnesses significant changes in the dynamics of both factors and their impact on credit market activities. Thus, unlike the pre-crisis period and the period of acute phase of the crisis, when the movement in both factors shows clear trends, this post-crisis period is marked by greater volatility in the supply and demand for loans.** These developments suggest prudential decision-making by the banks and by the private sector amid high uncertainty about the pace of exit from the crisis and the dynamics of recovery of the global economic growth. **Additional news for this period is the separation of the credit supply from the demand for loans, primarily to the corporate sector. The analysis of two factors leads to different valuation of risks by sector, by the domestic banks in the period after the acute phase of the crisis, which corresponds with the fast pace of recovery in the household credit segment compared to the segment of the corporate sector** (see Figure 1). Namely, **as of the end of 2009, banks report net easing of the terms of lending to households.** Furthermore, by the end of the period under observation, the banks' answers remain in the zone of loose terms of lending, albeit with certain fluctuations in intensity analyzed by quarter, probably as a reflection of the fragile global and domestic environment. **Such changes in the banks' lending policy to households keep up with the changes in the demand in this sector, which by the end of 2009 increased and basically remain positive until the end of the period of analysis.** Contrary to the households, **the banks terms of lending to the corporate sector remained tighter until the second half of 2013, albeit at a slower pace compared with the acute phase of the crisis. Thus banks did not meet the credit demand, which in the period after the recovery in the last quarter of 2009 has almost continuously been maintained at a relatively high level.** Retention of restrictive terms of lending to companies, amid solid credit demand, suggests prudent banks' assessment of the quality of demand and increased risk aversion. This prudential behavior of banks to the corporate sector can partly be explained by the fact that significantly higher amounts of loans have been approved to the corporate sector compared to the households, and accordingly, the risk borne by the bank from the irregular repayment of the loans is greater. At the same time, the effects of the global crisis directly affected the real sector, resulting in deteriorated performance of the corporate sector. The recovery of the domestic economy, although quickly after the initial shock, took place in significantly uncertain environment, creating uncertainty about the ability of the corporate sector for regular servicing of loan obligations in the next period. On the other hand, the negative impact of the global crisis on the domestic labor market was limited, which may have also contributed to perception of lower risks in the household sector. Non-performing loans may be considered as an additional factor, given that the quality of loan portfolio of the corporate sector deteriorated the most. As for the households, the changes in the loan portfolio quality were moderate, suggesting relatively low credit risk. When the global environment stabilized, and the national economy began to report more stable economic growth rates, banks responded by loosening the lending terms to the corporate sector as well. Thus, **in the second half of 2013, banks generally started to ease the lending terms, which although still unstable and moderate, suggests favorable developments in the banks' perceptions about the credit risk to the corporate sector.** This is also a period of significant recovery of lending to corporate sector, after a long period of restrained lending activity. These developments suggest **higher relevance of the factors on the supply side when determining the pace of recovery of the credit market to the corporate sector in the period after the acute phase of the global crisis.**

Chart 3 Credit supply and factors affecting the supply

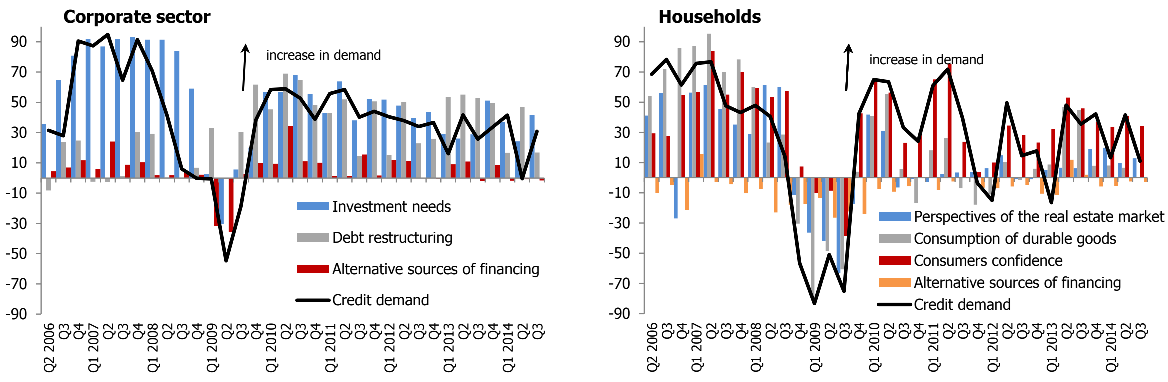




Note: Corporate sector: the factor of terms of funding is calculated as the average of net percentages of the following factors: costs associated with the capital position of the bank, bank's access to market funding and bank's liquidity position; competition factor as the average of net percentages of the following factors: competition from other banks, competition from non-banking sector and competition from market financing; risk perception factor as the average of net percentages of the following factors: expectations for the overall economic activity, expectations about the prospect of the branch the company belongs to and the risk of failure to foreclose collateral. Household sector: the factor of terms of funding is calculated as the average of net percentages of the following factors: costs of funds and restrictions of the balance sheet of consumer and housing loans; competition factor as the average of net percentages of competition factors of other banks for consumer and housing loans; and risk perception factor as the average of net percentages of factors: expectations for overall economic activity, the risk of failure to foreclose the collateral and the creditworthiness of consumers, the consumer and housing loans.
Source: NBRM

With respect to factors that affect terms of lending, the surveys show that companies point to risk perception as a leading factor, valid for three periods: before, during and after the acute phase of the global crisis. Factors relating to the banks' balance sheets and competition before the crisis affect the terms of lending, in terms of easing. In 2009, they acted in the opposite direction and in the following period, the impact of these factors significantly reduced, and therefore, the banks often assess these factors to have very little or no influence on the changes in terms of lending. These developments suggest that the sources of funding were not a limiting factor for the recovery of lending to the corporate sector in the post-crisis period. On the other hand, **considering the household sector, the banks point to competition from other banks as a leading factor in the design of the credit policy.** The exception is the acute phase of the crisis when the pressure of the competition gets secondary importance, on account of the increased importance of the factors associated with risk perceptions and terms of funding. These findings in part could be explained by the heterogeneous structure of the household sector, allowing greater diversification of credit risk. An additional factor could be the wider range of credit products that banks offer to the households, ensuring ongoing competition between banks in developing and offering new and more competitive products and thus extending the market share and providing higher profits. **In terms of factors that affect the demand for loans by the corporate sector, the need for investing in fixed assets, inventory and working capital are the most important drivers in the period under observation.** However, the period after the acute phase of the global crisis have witnessed a gradual reduction of the needs of companies for external funding for the purposes of investing, at the expense of the increased need for credit support for the purposes of debt restructuring. This can be explained by the deterioration of the financial position of companies as a result of the weakening of the real sector. **With respect to households, consumer confidence factor could be indicated as a leading factor for shaping the credit demand.** Factors related to the outlook of residential construction market and the durable goods consumption were also influential, especially in the pre-crisis period and during the acute phase of the crisis.

Chart 4 Credit demand and factors affecting the demand



Note: Corporate sector: Corporate sector: investment need factor is calculated as the average of net percentage of factors of investments in fixed assets and investments in inventory and working capital; debt restructuring factor refers to the individual net percentage for this factor; alternative funding sources factor is calculated as the average of net percentages of the following factors: internal financing, loans from other banks and issuing own securities. Household sector: factors of property market prospects and durable goods consumption refer to individual net percentages of these two factors; consumer confidence factor is calculated as the average of net percentages for this factor in consumer and housing loans; and alternative funding sources factor is calculated as the average of net percentages of the following factors: household savings, loans from other banks and other sources of funding, for consumer and housing loans.
Source: NBRM

In summary, our analysis shows that in the pre-crisis period and during the acute phase of the global crisis, the changes in the dynamics of lending activity were almost equally determined by factors on the supply side and the factors on the side of demand for loans. For the period after the acute phase of the crisis, which includes the period of recovery of the credit market, our analysis indicates an increasing importance of the factors on the supply side in determining the credit market developments, which primarily relates to the corporate sector. Banks' answers show that the slower recovery of lending to companies in the post-crisis period mostly reflects the banks' risk perceptions and prudential evaluation of demand, unlike the sources of funding that were not considered a significant limiting factor. The analysis also shows a relatively high sensitivity of the banks and the private sector (mainly households) when making decisions on approving of/applying for new credits, to changes in domestic and global macroeconomic environment, which particularly applies to periods of high uncertainty and large negative shocks.

Box 4: Output gap in Macedonia - effects of different methods of calculation and revisions in databases

Output gap is an indicator of the cyclical position of the economy (the economy moving above or below the long-term potential) and hence indicates the direction of the pressures on the movement of prices. Given that the output gap covers the most important economic categories, it is an indicator of the fundamental trends in the economy and is one of the most important indicators of monetary policy.

On the other hand, the output gap is a concept which is not directly measurable, with some degree of uncertainty around it assessment. The most frequent sources of uncertainty include different methods of calculation, and the revision of the published GDP data. As for the methods of calculating the output gap, approaches in the literature could be classified into two general groups - statistical and structural. Statistical methods are relatively simple to use, but do not include economic theories, so they usually serve only for comparison with the results of structural methods that are based on a particular economic theory. The second source of uncertainty in the assessment of the output gap includes revisions of GDP data that are often associated with the dissemination of new data, i.e. are regular[101]. However, in certain cases, the statistical offices make major revisions to the data related to certain methodological changes. GDP data revisions, regardless of their nature, can have a significant impact on the size and movement of the output gap and therefore, the NBRM quarterly reports repeatedly present an analysis of GDP data revisions[102]. **The aim of this box is to make a brief illustration of the differences in the output gap that results from the calculation methods, as well as the differences resulting from the data revisions.**

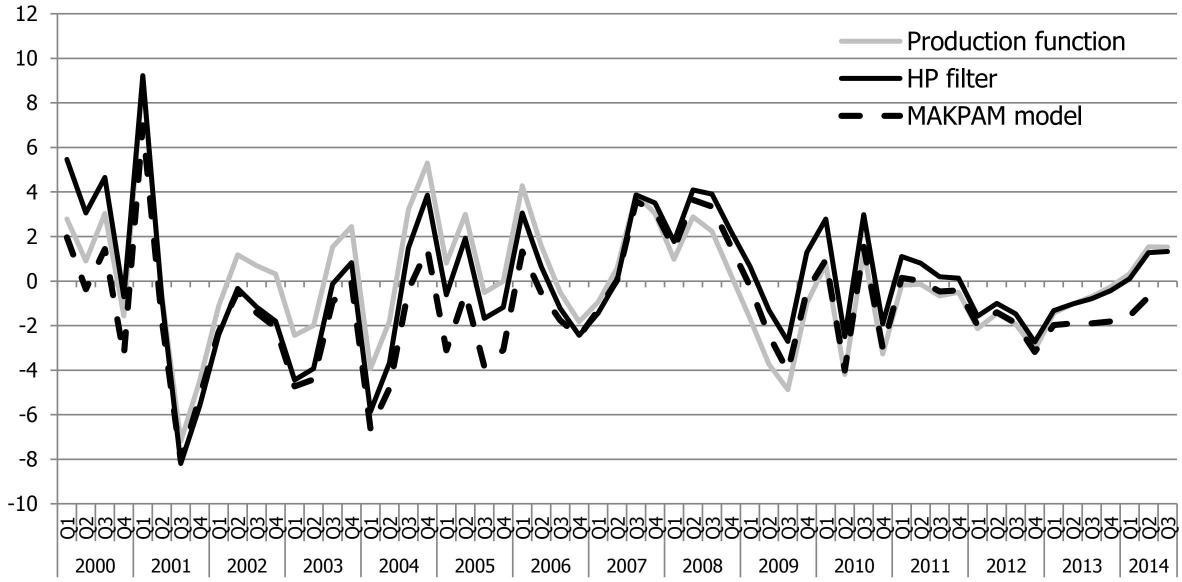
Chart 1 shows the output gap calculated by using the Hodrick-Prescott (HP) filter, the output function and the NBRM structural model - MAKPAM. The HP filter, despite the criticisms, is the most popular and simplest statistical method for calculating the output gap. The calculation of the output gap through the method of production function in this Box uses the approach of Jovanovic and Kabashi (2011)[103]. MAKPAM structural model is a small macroeconomic gap model that covers the most important economic relations in the Macedonian economy.

[101] GDP data compiled by the State Statistical Office, are subject to several regular revisions before the dissemination of the final data. Thus, the first quarterly GDP data is published 80 days after the reference quarter, while final data is obtained after almost two years.

[102] Quarterly Report, July 2009; Quarterly Report, January 2010; Quarterly Report, July 2010; Quarterly Report, January 2011; Quarterly Report, January 2014.

[103] Jovanovic, B., Kabashi, R., Potential Product and Output Gap of Macedonia According to Several Methods of Calculation, National Bank of the Republic of Macedonia, March 2011.

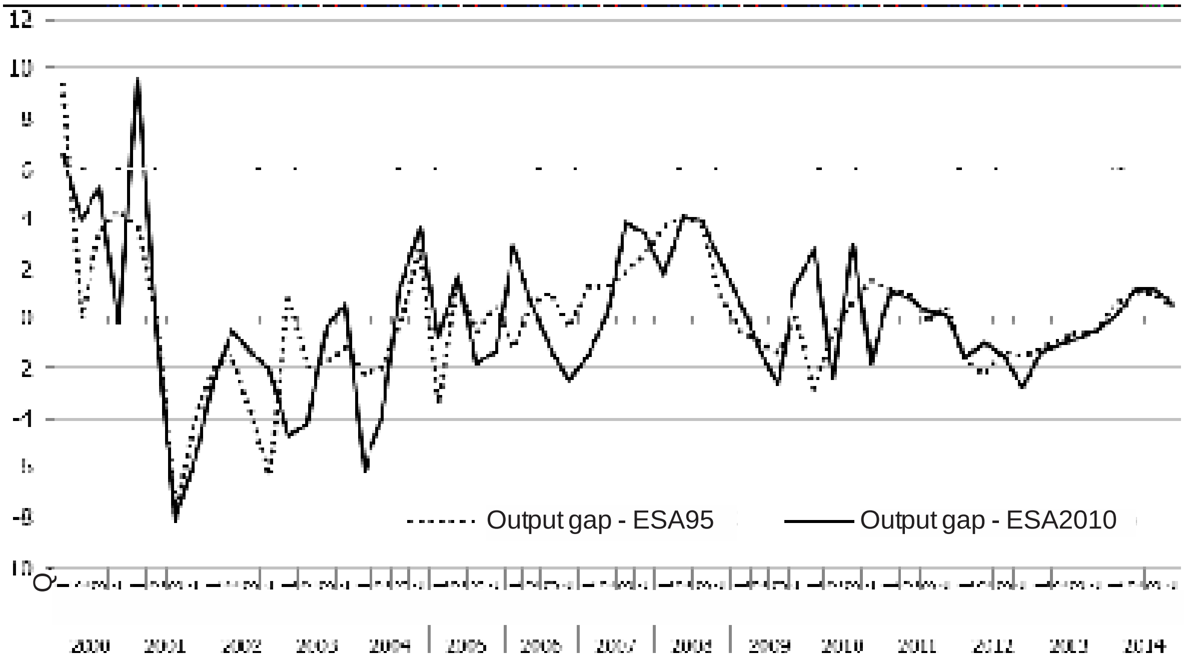
Chart 1
Output gap calculated using various calculation methods
(% of the potential product)



Generally, different calculation methods produce series for the output gap with a high degree of synchronization during the analyzed period. However, the closer analysis of the series points to three important differences. The first difference concerns the period 2008-2009, i.e. the period of spillover of the negative effects of the global financial and economic crisis in Macedonia. Namely, according to the output function method, the output gap entered the negative zone in the fourth quarter of 2008. On the other hand, the output gap obtained through the other two methods becomes negative later, i.e. in the second quarter of 2009. **The second difference** relates to the size of the negative gap in the period 2009-2014. Thus according to all three methods, the output gap was most negative in the third quarter of 2009. However, according to the output function method, it is estimated at 4.9% of the potential product, according to the HP filter - at 2.7% of the potential product, while according to the MAKPAM model, the output gap was at 4.1% of the potential product in the third quarter of 2009. Third, different methods indicate differences in terms of the sign of the output gap at the end of the period, i.e. the production function and the HP filter suggest that the output gap in the third quarter of 2014 is positive, while the MAKPAM model suggests that the output gap in this period is still negative.

Chart 2

Output gap calculated using HP filter according to ESA95 and ESA2010 methodology
(% of the potential product)



The second source of uncertainty in the assessment of the output gap includes real GDP data revisions. To illustrate the effect of the revisions, the latest revision of the State Statistical Office (SSO) has been used, which was released on 1 September 2014. It is a major revision that includes methodological changes in the measurement of certain categories and transition from the old methodology of the European System of Accounts (ESA95) to the new methodology ESA2010[104]. Chart 2 shows the output gap according to two data series - GDP series before revision and GDP series that contain revised data, whereby the calculation is made through the HP filter[105]. **The main conclusions regarding the effect of the revisions could be systematized into two groups. First**, despite the synchronicity between the movement and the direction of output gaps obtained using the two data series, Chart 2 indicates higher volatility of the output gap calculated according to the revised GDP data. Namely, the standard deviation of the output gap derived from the new data equals about 3 percentage points, versus 2.6 percentage points, which is the standard deviation of the output gap derived from old data. **Second**, the methodological change also brought about changes in the direction of the output gap in certain periods. Thus, in 25% of the analyzed quarterly data, production gaps calculated using the two methodologies move in the opposite direction. On average, over the years, the discrepancy of the direction is lower- the sign of output gaps remains the same for most of the period under observation, with the exception of 2010, where the output gap calculated using old data is negative, while the output gap calculated by using revised data is positive (Table 1).

[104] For more detailed information on data revision see Box 4 and the website of the State Statistical Office of the Republic of Macedonia, http://www.stat.gov.mk/ESS_revizija.aspx

[105] In order to avoid the known technical limitations of the HP filter in terms of recent observations of the sample, data from the October projections of the NBRM have been used for 2014.

Table 1
Output gap - ESA95 and ESA2010
(average of quarterly data for each year)

	ECC95	ECC2010
2000	4.3	3.9
2001	-2.1	-1.2
2002	-3.4	-1.6
2003	-1.0	-2.2
2004	-0.4	-1.3
2005	-0.5	-0.5
2006	0.0	-0.1
2007	1.7	1.5
2008	3.1	3.0
2009	-0.7	-0.5
2010	-0.3	0.4
2011	0.6	0.6
2012	-1.7	-1.7
2013	-0.8	-1.0
2014	0.8	0.7

This box attempts to identify the effects of different methods of calculation and/or of revisions of data on the output gap. Moreover, in both cases it was found that in most of the analyzed period the degree of synchronization between the series is relatively high. However, at certain times, there are some deviations that relate to both the size and the direction i.e. the sign of the output gap. These differences justify the use of multiple approaches for calculating the output gap. However, when it comes to the method of calculating the output gap, one should not overlook the fact that in certain situations the method of calculation is conditioned upon the use of the resulting indicator. For example, the conduct of macroeconomic policies needs output gap that takes into account the stocks and flows in the overall economy, i.e. in this case, the most appropriate method of calculation would be the structural model that covers the most important economic principles and relations. **In addition, revisions of GDP data, as shown by the analysis, also have certain effects in the calculation of the output gap** that indicates the need for using alternative sources of data about the situation of the economy, which are not subject to statistical revisions. In order to reduce the effects of data revisions on the output gap, close exploration of the possibility to predict future revisions would be beneficial[106].

Box 5: Review of data on GDP methodology under ESA 2010

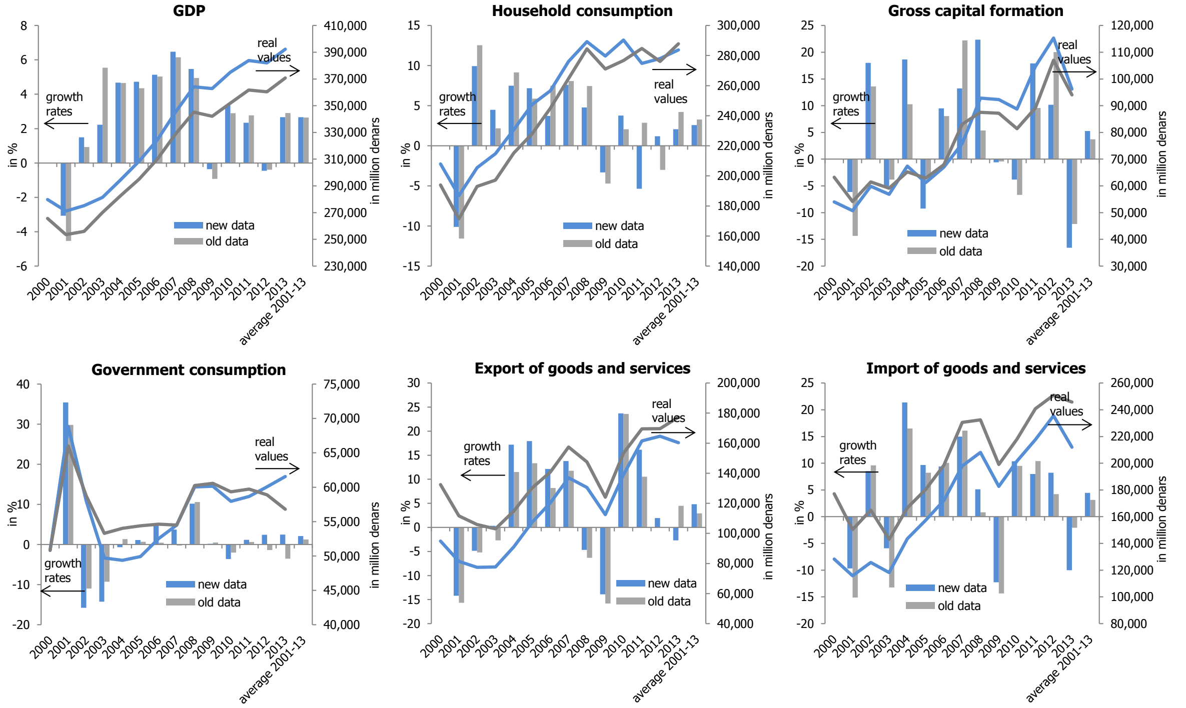
In October 2014, SSO announced new revised GDP data for the period 2000-2013. Revised data include methodological improvements with respect to the calculating methods and qualitative data sources. Specifically, the latest disseminated data, besides their methodological improvements in accordance with ESA 95 and implementation of the National Classification of Economic Activities (NACE Rev. 2), they are also compiled in accordance with the new methodology ESA 2010 (European System of Accounts 2010) and SNA 2008 methodology (System of National

[106] In the paper: *GDP Data Revisions in Macedonia - Is There any Systematic Pattern?,* Bogoev, J. and Ramadani, G. (September 2012) analyzes the possibility of predicting GDP revisions in Macedonia. The conclusion is that the revisions are not of a systematic nature. There is a need to extend the framework with new data on GDP revisions in the future, in order to see whether the conclusion remains valid or is it possible to predict the future revisions.

Accounts 2008) as a common international standard of 2009[107]. The purpose of this box is to outline the major differences between revised data and preliminary data. Analysis was performed in three areas - analysis of differences in the real annual growth rates of GDP and expenditure components of GDP, analysis of differences in the movement levels and analysis of differences in the contribution of individual expenditure components.

Chart 1

Comparison between new and old data on real growth rates and GDP levels and components



Source: SSO, definite data for 2000-2012, while the data for 2013 are preliminary

When analyzing the differences in the real growth rates, two important aspects are crucial - the size of the growth and the direction of movement. Overall, in terms of the size of the GDP growth rates, the analysis indicates absence of significant differences between the new and old data (Chart 1). Namely, for the period 2001-2013, the growth of GDP, calculated using new data, averages 2.7% and is slightly different from the one calculated using old data (2.6%). Larger variations in the growth pace are observed only in 2001 and 2003 (in 2001, new data suggest a smaller decline in GDP, while in 2003 the economic growth was slower than previously estimated). On the other hand, analyzing by component, larger revisions are noted. Thus, the greatest average upward revision was made in export demand (1.9 percentage points) and the investment demand (1.5 percentage points), while the average growth of private consumption is revised downward by 0.7 percentage points. On average for the period, all real growth rates of GDP components, except consumer spending, are revised upward. **As for the change in the direction of GDP growth (i.e. the sign of change), the analysis indicates absence of such differences (Chart 1).** In other words, the new revised GDP rates remain with the previously published sign (positive or negative). Looking at the components of GDP, certain divergent revisions in terms of the direction of change are observed in household

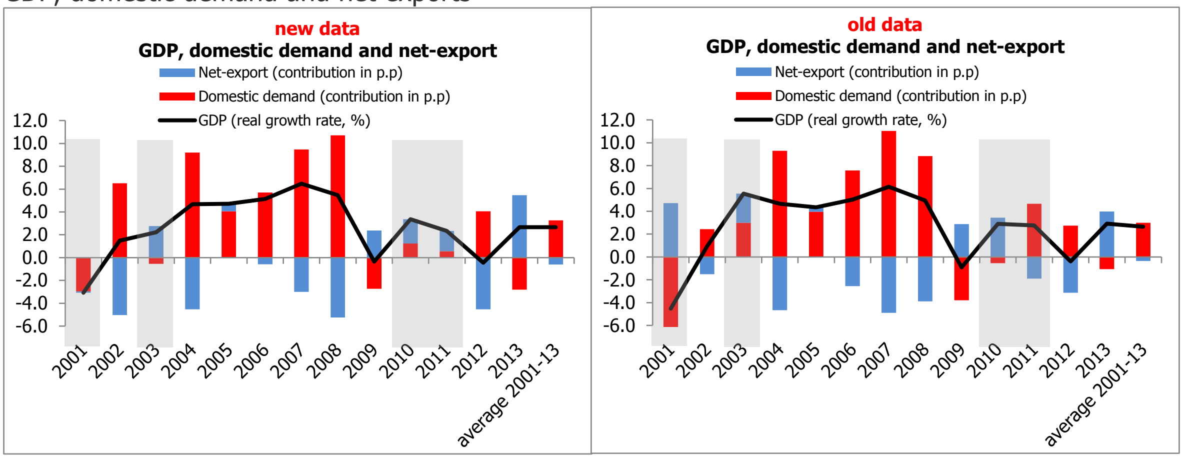
[107] For more information see the SSO's data revision at: http://www.stat.gov.mk/ESS_revizija.aspx
and Information on data revision for national accounts and implementation of the new methodology ESS 2010 at: http://www.stat.gov.mk/Dokumenti/ESA2010_mk.pdf.

consumption, exports and public spending in some years. Thus, in 2011, consumer spending registered a decrease rather than growth, while in 2012, the fall in consumption was revised in insignificant growth. Furthermore, according to the new revised data, exports registered an increase in 2012, rather than stagnation, and in 2013, the growth was revised into a negative rate. The growth rate of public spending in 2004 and 2007, and in more recent period (2012 and 2013) was revised in a different direction.

When considering the level of GDP, data according to the new ESA 2010 methodology show consistently higher level throughout the period of analysis (Chart 1). Looking at the GDP components, the higher level of GDP comes from the upward data revision for the level of consumer spending, followed by the smaller trade deficit due to the greater downward revision of the imports, and to some extent, to the upward revision of investments, particularly in the second half of the period under observation.

The revisions in growth rates and levels also affect the contributions of individual components to the overall GDP growth, i.e. may change the picture of the generators of economic growth in a certain period. As can be seen in Chart 2, there are changes in the growth structure between the new and old data at the beginning of the period (2001 and 2003) and in the post-crisis period (2010 and 2011). Thus, in 2001 the negative growth rate of GDP, except by the fall in domestic demand, as illustrated by the old data, is now explained by the fall in net export demand, as well. In 2003, the growth was driven solely by net foreign demand, while domestic demand slightly declined. The economic growth in the post-crisis period reflects the positive contribution of domestic demand and net foreign demand. On the other hand, according to the old data, the growth in 2010 was only the result of net exports, amid negative contribution of the domestic demand, while growth in 2011 was explained by the positive domestic demand, amid negative contribution of net exports. In the remaining period under observation, growth factors remain the same compared to the old data, but some differences are observed only in the intensity of the impact on the total growth of economic activity.

Chart 2
GDP, domestic demand and net exports



Source: SSO, data for 2000-2012 are definite, while data for 2013 are preliminary

In summary, the methodological improvements and compilation of data under the new ESA 2010 methodology did not cause significant changes in the intensity and direction of the GDP growth. Larger deviations in growth rates are observed among the GDP components, which, at certain times, presented a different picture for the generators of the economic growth. In terms of the GDP level, the new revised data indicate higher GDP, mainly due to the higher private consumption and less to the negative net exports.