

National Bank of the Republic of Macedonia



Quarterly Report February 2016



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Introduction

During the fourth quarter of 2015, the NBRM maintained the policy rate unchanged at the level of 3.25%, when the regular assessments of economic and financial conditions showed that the current monetary setup is appropriate. Analyzing macroeconomic indicators, during the fourth quarter, changes in the **headline domestic inflation** were again predominantly affected by the fall in world oil prices, leading to a decline in the domestic prices on an annual basis. Downward pressures have also been present through the food component, while the core inflation continued hovering in the zone of moderate growth rates. Considering such inflation structure, it is still estimated that the adaptation of the general price level is temporarily, without pronounced risks to its embedding in the inflationary expectations in the coming period. The **real sector** activity kept on growing at a solid pace in the third quarter, and the latest short-term indicators signaled continuous increase in the fourth quarter amid favorable movements in key economic sectors. Banks continued to support the economic growth through enhanced **lending**, responding to the increased demand with increased supply of credit. Foreign reserves in the fourth quarter have registered an increase, which was mostly due to the government borrowing on the international capital market by issuing Eurobond. The foreign exchange market developments have been stable over a long period of time, without the need of major interventions of the NBRM. All reserve adequacy indicators still point to an appropriate level of foreign reserves with enough room for dealing with possible shocks. **During this period, risks are found to have been predominantly unfavorable, with regard to both the exogenous risks and the risks arising from the domestic political turmoil.** As far as **exogenous risks** are concerned, the latest performance points to slightly less favorable global surrounding, taking into account the slow pace of recovery and slower pace of global growth in the third quarter, the deceleration of growth in the Chinese economy, as well as the increased uncertainty and pronounced geopolitical risks in this period. Despite the relatively small and limited impact of **domestic risks** thus far, any prolongation of uncertainty related to political developments brings about possibility to spill over into the economy due to the greater restraint of both domestic and foreign investors. **Notwithstanding these risks, the NBRM, within its regular assessment of the monetary policy setup has found that the economic fundamentals are sound and the economy is not facing greater disequilibria.**

Contrary to the assessment of the appropriateness of the current level of policy rate, monitoring the banking system trends and the assessment of potential risks pointed to the need of taking preventive targeted macroprudential measures. In December, the NBRM adopted a set of macro prudential measures¹ to protect against any future risks for the financial stability and prevent future macroeconomic imbalances. These measures aim to slow down the rapid growth of long-term consumer loans, but also facilitate the credit standards for the corporate sector, SMEs in particular. Additionally, in December, the validity of non-standard measure aimed to support lending to net exporters and domestic producers of electricity was extended.

The key macroeconomic parameters in the domestic economy were generally moving within the October cycle projections. In the third quarter, **gross domestic product** registered an annual growth of 3.5%, which is in line with the October projection, although the growth rate is somewhat higher than expected. Unlike the previous period, private consumption was a key driver of growth in the third quarter, amid continued positive trends in the labor market and boost of lending to households. Lower energy prices made additional contribution to the growth of consumption making positive impact on household disposable income. In addition, public consumption recorded a significant annual growth in the third quarter. After falling in the previous quarter, gross capital formation also registered positive developments, probably reflecting the intensification of the implementation of public capital investments. Real exports also registered an annual growth, mainly reflecting the activity of the new production facilities, as well as the gradual economic recovery of our major trading partners. As a result of the growth of export demand and all components of domestic demand, imports increased in the third quarter. However, with the growth of exports exceeding that of the imports, the contribution of net exports to GDP growth in the third quarter was positive, similar to the previous three quarters, but at a slower pace. The performance in the third quarter and the available high frequency data for the last quarter of the year show that the economy **has remained within the area of solid growth, and is in**

¹ For more details about the measures adopted by the NBRM in December 2015 see Box 3



line with the October projection of GDP growth of 3.2% in 2015. GDP growth for 2016 and 2017 is projected to 3.5% and 4%, respectively, when it is expected that the main generator of growth will be the export sector and investments, which will generate positive spillover effects on the labor market and will further encourage household consumption. **Risks surrounding this macroeconomic scenario have not undergone significant changes compared to the October projections.** They are still attributed to the external environment (the pace of recovery of the global economy and volatility in global financial markets), as well as domestic factors, i.e. the uncertainty associated to political developments and the possibility to be spilled over into the economy because of the greater restraint of domestic and foreign companies.

During the fourth quarter, domestic prices decreased annually by 0.4%, on average. This is a slight downward deviation from the October projections as a result of the annual decline in food prices, despite the expected growth. It is estimated that changes in domestic prices are mainly attributable to factors on the supply side, i.e. to the decline in import energy and food prices, which directly affects domestic prices, while the price effect of imported consumer goods from the major trading partners is relatively weak (low foreign effective inflation). The last quarter is marked by reversal of the contribution of food prices to a negative zone (as opposed to the positive contribution throughout the rest of the year), while retaining the adverse effect of energy prices, in line with the downward trend of oil prices on the world market. In contrast, there was a slight acceleration in the **core inflation**, which was 1% in the last quarter. **On average, headline inflation for 2015 declined by 0.3%,** reflecting the average annual decline in energy prices, notwithstanding the minor positive contribution of core inflation and food prices. Expectations of 1.5% and 1.6% inflation for 2016 and 2017, respectively, remain, and the risks about the projection are downward given the continuous downward adjustments of the estimates for oil and food prices. However, it is worth mentioning that the movement of prices of primary commodities is frequently affected by temporary factors, which makes the uncertainty about their projection relatively significant.

Analyzing external sector, in the third quarter of 2015, the current and capital account recorded a surplus of Euro 142.4 million, or 1.6% of GDP, which is a slightly better position of the current account than expected, amid improved trade balance. At the same time, the financial account registered net outflows of Euro 188.4 million or 2.1% of GDP, primarily reflecting higher net liabilities on trade credits. Net financial outflows in the third quarter were slightly higher than projected and in line with the expectations for this period that part of the balance of payments transactions will be financed using foreign reserves. In the fourth quarter, **gross foreign reserves** registered an increase which is in line with the expected trajectory of foreign reserves in the last quarter projected in October. Foreign reserves rose mostly due to the government borrowing in the foreign capital markets by issuing Eurobond. The foreign exchange market experienced stable movements without the need for major NBRM interventions. The available external sector indicators for the fourth quarter are still insufficient to obtain an accurate picture of the deviations in the balance of payments position compared with the projections. Latest foreign trade data as of November give indications of slightly higher than expected trade deficit in the last quarter, while currency exchange data suggests net inflows of private transfers as projected. As of October, balance of payments signals smaller than expected financial inflows in the economy. However, the assessment period is very short, and part of the financial flows are volatile. Therefore, it is difficult to provide reliable conclusions about the deviations in this area. According to the October projection, foreign reserves are expected to moderately increase on a cumulative basis for the period 2015-2017. Foreign reserves adequacy indicators remain in the safe zone, suggesting a sufficient level of foreign reserves to deal with any unforeseen shocks.

During the fourth quarter, the credit growth rate accelerated, which is a frequent feature of the credit market trends at the end of the year. The volume of new lending in the last quarter was 2.6 times higher than the average quarterly amount approved in the previous three quarters of the year, which is the highest quarterly amount of credits placed in the post crisis period. Sector-by-sector analysis shows that the acceleration of credit growth stems from increased credit support to the corporate sector, accounting for more than two thirds of the new lending in the last quarter. This is a significant shift in terms of the movements in the previous three quarters, when household loans played the role of generator of the credit growth. The growth of loans to households in the fourth quarter was somewhat more moderate compared to the previous two quarters, with the consumer loans still being the main



generator of the growth. On an annual basis, total loans in December grew by 9.5%, exceeding the October projection for the end of the year (7.7%). Analyzing the drivers of credit market, surveys show positive movements on both the demand side and the supply side of credits. Thus, amid restrained growth of economic activity, positive labor market developments and favorable terms of lending by the banking sector, the private sector continued to increase demand for loans. Solid solvency and liquidity position of banks, enhanced growth of funding sources and increased competition in the banking sector are contributing factors for banks to increase supply of loans. Analyzing sources of funding, **the last quarter has seen an intense growth in total deposits**, therewith the annual growth rate of total deposits in December reached 6.5% which is above the projection for the end of the year (3.7%). Greater contribution to the growth of total deposits in the last quarter was made by corporate deposits, as well as the high growth of household deposits, primarily local currency deposits. These deposit market trends signal stabilization of expectations and gradual depletion of the effects of non-economic factors that resulted in weaker performance in household deposits in the previous two quarters. Bank deposit base is expected to continue increasing in the period ahead, ensuring stable sources of financing of credit growth, which according to the October projection are expected to range between 7-8% in the next two years.

In summary, recent developments show that despite the increasing endogenous and exogenous risks in this period, the fundamentals of domestic economy have remained solid.

The economy has still been recovering at a solid pace, in part supported by the lending of the domestic banks. Economy has recovered without price pressures and with adequate level of foreign reserves. Risks are mainly unfavorable and have arisen from both external and uncertain domestic surrounding. Exogenous factors have remained attributable to the potential changes in the pace of recovery of the global economic growth (the growth in the EU, the growth of the Chinese economy), as well as to the movements in the prices of primary products in world markets. Despite the relatively small and limited impact of domestic risks thus far, any continuation of uncertainty related to political developments tends to spill over into the economy due to the restraint of both domestic and foreign investors. Hence, the NBRM will continue to closely monitor the developments in the period ahead, and if appropriate, will make adjustments to the monetary policy aimed at successful achievement of the monetary policy objectives.

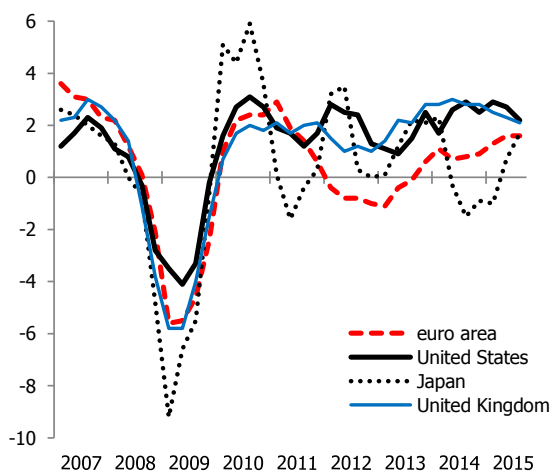


I. Macroeconomic developments

1.1. International economic surrounding²

During 2015, the global economy continued to recover, but at a slower pace. This change in the growth pace results from the slower growth in the emerging economies and the slower recovery of some developed economies. Given these developments, the latest global growth estimates for 2015 suggest moderate slowdown compared to the previous year. These projections still show differences in the growth rate between developed and emerging economies. In the developed economies, estimates indicate a slight acceleration of growth, supported by the fall in oil prices, relaxed monetary policy, improved labor market, increasing confidence and alleviation of the adverse effects of the private sector deleveraging and fiscal consolidation, and in some countries by the depreciation of currencies. In emerging economies, the economic outlook varies by country, but in general the estimates for the whole group show further slowdown of growth. These assessments are the result of several factors such as weaker growth in countries exporting primary commodities due to the fall in prices of these commodities, slower growth of the Chinese economy, but also to the adjustment of the economies after the phase of high credit and investment growth. The latest projections indicate a moderate acceleration of global growth in 2016. Risks surrounding these projections remain downwards. This applies especially to the emerging economies that face tighter financing conditions, especially after the increase of Fed's interest rates, as well as lower prices of primary commodities, which affects countries that export these commodities. Global inflation has still been maintained at a low level, and no significant inflationary pressures are expected in the period ahead, given the lower energy prices and still unused capacities in the global economy.

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



Source: OECD.

Global economic activity has been recovering, with the indicators pointing to a moderate and uneven growth in 2015.

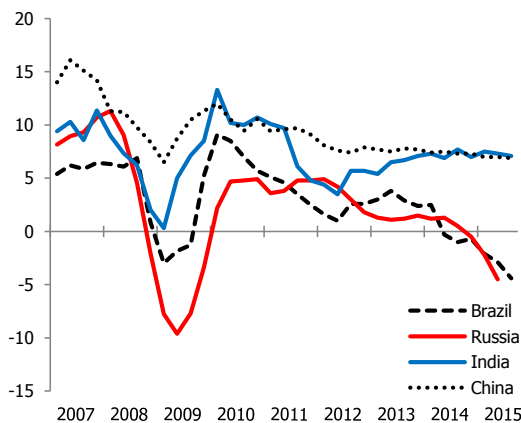
Throughout the year, economic activity in most of the developed countries continued to slowly recover while emerging economies and developing countries have seen slower economic growth, with significant differences between individual countries (some of the countries have registered an increase, while in countries such as Russia and Brazil, the economic activity has reduced). As for the performance of individual economies in the third quarter, the US GDP growth slowed down to 0.5% on a quarterly basis (compared to 1% in the second quarter), with an annual growth rate of 2.2%. Private consumption is a major driver of growth in the US economy, fueled by rising of employment, nominal wages and real disposable income amid lower oil prices and slower inflation, as well as improved credit standards and household balances. The unemployment rate further declined and in October and November it reduced to 5% on average. On the other hand, somewhat weaker performance has been seen in investments as well as net exports caused by the appreciation of the US dollar. The British economy grew by 0.4%

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



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 business conditions compared to the previous month and it can take values between 0 and 100. PMI=50 is considered as a reference value, indicating unchanged economic conditions. A PMI value over 50 is taken to indicate that the economy is expanding, while a PMI value below 50 suggests that the economy is contracting.

Source: Markit, ISM-Chicago.

compared to the previous quarter (an annual growth of 2.1%), mostly driven by the growing private consumption and to a lesser extent, by investment, despite the negative effect of fiscal consolidation. After the quarterly decline in the previous quarter, Japan reported positive economic results in the third quarter, driven by higher investment activity. The performance of emerging and developing economies is heterogeneous, partly reflecting the divergent impact of downward correction in world prices of primary commodities on the exporting and importing countries. The high-frequency survey indicators of economic activity - PMI³ point to a moderate growth of the world economy at the end of 2015. Namely, in the fourth quarter, the global composite PMI averaged 53.2 index points, amid improved performance of manufacturing industry and weaker performance of services sector. Overall, the latest expectations indicate moderate and uneven recovery of the world economy in the future. It is associated with the stable economic outlook of developed countries, determined by lower energy prices and further improvement of labor markets. However, downward risks still prevail and are attributable to the slower growth of China and other emerging economies. Less favorable financing conditions, increased political uncertainty and declining world prices of primary commodities can further deepen macroeconomic imbalances and adversely affect confidence and economic growth in these countries. Also, risk factors for the global growth in the next period include geopolitical risks associated with the developments in the Middle East and the effects of the normalization of the Fed monetary policy on the financial markets.

Available data show that global inflation was kept low at the end of 2015, reflecting the decline in stock prices of oil.

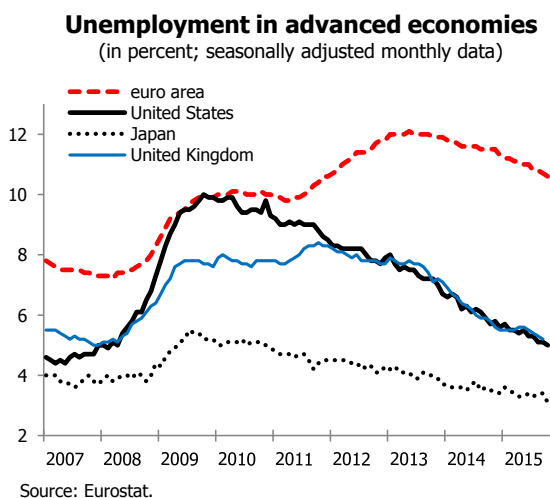
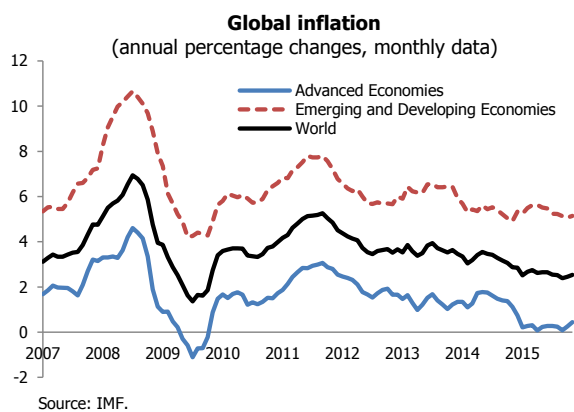
During October and November, the general level of world prices grew by 2.5% on average, which is unchanged growth compared to the previous quarter. In this two-month period, inflation accelerated in the United States by 0.3% and stagnated in the UK. Furthermore, within the emerging countries, inflation remained high in Brazil and Russia, and slowed down in China. According to latest estimates, no major inflationary pressures are expected in the period ahead, due to the low prices of energy and other

³ 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.



primary commodities and still unused capacities in the global economy.

In the third quarter, economic activity in the euro area continued to recover slowly. Compared to the previous quarter, real GDP growth marginally decelerated at a rate of 0.3%, resulting in an annual growth rate of 1.6%. Observed by individual components, personal consumption is the main driver of the positive economic performance. It is stimulated by the higher purchasing power of households, primarily as a result of the favorable labor market developments. The unemployment rate in the period from October to November further reduced to 10.6%. Yet, the unemployment rate has been declining slowly, so it is estimated that it requires a longer period before it reinstates to the pre-crisis levels. On the other hand, the economic growth of the euro area has been limited by the relatively weak investment activity and net exports, reflecting the unfavorable impact of the reduced foreign demand of emerging countries. Analyzing individual economies, Spain has registered continuous trend of gradual economic recovery with solid quarterly GDP growth (0.8%), fueled by increased domestic demand. Other major economies of the euro area such as Germany, France and Italy have seen lower quarterly performance (growth of 0.3%, 0.3% and 0.2%, respectively). According to the latest ECB projections⁴, the euro area is expected to continue recovering in 2016 and 2017. Moreover, it will be driven by domestic demand, amid accommodative monetary policy of the ECB, low oil prices, increased public spending and further improvement in the labor market. However, downward risks have still prevailed, reflecting increased uncertainty about global economic growth, particularly associated with the slower growth of China, as well as geopolitical risks.



In the fourth quarter, inflation in the euro area remained low and well below the targeted rate of 2%. Namely, in this quarter, the average annual inflation rate amounted to 0.2%. Such performance results from the decline in energy component due to lower market prices of oil. Food inflation has accelerated, reflecting the weather effect on prices of fruits and vegetables. Core inflation has stabilized, as a combined effect of the weakening exchange rate of the euro and the strengthening

⁴ ECB, Economic Bulletin, issue 8/2015, December 2015.

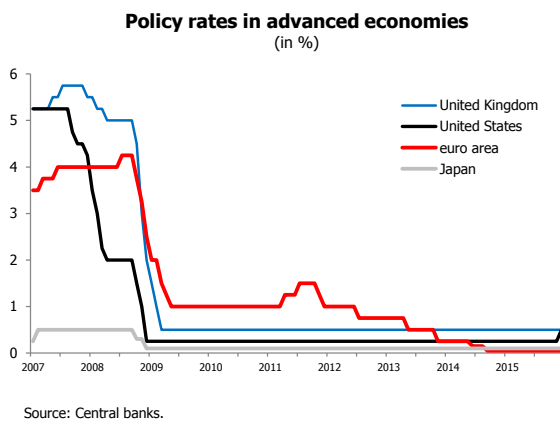
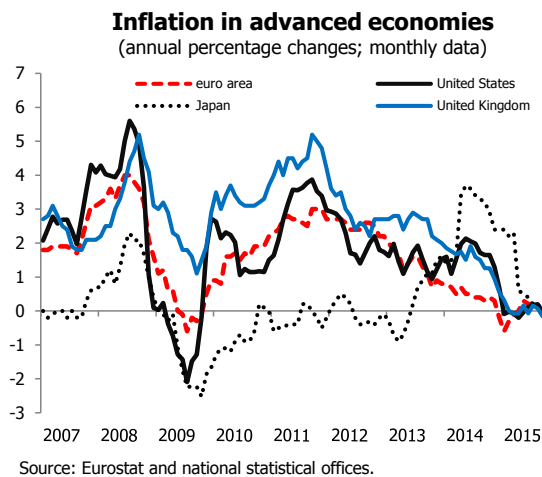


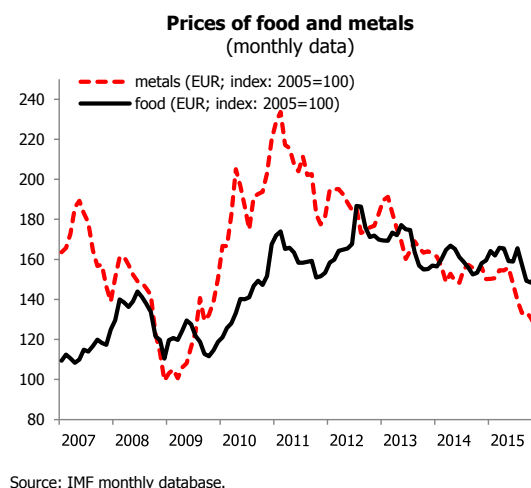
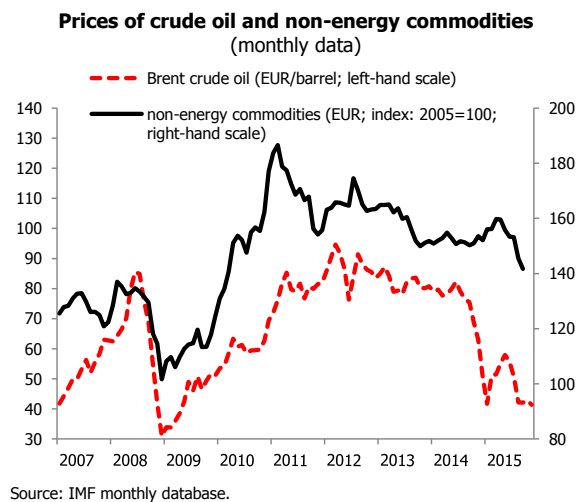
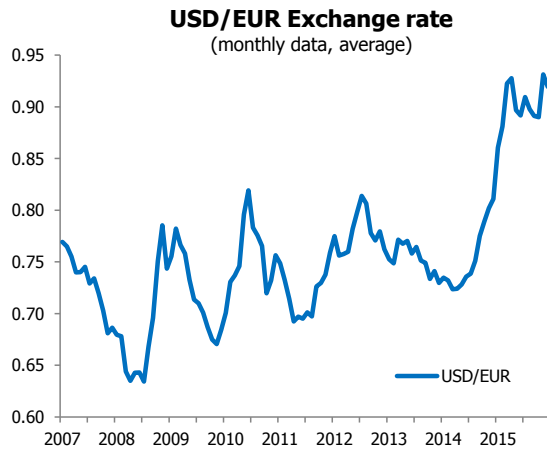
of domestic demand.

In the fourth quarter of 2015, the monetary policy of the central banks of developed countries has shown divergent movements. At the regular October meeting, Fed concluded that the economy in the second half of 2015 had been stable, yet with low growth. Such a conclusion has relied upon the accelerated pace of growth of household consumption and gross capital formation, notwithstanding the weaker exports and the improved labor market. Fed believes that the inflation well below the target of 2% mainly reflects the low energy price, but expects that its effect will decrease in the coming period and that inflation will gradually reach the target of 2%. Consequently, at the December meeting, Fed decided to increase the policy rate by 0.25 percentage points to 0.25%-0.5%. This decision has marked the beginning of gradual tightening of the monetary policy in the United States.

Unlike Fed, the European Central Bank (ECB) adopted several decisions in December aimed at easing of the monetary policy, in order to bring the inflation closer to the target of 2%. First, it lowered deposit interest rate by ten basis points to -0.3%, while the policy rate remained unchanged. Secondly, concerning non-standard monetary policy measures, during the fourth quarter, the ECB continued implementing the expanded asset purchase program in the euro area and extended it at least to March 2017. Third, the ECB decided to reinvest repayments of principal of securities purchased from the asset purchase program, as long as it is necessary. Fourth, in the public sector purchase program, the ECB has also included market instruments denominated in euros, issued by regional and local governments in the euro area. This decision has expanded the list of assets eligible for regular purchases by the respective national central banks. Liquidity has also increased as a result of the final decision of the ECB to continue implementing basic refinancing operations as well as longer-term refinancing operations using tender with fixed interest rate and unlimited amount, until at least the end of the last period of reserve requirement for 2017.

Volatile movements of the nominal exchange rate of the US dollar against the euro continued in the fourth quarter of 2015. Unlike the previous quarter, when the US dollar depreciated by 0.7%, in the





fourth quarter, the US dollar appreciated by 1.6% against the euro. Analyzed by months, the exchange rate of the US dollar against the euro remained the same in October (depreciation of only 0.1%). In November, there was a strong appreciation of 4.6%, while in December it again depreciated by 1.3%. Such movements of the US dollar in the period under observation have been attributable to the expectations that Fed will increase its policy rate at the regular meeting in December. The appreciation of the US dollar against the euro was also determined by the terrorist attacks on 13 November in Paris⁵. Annually, the US dollar against the euro appreciated by 13.4%, and in December 2015, one US dollar was exchanged for 0.92 euros.

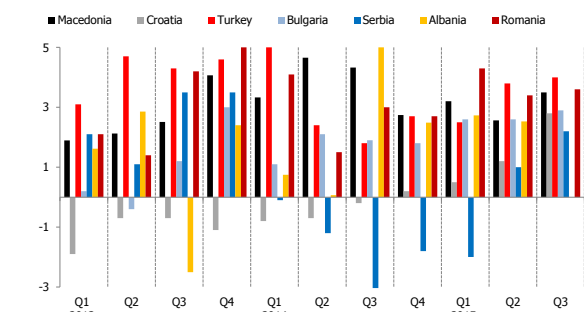
During the fourth quarter of 2015, there was a further reduction in the average oil price, expressed in euros. In this period, crude oil "Brent" was sold at an average price of 39.6 euros per barrel, which is a quarterly decline of 12%. Such low level of oil price is the result of increased oil production in the United States and the failure of the OPEC countries to reach an agreement on production cuts at the December meeting in Vienna. On the demand side, the weaker performance of the Chinese economy and the slow recovery of European economies have created downward pressure on the oil price. On a monthly basis, although in October oil price slightly increased (up 1.8%), in November and December, it returned to the zone of negative monthly changes (down 3.4% and 16.2%, respectively). The annual analysis shows that the drop in oil prices expressed in euros is significant and equals 34.7%. **Prices of non-energy primary commodities⁶ in euros in the fourth quarter decreased by 4.2% on a quarterly basis.** The quarterly decline of 7.1% in metal prices is mainly due to the weaker performance of the Chinese economy, and the high level of supply in world markets. Food prices declined by 4.5% due to the solid global supply, weaker global demand and relatively high inventories.

The trend of recovery and strong economic performance in the region continued in the third quarter of 2015. The Serbian economy has grown by 2.2%, which is the highest quarterly growth since 2014. In the period under observation, in Serbia, all

⁵ <http://www.euroexchangeratenews.co.uk/euro-to-us-dollar-eurusd-exchange-rate-forecast-paris-attack-lowers-euros-value-today-15042>

⁶ The price index of non-energy primary products includes: prices of food, beverages, agricultural raw materials and metals.

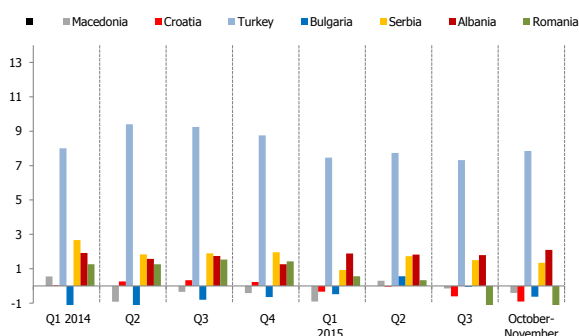
Real GDP growth in countries from the region
(annual percentage changes, quarterly data)



Source: Eurostat and national statistical offices.

* According to ESA 2010 methodology, except for Turkey and Albania.

Inflation in countries from the region
(annual percentage changes)



Source: Eurostat and national statistical offices.

categories, except for household private consumption, made a positive contribution to the economic growth including net exports. The Turkish economy grew by 4% in the third quarter of 2015, mainly due to the growth of private and public consumption, with simultaneous negative contribution of gross capital formation and net exports. The Croatian economy grew by 2.8% in the third quarter of 2015, which is the highest quarterly growth since 2009. All GDP components have made their contribution to improve economic performance of Croatia. Bulgaria has also reported a solid economic growth of 2.9%, but with a negative contribution to the growth of gross capital formation. The Romanian economy continued reporting solid performance (growth of 3.6%), among the highest in Europe.

The downtrend in prices that started in the third quarter of 2015 continued in the October-November period. Measured by consumer prices, except in Albania, Serbia and Turkey, all other countries in the region reported negative annual inflation rates. Downward changes in the energy component are the underlying factor for deflationary movements, amid a slight increase in food prices. The fall in oil price has also had an adverse effect on the Turkish inflation, but the depreciation of the Turkish Lira, and higher food prices have increased the inflation rate in Turkey to 8.1% which is a record high in the past six months. In Romania, food prices continue to decline due to the reduction in the VAT rate. In Serbia, the rate of inflation in this two-month period was 1.3% which is below the threshold of the inflation target ($4 \pm 1.5\%$).

1.2. Domestic supply

The domestic economy continued growing in the third quarter of 2015, when GDP rose by 3.5% annually (quarterly growth of 1.8%), which is an acceleration of the pace compared to the previous quarter. Analyzed by sector, in the third quarter, construction sector was the driving force whose value added growth registered significant acceleration attributable to the intense activity in civil engineering, which is partly explained by public investments in several large infrastructure projects. Trade, transport and communication sector, as well as the catering sector have made significant contribution to the growth. Higher added value is also typical for the industrial sector, but again, the growth has been relatively modest. On the other hand, agriculture has reported lower value added for the fourth consecutive quarter, same as some service sectors.

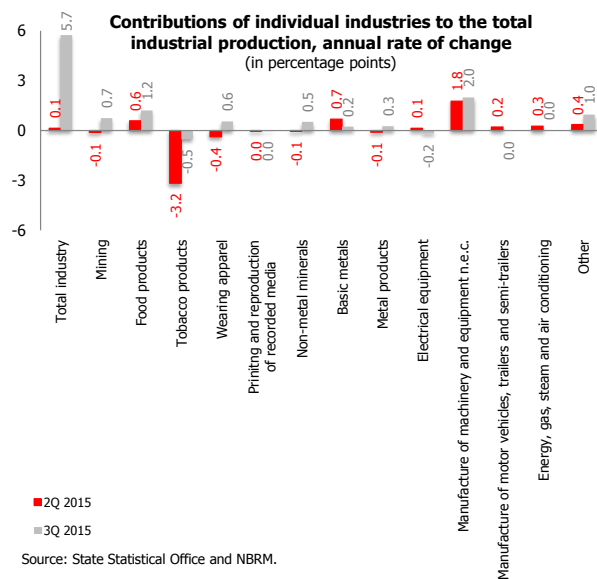
In the third quarter of 2015, the GDP quarterly growth accelerated to 1.8% (seasonally adjusted), while on annual



basis, GDP rose by 3.5%, which is slightly faster compared to the previous quarter. Construction, and trade, transport and communications, as well as catering services are generators of the annual growth. Moreover, growth has been reported by majority of other services (excluding public administration and defense, and arts, entertainment and recreation). On the other hand, the value added of agricultural sector has been decreasing for the fourth consecutive quarter.

	annual growth rates, in %					contributions to GDP growth (in p.p.)				
	2013	2014	Q1 2015	Q2 2015	Q3 2015	2013	2014	Q1 2015	Q2 2015	Q3 2015
Agriculture	8.6	2.2	-3.5	-1.2	-4.6	0.6	0.2	-0.2	-0.1	-0.4
Industry	3.7	20.1	1.8	0.7	1.1	0.5	2.5	0.2	0.1	0.2
Manufacturing	9.6	28.0	-9.4	-2.6	1.5	0.8	2.6	-1.0	-0.3	0.2
Construction	12.8	1.8	5.4	2.8	29.4	1.2	0.2	0.7	0.3	2.6
Trade and transport	11.1	1.8	6.9	6.0	7.0	1.8	0.3	1.1	1.1	1.2
Information and communication	4.8	14.6	8.7	6.3	3.4	0.3	0.8	0.5	0.4	0.2
Financial and insurance activities	-1.4	11.3	8.3	12.2	11.7	-0.1	0.4	0.3	0.5	0.4
Real estate activities	-1.3	2.8	1.1	2.8	1.9	-0.2	0.3	0.1	0.3	0.2
Professional, scientific and technical activities	9.6	9.9	8.6	12.1	15.9	0.3	0.3	0.3	0.5	0.6
Public administration	-7.5	2.1	-0.4	-1.0	-3.1	-1.0	0.2	0.0	-0.1	-0.3
Other service activities	12.7	12.4	4.8	-3.1	-13.6	0.3	0.3	0.1	-0.1	-0.4
Gross Domestic Product	2.9	3.5	3.5	3.3	3.5	2.9	3.5	3.5	3.3	3.5

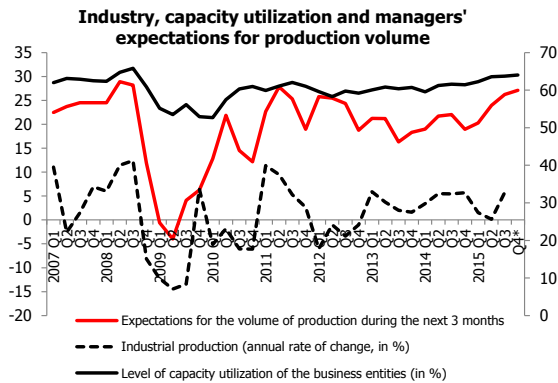
Source: State Statistical Office and NBRM calculations.



The third quarter registered an increased value added in the industrial sector. Thus, compared to the previous quarter, value added of this sector reached double-digit growth rate, while on annual basis, the growth was relatively modest reflecting the high base effect from last year. Main driver of the industry growth is manufacturing, whose improved performance in the third quarter was largely attributable to the activity of the new foreign export capacities, but also to the production of other segments⁷. Thus, the analysis of individual activities within the manufacturing industry points to the production of machines and equipment, non-metal ore products, food products and clothing as activities that have made the highest contribution to the annual growth of the manufacturing industry. The improved performance of manufacturing industry has also been confirmed by the results of the **Business Tendency Survey in the manufacturing industry**⁸, where managers assess the economic standing of their businesses as more favorable, amid higher assessment of the output volume relative to the preceding three months, and given the higher average capacity utilization in the third quarter of the year. Observing the limiting factors,

⁷ The analysis by activity is based on data on industrial output.

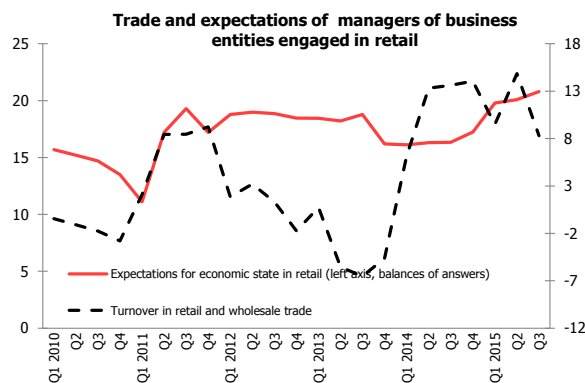
⁸ Refers to the surveys conducted in the third quarter of 2015.



Source: State Statistical Office.
* average of expectations for October and November of 2015.

corporate managers stress the lack of skilled labor and insufficient domestic demand as factors that have highly negative impact in the third quarter (compared to the same period last year). Besides manufacturing, improved performance in the third quarter were also observed in **mining**, while the production volume of **electricity, gas, steam and air conditioning** sectors remained almost unchanged compared to the same period last year.

The available data for the October-November period suggest continuation of favorable trends in the industrial sector in the fourth quarter. Namely, in the first two months of the fourth quarter, industrial output recorded an average annual increase of 12.3%, reaching double-digit growth rates in the both months. The growth stems from manufacturing, while the production in mining and electricity supply recorded an annual decrease. The favorable trends in manufacturing industry are also supported by surveys conducted in October and November that indicate steady growth of the capacity utilization level, as well as more optimistic perceptions of the managers in the manufacturing sector about the output volume and the number of employees in the next three months.

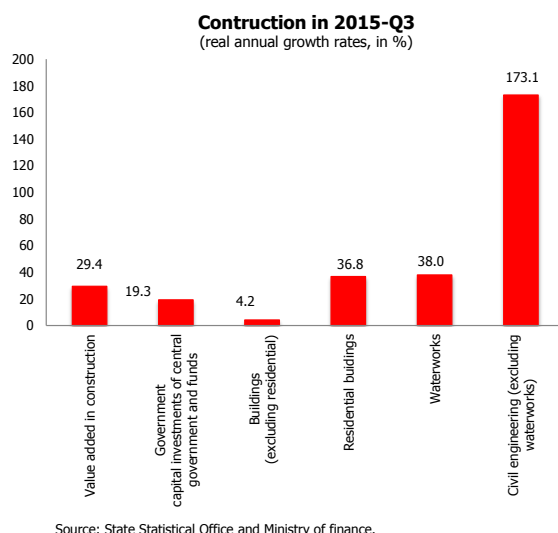
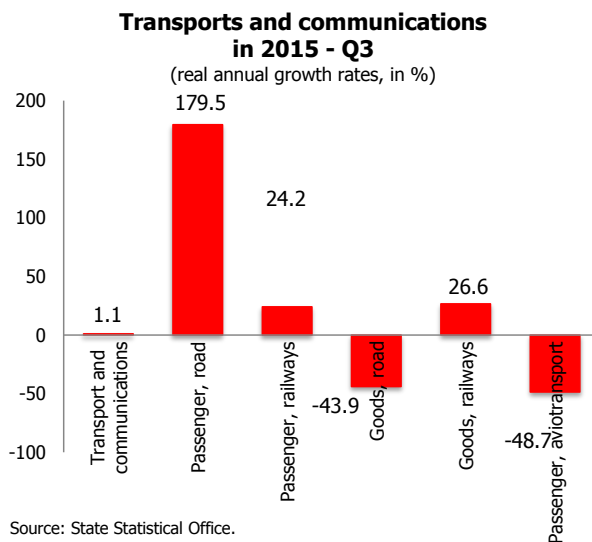
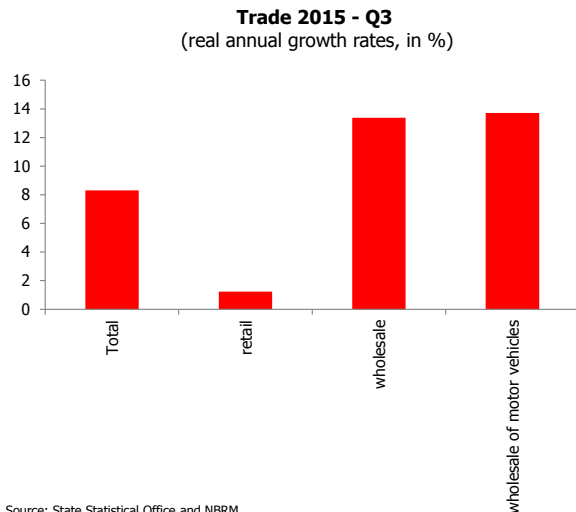


Source: State Statistical Office and NBRM.

Favorable trends in the trade sector that started in 2014 continued in the third quarter⁹, but at a slower annual pace. Thus, slowing annual growth was observed in the turnover of trade in motor vehicles, wholesale, and retail. When it comes to trends in retail, the growth in this sector compared to last year is also confirmed by the results of the Retail Managers Survey¹⁰ conducted in the third quarter. The results point to more favorable managers' assessments of the current business situation of companies, as well as alleviation of the limiting effect of the weak demand of buyers (significantly lower assessments for this factor compared to the same period last year). On the other hand, managers point to increased limiting effect of the shortage of qualified staff and sales area, as well as increased labor costs (compared to the same period last year). **Favorable trends in trade are expected to continue in the fourth quarter** amid intensifying growth rate of the

⁹ The analysis of trends in trade uses data on the trade turnover.

¹⁰ SSO's Business Tendency Survey in retail trade for the third quarter of 2015. The balance of responses is the difference between weighted positive and negative responses of corporate managers. The balance is designed to show the movement of the observed economic indicator rather than its true size, i.e. it provides qualitative rather than quantitative (numerical) data from corporate managers.



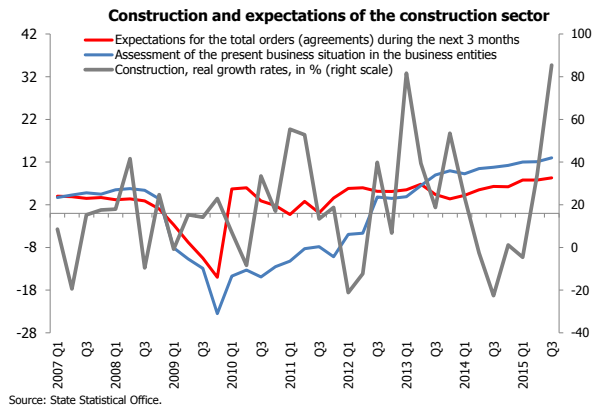
turnover in total trade in the period from October to November. These developments are in line with the results of the Retail Managers Survey in the third quarter, where the managers expressed more favorable expectations for the number of orders in the next three months, and a more favorable business situation of companies for the next six months.

Observing the trends in the transport and communication sector, this quarter continued registering favorable trends in passenger traffic given the particularly high increase of rail road traffic, partly due to greater demand for this type of service because of the refugee crisis. Contrary to the favorable trends in passenger traffic, freight traffic in general has deteriorated, amid continuing downward trend in the volume of freight rail and air traffic. Recovery has been observed only in road freight transport. **The small number of high frequency indicators hinders any precise assessment of the developments in the transport and communications sector in the fourth quarter**, although the currently available data suggest growth of this activity given the high annual growth of passenger rail traffic.

Construction is the leading sector of growth in the third quarter of the year, with significant acceleration of the annual and quarterly growth in the added value¹¹. Favorable movements have been observed in all areas of the construction sector, with most of the growth being explained by the increased activity in the field of civil engineering given the implementation of several larger public infrastructural projects. The results of business tendency surveys in construction¹² also point to accelerated activity in this sector amid more favorable assessments of the current business and financial situation in corporations compared to the same period last year. However, for this quarter, the managers have again highlighted several factors that limit the growth of construction activity, such as lack of skilled labor, higher labor costs and increased costs for construction materials. **Construction activity is expected to keep on increasing in the fourth quarter**, taking into account the continuation of double-digit growth in the value of completed construction works in October (although at a slower pace compared to the third quarter). The

¹¹ Seasonally-adjusted.

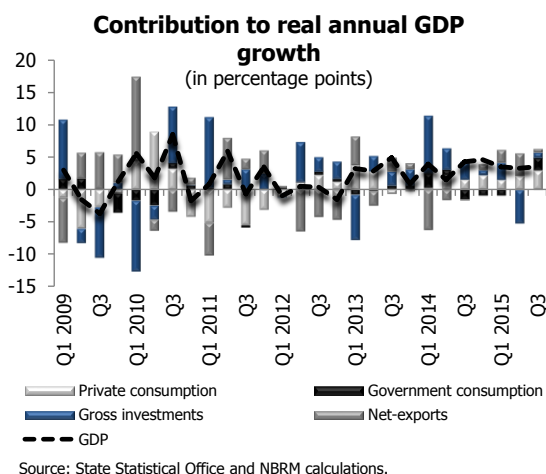
¹² Refers to the surveys conducted in the third quarter of 2015.



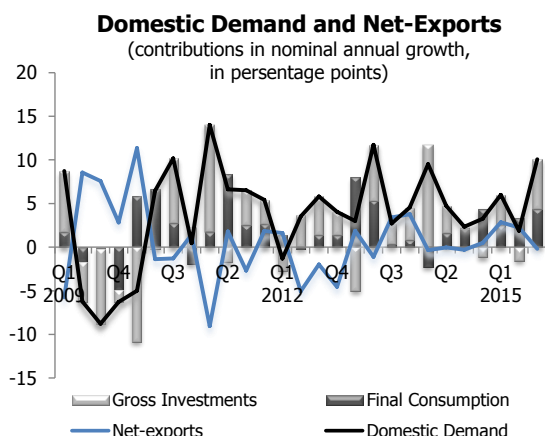
favorable expectations of company managers in the construction sector are in the same direction, both in terms of volume of orders, and in terms of the number of employees in the fourth quarter.

1.3. Aggregate demand

Annual GDP growth of 3.5% in the third quarter of 2015 was slightly higher than that of the previous quarter. The steady pace of growth indicates limited adverse effects of non-economic factors associated with the domestic political developments and the developments in Greece on the growth rate of demand in the domestic economy. The growth structure analysis shows high positive contribution of the domestic demand and positive, but significantly lower contribution of net exports. Household consumption is the component with the highest individual contribution to growth in the third quarter, underpinned by favorable labor market developments, and somewhat faster growth of lending to this segment. Lower energy prices have most probably ensured additional support to the growth of consumption through the growth of real disposable income of households. Significant growth in the third quarter was observed in public spending. Also, after the decline in the previous quarter, positive developments were registered in gross capital formation, which most probably reflects intensive implementation of public projects of strategic interest.



In the third quarter, the gross domestic product (GDP) grew by 1.8% compared to the previous quarter (seasonally adjusted) and by 3.5% compared to the same period last year, which is slightly faster pace compared with the previous quarter. The growth is mainly due to the domestic demand, with simultaneous small positive contribution of net exports. The above reflects a structure different from that in the previous quarter, when the positive contribution to the annual growth was attributable solely to net exports. Household consumption, coupled by the favorable labor market trends and the enhanced lending to this segment, was the main generator of growth. In the same period, public spending also provided exceptionally high support to the growth. Alongside of this, after falling in the previous quarter, gross capital formation has returned to the zone of positive annual growth,



Source: State Statistical Office and NBRM calculations.

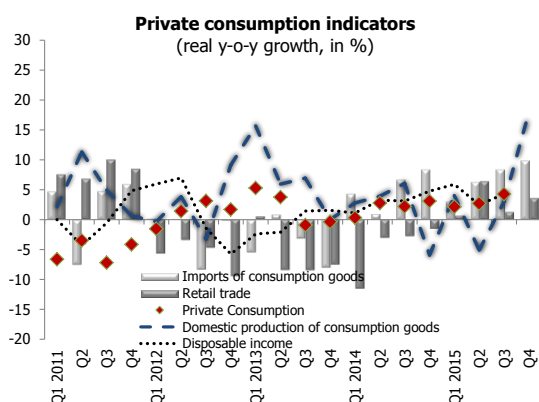
registering a slight growth, which taking into account the high increase in the value of completed construction works, probably show intense implementation of infrastructure projects of public interest. Exports also made positive contribution, yet significantly lower than the average recorded in the preceding two-year period, when this component was continually pointed out as the main generator of growth. Growth of domestic and export demand also increased imports, but at moderate growth rate.

	Real annual growth rates (%)					Contributions to real annual growth (in p.p.)				
	2013	2014	2015-Q1	2015-Q2	2015-Q3	2013	2014	2015-Q1	2015-Q2	2015-Q3
Private consumption	1.9	2.1	2.1	2.7	4.3	1.4	1.5	1.5	2.0	2.9
Government consumption	0.5	1.0	-5.6	0.7	15.4	0.1	0.2	-1.1	0.1	2.3
Exports of goods and services	6.1	18.2	4.9	7.9	3.1	2.8	7.9	2.3	3.8	1.5
Imports of goods and services	2.2	16.0	0.4	0.8	1.6	-1.4	-9.8	-0.4	-0.4	-1.2
Gross capital formation	0.5	13.1	8.6	-16.0	2.8	0.1	3.8	2.6	-5.0	0.9
Domestic demand	1.3	4.7	2.7	-2.4	5.2	1.6	5.5	2.9	-2.9	6.0
Net exports*	-6.9	10.1	-10.3	-16.1	-4.6	1.3	-1.9	1.9	3.4	0.3
Statistical discrepancy								-1.4	2.7	-2.8
GDP	2.9	3.5	3.5	3.3	3.5	2.9	3.5	3.5	3.3	3.5

*decrease represents lower deficit

Source: SSO and NBRM calculations.

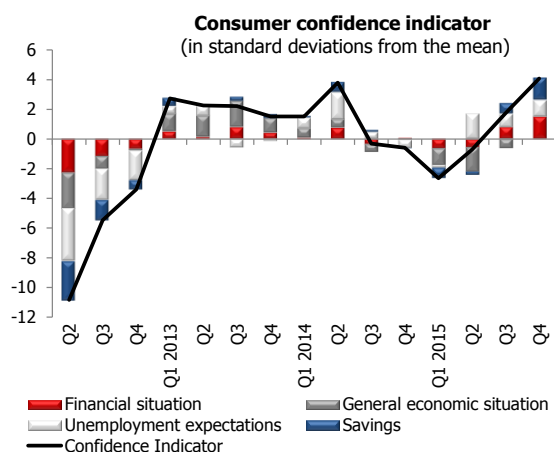
1.3.1. Private consumption



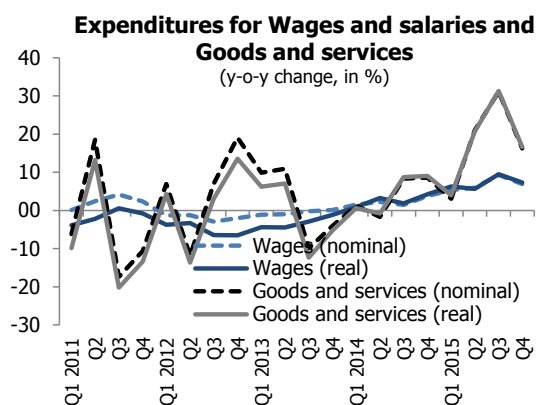
Source: State Statistical Office, Ministry of Finance and NBRM calculations.

In the third quarter, household consumption registered a quarterly increase of 0.4% (seasonally adjusted) and real annual growth of 4.3%, which is an enhancement compared to the dynamics registered in the previous quarter. Supported by favorable labor market developments as well as slightly faster credit growth, household consumption was the main generator of growth. Additional support was provided by lower energy prices, which most likely increased the real disposable income of households, and thus their consumer sentiment.

Most of the latest high-frequency data have indicated higher private consumption in the last quarter of the



Source: European Commission and NBRM's calculations.



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

year¹³. This is suggested by the growth of pensions as one of the components of disposable income and the relatively stable growth of household lending, which according to the Lending Survey¹⁴, corresponds to the banks' announcements to ease credit standards as well as the expectations for increased demand for loans in this period. High frequency data are also confirmed by the signals from the surveys¹⁵ which point to a more pronounced consumer sentiment for the period, mainly fueled by favorable expectations in terms of the unemployment and the financial situation of consumers. Additional positive indications of private consumption also come from the retail trade, the imports of consumer goods and from the increased domestic production of consumer goods.

1.3.2. Public consumption

In the third quarter, public consumption recorded a quarterly growth of 2.9% (seasonally adjusted) and exceptionally high real annual growth of 15.4%. The annual dynamics has accelerated mostly due to the high growth in health care transfers¹⁶, expenditures for goods and services, as well as higher wage costs.

Data for the October-November period indicate an annual increase in public spending in the last quarter, but at a likely slower pace, especially considering the intensive slowdown in expenditures for goods and services.

1.3.3. Investment consumption

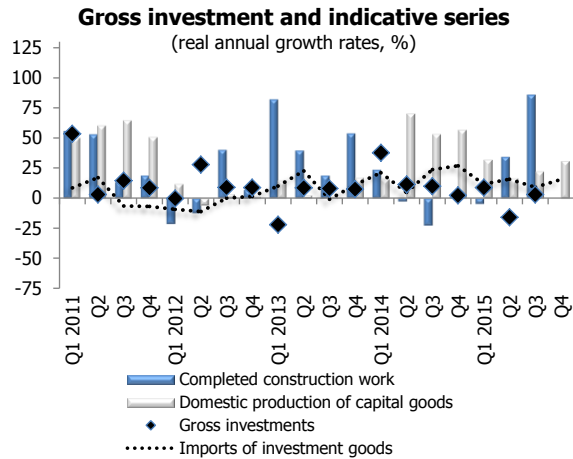
In the third quarter, the gross capital formation registered a quarterly growth of 18.4% (seasonally adjusted) and an annual growth of 2.8%, following the steep decline in the previous quarter. The signals of the two most important indicative categories of investment in fixed assets or completed construction works, as well as imports of machinery and equipment are in line with the increased investment activity in this period. Faster annual increase has been registered in the domestic production of capital goods, as well as corporate loans of banks. In the third quarter,

¹³ The analysis of net private transfers was made using October data. Other factors have been analyzed as of November.

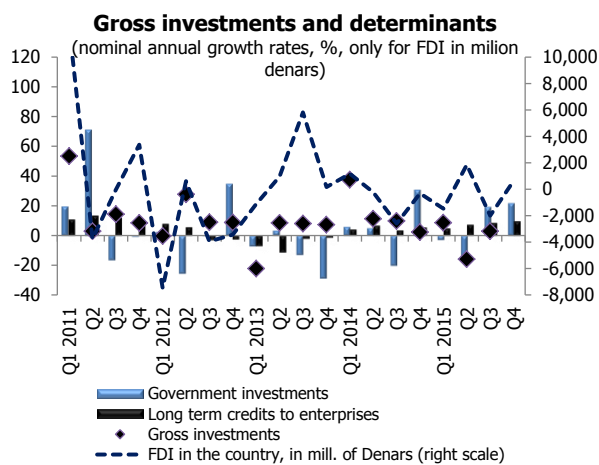
¹⁴ NBRM's Lending Survey conducted in December 2015.

¹⁵ European Commission's Consumer Survey as of December 2015.

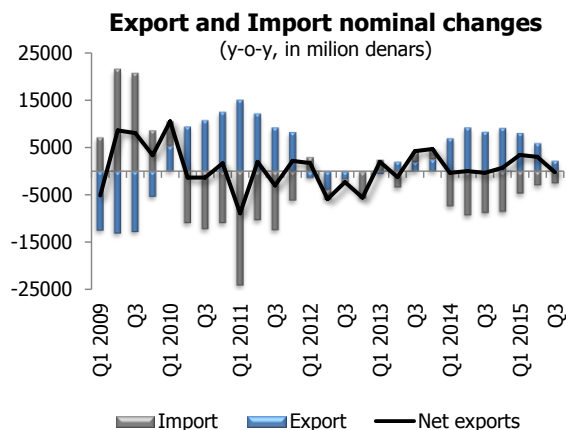
¹⁶ Most of these assets relate to expenditures on goods and services.



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



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



Source: State Statistical Office.

government expenses for capital investments went up annually after the negative performance of this category in the first half of the year.

In terms of the movement of investments in the last quarter of the year, most of the signals coming from the available high frequency data point to continuing growth¹⁷. The increased capacity utilization in the manufacturing industry along with the managers' opinion for less restrictive effect of financial factors, coupled with solid long-term corporate lending by banks (due to the increased demand given the eased credit standards of most of the banks¹⁸), supports future growth of investment in fixed assets of the corporate sector. Greater optimism has also been expressed by construction managers who suggest larger production orders, and greater optimism regarding the employment outlook in this period¹⁹.

In October, inflows of foreign direct investment increased, as well. After the exceptionally high growth in the previous quarter, the value of completed construction works has also increased, but at a slower pace.

Meanwhile, in October and November there was also an exceptionally high growth of government expenses for capital investments.

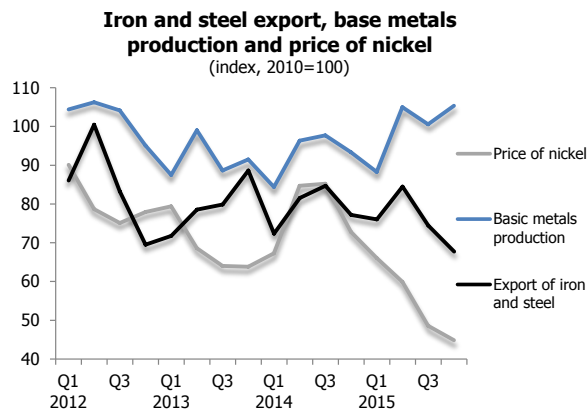
1.3.4. Net external demand

Net exports have been making positive contribution to the growth of economic activity for four consecutive quarters, but with significantly lower intensity in the third quarter. Real export of goods and services recorded an annual growth of 3.1% (deceleration of the positive annual growth pace) and quarterly fall of 3.7% (seasonally adjusted). Moreover, as before, the annual growth in exports is largely associated with the activity of the new production facilities, as well as the gradual improvement of the economic situation in our major trading partners. On the other hand, the fall in global price of metals narrows the profitability of domestic metal manufacturing sector, and hence its export activity.

¹⁷ Data on completed construction works and foreign direct investments have been analyzed as of October, while for the other indicative categories, the cut off date is November.

¹⁸ NBRM's Lending Survey conducted in December 2015.

¹⁹ Refers to the surveys conducted in the third quarter of 2015.



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

Import of goods and services in real terms increased in the third quarter by 1.6% annually, which is double compared to the dynamics registered in the previous quarter. Imports have registered a quarterly decrease of 1.1% (seasonally adjusted).

Foreign trade data for the period from October to November indicate higher nominal export and import of goods. However, import growth exceeds export growth that tends to widen trade deficit. Analyzing structure, in the same two-month period, exports of iron and steel almost doubled the negative contribution compared to the average for the third quarter. Additionally, exports of chemical products which are mainly associated with the activity of new industrial facilities, after the October decline, which comes after a long period of favorable annual shifts, was back on the track of positive performances in November. The period from October to November witnessed growth in most categories of imports, but mostly in industrial goods.

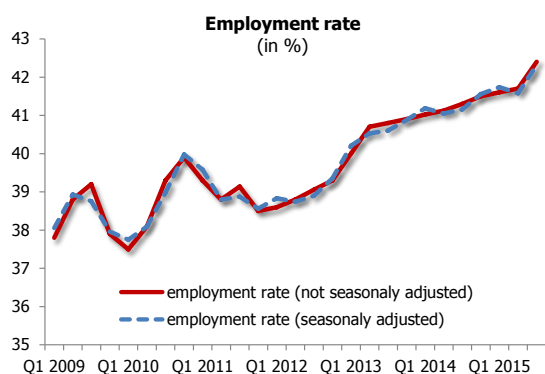
1.4. Employment and wages

In the third quarter, the number of employees increased by 3%, which is the highest annual growth rate since 2014. It represents a three and a half years period of continuous positive annual growth rates, which in turn indicates continuous increasing of capacity of the domestic economy to absorb labor²⁰. These developments correspond with the real sector performances, which are also favorable. The aggregated signals from business tendency surveys point to stronger optimism about employment for the next three months. In the third quarter, cost competitiveness of the economy somehow deteriorated, considering the faster annual rise of wages compared to the growth of labor productivity, a trend present for four consecutive quarters.

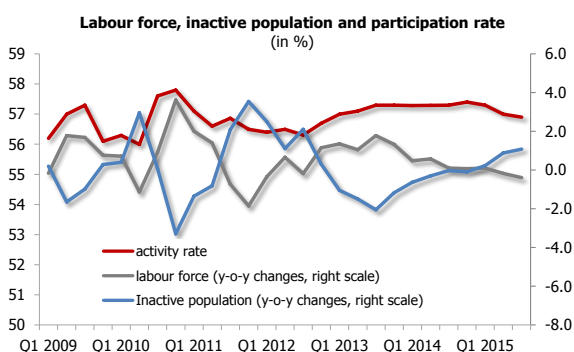
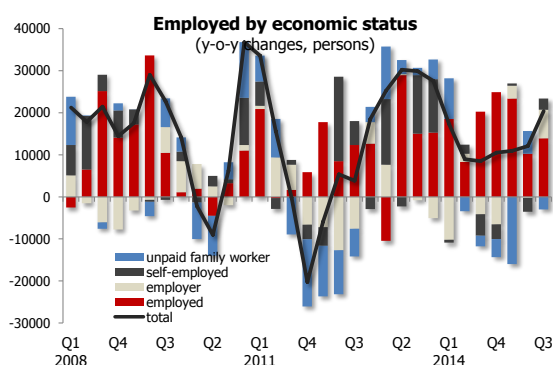
In the third quarter, the number of employees increased by 3% on an annual basis, which is the strongest growth since 2014. Also, after the slight decrease in the previous quarter, **employment recorded a quarterly growth of 1.8%²¹.** The annual growth in the number of employees is mostly associated with the services sector, with simultaneous positive developments in industry

²⁰ The growth in the demand for labor has been associated with the activity of the new facilities in the technological-industrial development zones for several years now. Also, for a longer period, the labor market has had a solid response to the fiscal policies aimed at accelerating economic activity and employment, such as active employment measures, implementation of public infrastructure projects, policies of subsidizing agricultural production, and credit lines provided through the European Investment Bank (EIB), offered in the form of subsidized loans intended to improve the liquidity of the investment activity of SMEs.

²¹ The analysis of quarterly dynamics of employment, unemployment and total active population was made using seasonally adjusted data.



Source: State Statistical Office, Labour Force Survey.



Source: State Statistical Office, Labor Force Survey.

and agriculture. Analyzed by sector, almost half of the growth comes from the trends in trade, followed by public administration, defense and compulsory social insurance, as well as the manufacturing industry. In terms of the economic status²², the growth mostly results from the category of employed population. These developments have increased the employment rate by 1.1 percentage points annually, to 42.4%. The results of the Job Vacancy Survey confirm the positive developments in the employment²³. Namely, the number of vacancies, as an additional indicator of the movement of labor demand registered an annual growth of 2.6% in the third quarter. At the same time, given the significant acceleration in the number of occupied positions, the rate of vacancies²⁴ recorded a slight downward correction compared to the same period of the previous year, positioning itself at 1.55%. The administrative and auxiliary services, mining, as well as accommodation and food services are characterized by the highest annual growth of the rate of vacancies.

In terms of employment prospects in the short run, the cumulative signals from the business tendency surveys²⁵ indicate stronger optimism among company managers.

In the third quarter, labor supply decreased by 0.4%, which is some increase of the negative annual pace from the previous quarter. Such decline of the number of economically active population, amid faster growth of the number of inactive job-seekers decreased the activity rate from 57.3% in the same period of 2014 to 56.9%, which is a record low since 2013.

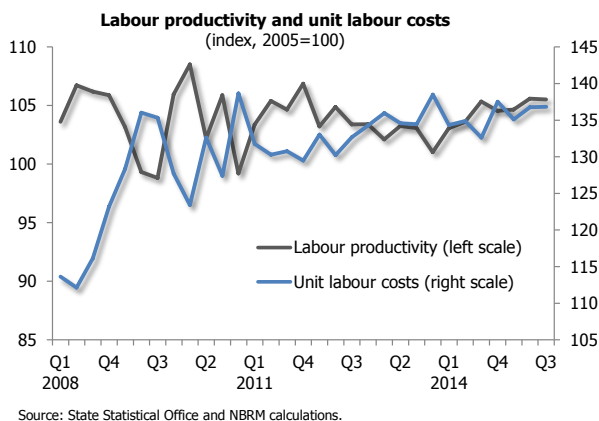
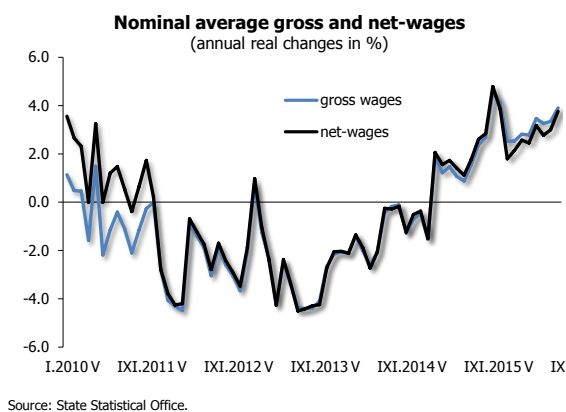
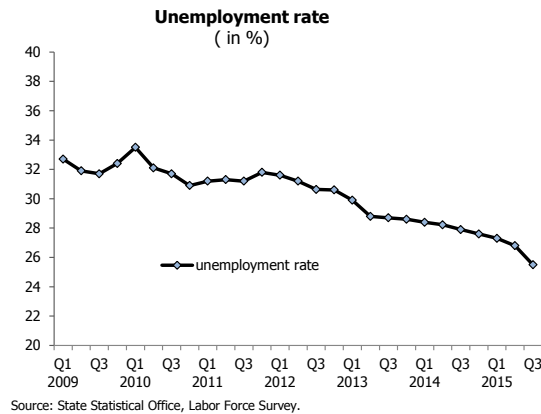
In the third quarter, the considerably strengthened demand amid reduced labor supply resulted in accelerated pace of decline in unemployment. Namely, the number of unemployed in the third quarter decreased by 9% on an annual basis. Accordingly, the

²² 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).

²³ In 2012, the State Statistical Office began for the first time to conduct a Vacancy Survey as part of the labor market research. The purpose of this Survey is quarterly reporting on vacancies in companies in the Republic of Macedonia, as an important indicator for the macroeconomic developments and policies in the labor market.

²⁴ The rate of vacancies is defined as the ratio between the number of job vacancies and the total number of jobs, i.e. both vacant and occupied jobs.

²⁵ Source: State Statistical Office, business tendency surveys in manufacturing industry (October 2015), construction (third quarter of 2015) and trade (third quarter of 2015).

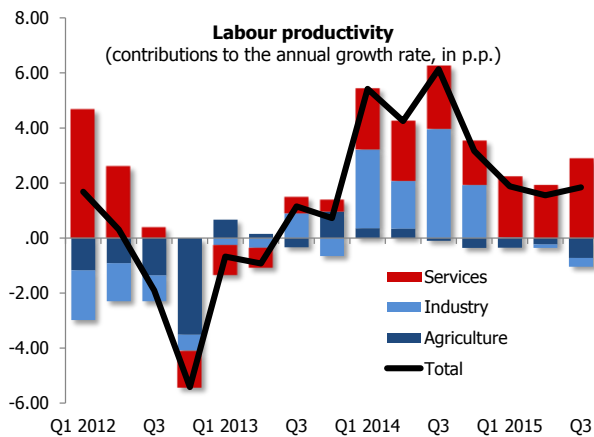


unemployment rate was revised downward by 2.4 percentage points, reducing to a record low of 25.5%.

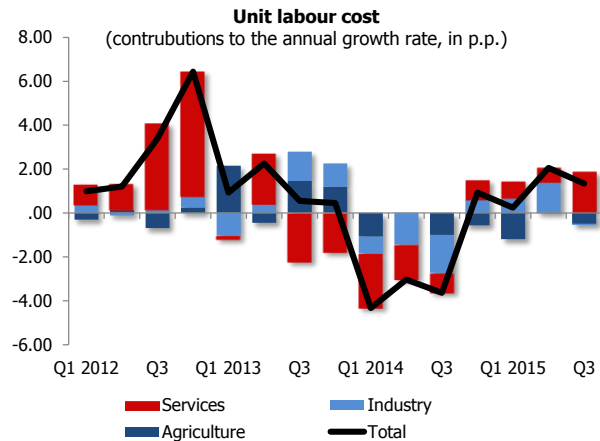
The average wages paid in the third quarter have increased annually, at almost unchanged pace compared to the previous quarter. Thus, in the third quarter, the nominal net and gross wages increased by 3.0% and 3.3%, respectively, on an annual basis. The wages in industry and service sectors have increased. Agriculture, where wages decreased annually, is an exception. The sector-by-sector analysis points to the segments of arts, entertainment and recreation, followed by other services, and administrative and auxiliary services as sectors with most intensive positive change. Nominal net and gross wages have almost stagnated on a quarterly basis. **In the third quarter, given the decreased general price level, the real net and gross wages registered an annual growth of 3.2% and 3.5%, respectively, which is a slight acceleration of the pace compared to that of the previous quarter.** Also, the faster decrease in general price level compared to the nominal fall in wages has increased the real net and gross wages quarterly by 0.5% and 0.6%, respectively.

Labor productivity registered an annual growth rate of 1.8% in the third quarter²⁶, which is slightly faster than that registered in the previous quarter. Also, with such performance, this indicator has ranged in the zone of positive annual changes for nine consecutive quarters. Productivity has increased as a result of the faster annual growth of economic activity compared to the employment growth. Analyzed by sector, the annual productivity growth is fully associated with the services sector. Productivity remained unchanged on a quarterly basis, amid increased economic activity and employment. **Unit labor costs have increased by 1.3% annually, which is a slowdown compared to the previous quarter.** The upward adjustment is due to the faster growth of gross wages compared to productivity growth. At the same time, the annual growth in unit labor costs is solely driven by the services sector. After the growth in the previous quarter, labor costs in the third quarter remained unchanged on a quarterly basis, amid stagnation in both gross wages and productivity.

²⁶ Total productivity is calculated as the ratio between the sum of added values of individual sectors included in the calculation and the number of employees in these sectors. The total GDP in Q3 2015 recorded an annual growth of 3.5%, while the sum of added values of individual sectors increased by 4.9%. Employment has increased by 3%, and hence productivity has increased by 1.8%.



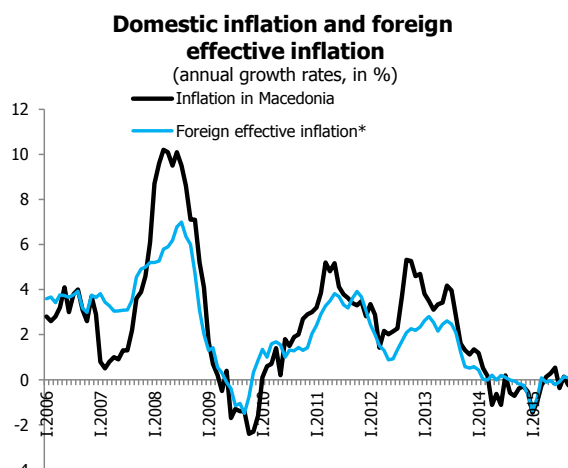
Source: State Statistical Office and NBRM calculations



Source: State Statistical Office and NBRM Calculations

1.5. Inflation

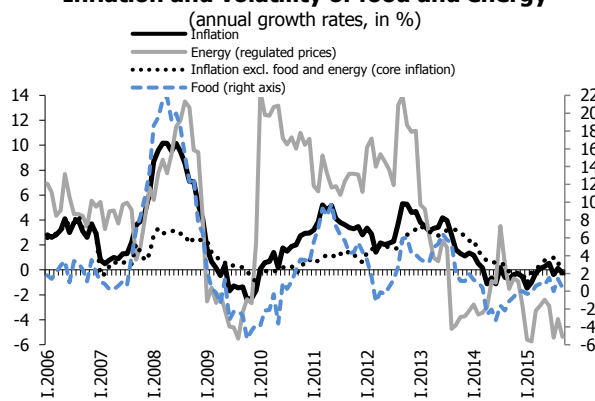
The global environment of generally low prices of primary commodities typical for 2015 has affected the domestic consumer energy and food prices, and hence, the inflation that remained in the negative zone in the fourth quarter of the year (annual and quarterly decline of consumer prices of 0.4% and 0.1%, respectively), while for the whole of 2015, the price change was -0.3%. Despite these developments in the energy and food components, core inflation has remained in the positive zone for the third consecutive quarter. As for producer prices on the domestic market, the low prices of crude oil on world markets have created downward pressure on these prices, which in the first two months of the fourth quarter remained in the negative zone. In terms of expectations for the future period, the Inflation Expectations Survey conducted in December pointed to unchanged inflation expectations relative to the previous quarter.



* 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.

The reduction in domestic consumer prices continued in the last quarter of the year, when prices decreased by 0.4%, annually. Analyzed by components, the decline in prices in the fourth quarter was mostly due to the energy component, primarily due to the lower prices of liquid fuels and lubricants, in line with the fall in oil prices on world markets. After the moderate growth in the previous three quarters, the fourth quarter witnessed a slight decline in food prices, mainly reflecting lower prices of meat and vegetables. On the other hand, core inflation in the fourth quarter increased, amid higher prices of several categories within the index, with the largest contribution of the higher tobacco prices²⁷.

²⁷ Since 1 July 2014, cigarette excise duty has been increasing (Denar 0.15 per cigarette) and it is intended to gradually increase each year. Starting from 1 July 2016 (until 1 July 2023), the excise duty will increase by Denar 0.20 each year.

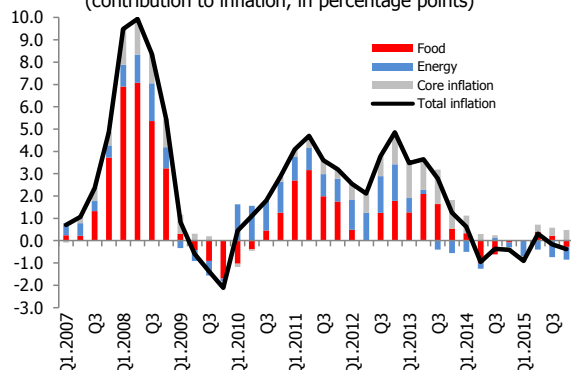
**Inflation and volatility of food and energy**

Source: State statistical office and NBRM calculations.

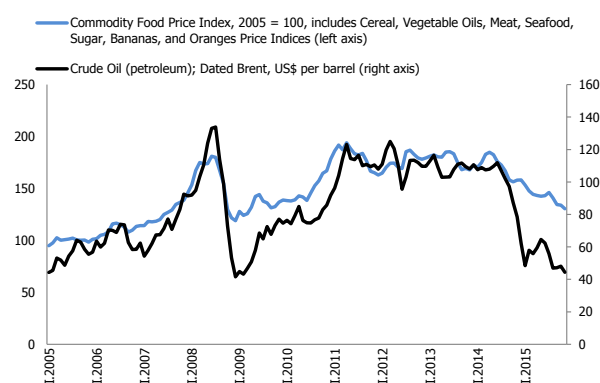
Unlike domestic effective inflation, **foreign effective inflation²⁸ followed an upward trajectory** and reached 0.6% in the fourth quarter compared to 0% in the previous quarter.

	annual growth rates, in %										contributions to GDP growth (in p.p.)									
	2014					2015					2014					2015				
	Q1	Q2	Q3	Q4	2014	Q1	Q2	Q3	Q4	2015	Q1	Q2	Q3	Q4	2014	Q1	Q2	Q3	Q4	2015
Consumer price index - all items	0.6	-1.0	-0.4	-0.4	-0.3	-0.9	0.3	-0.2	-0.4	-0.3	0.6	-1.0	-0.4	-0.4	-0.3	-0.9	0.3	-0.2	-0.4	-0.3
Food	0.9	-2.6	-1.6	-0.2	-0.9	0.1	1.0	0.6	-0.7	0.2	0.3	-1.0	-0.6	-0.1	-0.3	0.0	0.4	0.2	-0.3	0.1
Energy	-3.3	-1.6	0.8	-1.5	-1.4	-4.9	-2.7	-4.9	-3.9	-4.1	-0.5	-0.2	0.1	-0.2	-0.2	-0.7	-0.4	-0.7	-0.6	-0.6
Electricity	-3.2	-3.2	4.5	3.6	0.4	3.6	3.6	-0.3	-0.4	1.6	-0.2	-0.2	0.3	0.3	0.0	0.3	0.3	0.0	0.0	0.1
Heat energy	-12.3	-2.9	-8.2	-11.0	-8.7	-11.0	-11.0	-4.0	-0.2	-6.8	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	0.0	0.0	-0.1
Fuels and lubricants	-4.3	-0.8	-2.2	-8.2	-3.9	-20.1	-13.3	-17.2	-15.3	-16.5	-0.2	0.0	-0.1	-0.4	-0.2	-0.9	-0.6	-0.8	-0.6	-0.7
Food and energy (volatile prices)	-0.3	-2.4	-0.9	-0.6	-1.1	-1.3	0.0	-1.0	-1.6	-1.0	-0.2	-1.3	-0.5	-0.3	-0.6	-0.7	0.0	-0.5	-0.8	-0.5
Core inflation (inflation excl. food and energy)	1.7	0.6	0.3	-0.2	0.6	-0.4	0.7	0.7	1.0	0.5	0.8	0.3	0.1	-0.1	0.3	-0.2	0.3	0.4	0.5	0.2

Source: State Statistical Office and NBRM calculations.

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

Source: State statistical office and NBRM calculations.

Crude oil and food prices

Source: IMF Primary Commodity Prices.

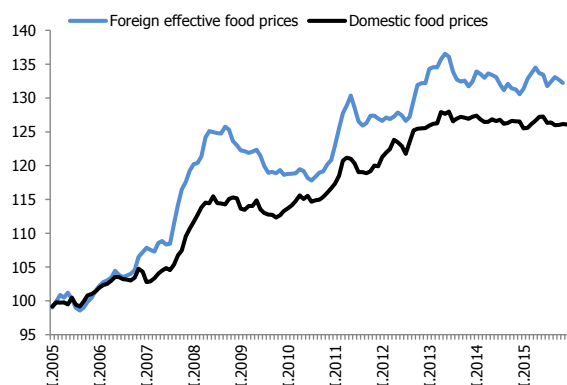
Analyzed dynamically, the small deepening of the annual decline in consumer prices in the last quarter of the year (versus the previous quarter) is mainly explained by the changes in food prices. In fact, this component has been increasing since the beginning of the year, while in the last quarter, it entered the zone of negative annual changes. The price of energy component and core inflation have acted in the opposite direction, and have registered small upward movements between the two quarters (narrowing of the fall in energy prices and acceleration of the growth of core inflation). **Core inflation was 1% in the fourth quarter** (versus 0.7% in the third quarter), and the shift has mainly reflected the acceleration of growth of prices of pharmaceutical products and prices of IT equipment as well as the slower drop in prices of transport equipment.

On a quarterly basis, consumer prices were lower by 0.1% in the four quarter of 2015, which is explained by the downward movements in two of the three components of inflation. Thus, same as in the preceding quarter, food and energy components have decreased, while core inflation is still in the positive zone (for third consecutive quarter).

²⁸ The calculation of foreign effective inflation derives from the weighted sum of consumer price indices of the countries that are major 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 of joint consumption goods from each country in the total nominal import of joint consumption goods in the period 2010-2012. The calculation of this indicator includes Bulgaria, Germany, Greece, France, Italy, Austria, Slovenia, Croatia and Serbia.

**Foreign effective food prices* and domestic food prices**

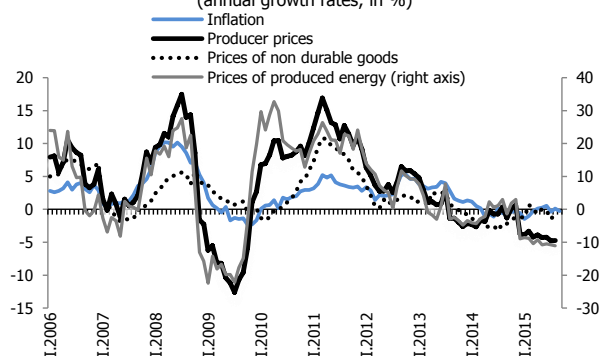
(indices, 2005 = 100)



* 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

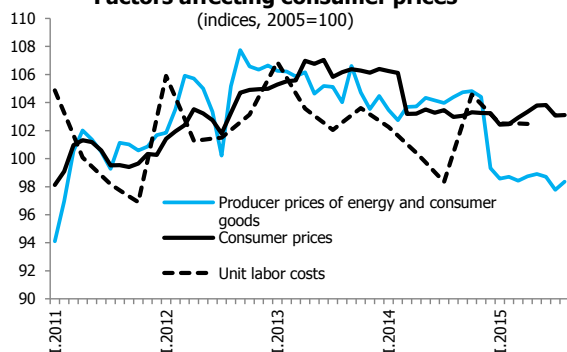
(annual growth rates, in %)



Source: State statistical office and NBRM calculations.

Factors affecting consumer prices

(indices, 2005=100)



Source: State statistical office and NBRM calculations.

Seasonally adjusted data indicate quarterly fall in consumer prices of 0.4%.

In the fourth quarter of 2015, the change in producer prices in the domestic market has remained in the negative zone for ninth consecutive quarter. Thus, the annual decline in producer prices in the first two months of the fourth quarter averaged 4.3%, which compared to the previous quarter, is a slightly more moderate decline (4.6% in the previous quarter). Lower producer prices of refined petroleum products have made the largest contribution to the annual decline. **Producer prices have registered a small quarterly increase of 0.3%** (seasonally adjusted rate of 0.3%) primarily due to the higher producer prices of clothes. **The movement of producer prices which affect domestic inflation component²⁹ generally indicates no potential inflationary pressures in the period ahead.** On annual basis, these prices continued to decline (annual decline of 5.6% versus 5.7% in the previous quarter). On the other hand, they have increased quarterly³⁰ but at a very slow pace (growth of 0.2% versus the 0.6% decline in the previous quarter).

In the third quarter of 2015, unit labor costs grew by 1.3% annually. Considering that the estimates for the output gap still do not point to significant pressures from the demand³¹, for the time being no inflationary pressures on prices of final products through this channel have been expected.

²⁹ Consumer goods (durable and non-durable) and energy.

³⁰ The quarterly change has been calculated using seasonally adjusted data.

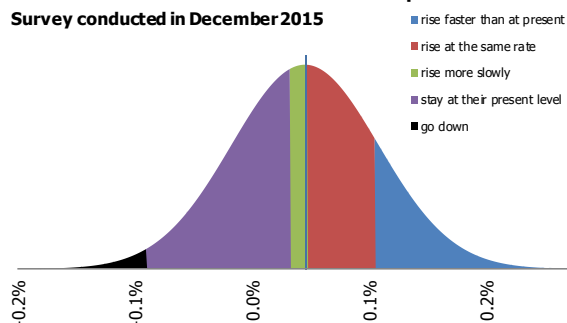
³¹ Estimates of the Central Bank show that the output gap is around zero by the end of 2015.

Box 1: Inflation Expectations Survey³²

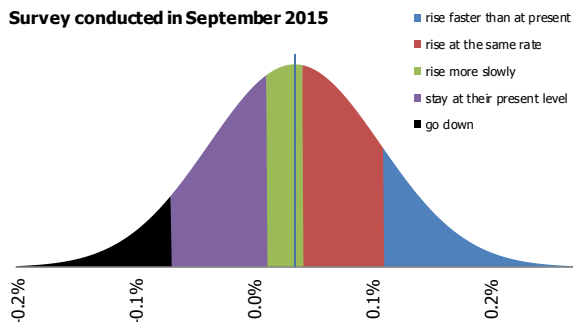
Inflation Expectations Survey includes three groups of respondents: economic analysts, companies and financial institutions. The questionnaire contains two questions to measure inflation expectations, one qualitative and one quantitative in nature. For the first question on inflation expectations, the respondents indicate the direction and extent of price changes compared with the change in the previous 12 months³³. Carlson and Parkin (1975) probability approach has been used for quantification of qualitative answers, which assumes that amid 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 years³⁴. 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.

Normal distribution of answers of the respondents

Survey conducted in December 2015



Survey conducted in September 2015



The Inflation Expectations Survey was conducted in December 2015³⁵. Same as in the previous survey cycle, **the average inflation rate for the previous 12-month period remained in the negative zone³⁶**. The results of the survey indicate unchanged inflation expectations relative to the previous survey, i.e. as in September, respondents expect inflation to be around 0% in the next 12-month period. Expectations for the inflation rate of around 0% are common for all three groups of respondents (economic analysts, enterprises and financial institutions).

In terms of the quantitative question on the expected rate of inflation for 2016, little changes compared to the expectations in the previous survey round are registered. Namely, in the period between the two surveys, the respondents' expectations for inflation for 2016 decreased by 0.5 percentage points, on average. Respondents

expect the inflation to accelerate in 2017 compared to 2016. According to respondents, **the factors that explain inflation expectations in December** are the geopolitical instability and import prices of energy and food products.

³² 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.

³³ 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"

³⁴ The quantitative question reads as follows: "What are your expectations/forecasts for the average inflation rate for 2016 and 2017?"

³⁵ Refers to the period December 2014 to November 2015. The percentage of responsiveness to the Survey conducted in December was 33.7%, which compared to the previous quarter, represents a decrease of responsiveness. Analyzed by groups of respondents, the financial institutions' responsiveness is 61.1%, followed by economic analysts with 42.0% and companies with 23.3%.

³⁶ In circumstances of a negative price growth, the interpretation of the results of the survey can be blurred, and therefore, it is necessary to change the method of calculation of the indicator for inflation expectations. Thus, in the procedure for quantification, the negative rate is replaced with the last positive growth rate. This is the way to avoid the contradictory responses from the survey that assume a positive price growth. Taking into account that changes in the method are of a purely technical nature, the quantification of qualitative answers for the expected rate of inflation in periods of negative inflation should be taken with caution, while the indicator for inflation expectations as approximate.



1.6. Balance of Payments³⁷

In the third quarter of the year, the balance on the current account registered a surplus, which is a common seasonal movement. On annual basis, the surplus in the current account increased, driven by favorable trends in the balance of trade in goods. The faster growth of exports relative to import component led to narrowed trade deficit. On the other hand, the surplus in the balance of services and secondary income also reduced. Analyzed on cumulative basis, from the beginning of the year, the current account is almost balanced, which is favorable adjustment compared to the previous year. The main factor for such a movement is the lower deficit in the trade of goods, given unfavorable annual changes in other current account components. In the third quarter, net outflows from the financial account were recorded, mostly as a result of deleveraging on the basis of trade credits and further net outflows in currency and deposits. Source of inflows in the financial account in this period were the long-term financial loans to the public sector, with the foreign direct investment having minimal positive effect. Net outflows through the financial account are also typical on a cumulative basis, a result of performance in the short-term components (trade credits and currency and deposits), as well as to the deleverage of the Government, despite the high amount of borrowings in the previous year. On the other hand, the foreign direct investments are still the main source of financial inflows. Having in mind these trends in individual components of the balance of payments, in the third quarter the decrease in foreign reserves continued, which was also present during the first half of the year.

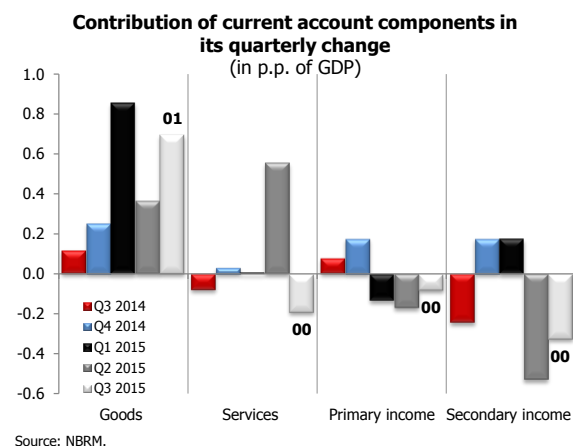
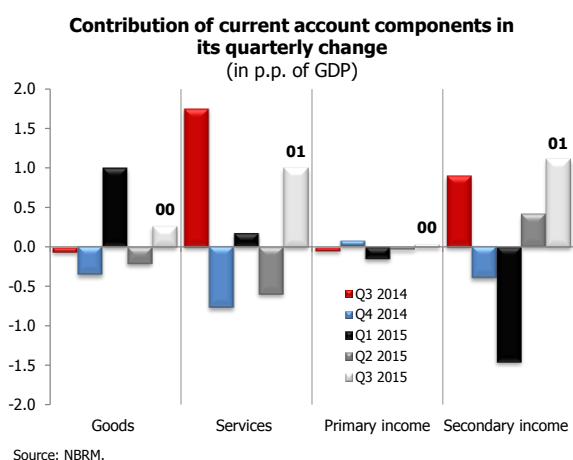
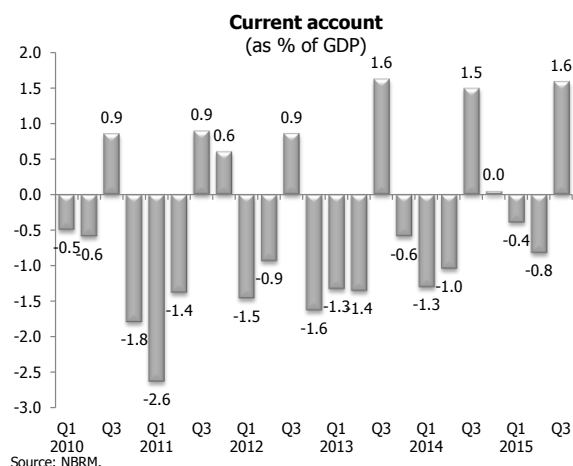
	2014					2015					2014					2015				
	Q1	Q2	Q3	X	I-X	Q1	Q2	Q3	X	I-X	Q1	Q2	Q3	X	I-X	Q1	Q2	Q3	X	I-X
	in euro million										% of GDP									
I. Current account	-111	-89	127	18	-55	-35	-74	142	-52	-19	-1.3	-1.0	1.5	0.2	-0.6	-0.4	-0.8	1.6	-0.6	-0.2
Goods and services	-367	-441	-297	-120	-1,224	-308	-381	-267	-166	-1,121	-4.3	-5.2	-3.5	-1.4	-14.4	-3.4	-4.2	-3.0	-1.9	-12.5
Credit	871	999	1,101	393	3,364	1,010	1,108	1,175	385	3,678	10.2	11.7	12.9	4.6	39.4	11.3	12.4	13.1	4.3	41.1
Debit	1,238	1,440	1,398	513	4,589	1,318	1,488	1,442	551	4,799	14.5	16.9	16.4	6.0	53.8	14.7	16.6	16.1	6.1	53.6
Goods	-471	-448	-453	-167	-1,539	-418	-438	-414	-177	-1,447	-5.5	-5.2	-5.3	-2.0	-18.0	-4.7	-4.9	-4.6	-2.0	-16.1
Services	105	7	156	47	315	111	57	146	11	325	1.2	0.1	1.8	0.6	3.7	1.2	0.6	1.6	0.1	3.6
Primary income	-40	-40	-44	-14	-137	-54	-57	-53	-18	-182	-0.5	-0.5	-0.5	-0.2	-1.6	-0.6	-0.6	-0.6	-0.2	-2.0
Secondary income	295	391	468	152	1,307	326	364	463	132	1,284	3.5	4.6	5.5	1.8	15.3	3.6	4.1	5.2	1.5	14.3
II. Capital account	1	0	-2	2	1	2	1	2	0	5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Net lending (+) / net borrowing (-) (balance from current and capital account)	-110	-89	126	19	-54	-34	-73	144	-52	-14	-1.3	-1.0	1.5	0.2	-0.6	-0.4	-0.8	1.6	-0.6	-0.2
III. Financial account	-43	-7	-413	23	-440	157	-12	188	-29	305	-0.5	-0.1	-4.8	0.3	-5.2	1.8	-0.1	2.1	-0.3	3.4
Direct investment	-90	-15	-36	11	-130	-66	-45	-5	-59	-175	-1.1	-0.2	-0.4	0.1	-1.5	-0.7	-0.5	-0.1	-0.7	-2.0
Portfolio investment	0	8	-496	-3	-492	-12	9	30	2	30	0.0	0.1	-5.8	0.0	-5.8	-0.1	0.1	0.3	0.0	0.3
Currency and deposits	44	55	114	27	241	65	71	88	70	295	0.5	0.6	1.3	0.3	2.8	0.7	0.8	1.0	0.8	3.3
Loans	-13	-58	4	9	-58	134	-6	-40	2	90	-0.2	-0.7	0.1	0.1	-0.7	1.5	-0.1	-0.4	0.0	1.0
Trade credit and advances	16	3	1	-21	-2	34	-42	116	-44	65	0.2	0.0	0.0	-0.2	0.0	0.4	-0.5	1.3	-0.5	0.7
Other accounts receivable/payable	0	0	0	0	0	0	0	0	0	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Special drawing rights (Net incurrence of liabilities)	0	0	0	0	0	0	0	0	0	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IV. Net errors and omissions	9	12	11	3	34	24	-1	12	1	35	0.1	0.1	0.1	0.0	0.4	0.3	0.0	0.1	0.0	0.4
V. Reserve assets	-59	-70	549	-1	420	-167	-62	-32	-23	-284	-0.7	-0.8	6.4	0.0	4.9	-1.9	-0.7	-0.4	-0.3	-3.2

Source: NBRM.

1.6.1. Current account

In the third quarter of 2015, the balance of payments' current account recorded a surplus of Euro 142.4 million, or

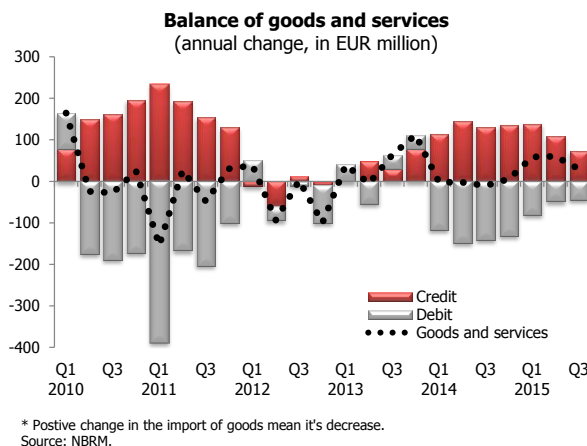
³⁷ Starting from the Quarterly Report, October 2014, the analysis of the movements in the balance of payments is based on data compiled under the Manual on the Balance of Payments and International Investment Position, sixth edition (IMF, 2009) (IMF, 1993). For more detailed information on the methodological 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).



1.6% of GDP³⁸, which is an improvement of 2.4 p.p. of GDP compared to the previous quarter, when the current account registered a deficit (of 0.8% of GDP). The quarterly change is a result of the positive developments registered in all components of the current account. However, more significant contribution to the improvement accounts to the higher net inflows of secondary income (of 1.1 p.p. of GDP) and higher surplus in trade of services (by 0.8 p.p. of GDP). The quarterly changes in secondary income were driven by higher net inflows from private transfers, in particular, the growth of purchased foreign currency cash on the foreign exchange market, which is a typical seasonal change. The seasonal factors influenced also on improvement in services, through higher inflows from travelings. The intensity of the positive quarterly changes in the balance of goods and in primary income is significantly more moderate.

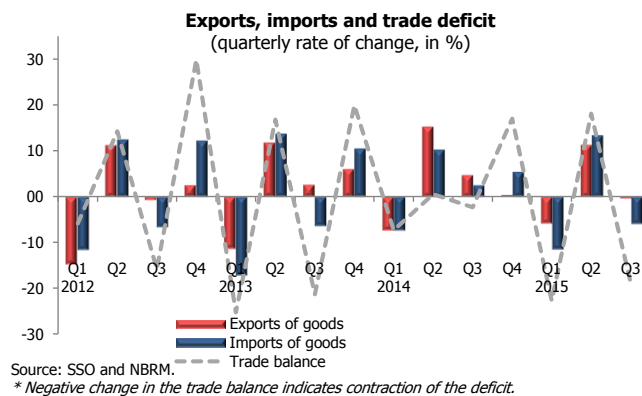
The annual analysis of the current account indicates a higher surplus in the third quarter of 2015 compared to the same period last year by 0.1 percentage points of GDP as a result of the improved performance in the trade balance, given unfavorable developments in the other components. The narrowing of the deficit in the trade of goods was result of larger exports, driven by good performance of new capacities in the economy, with nearly identical performance in imports. On the other hand, weaker conditions on metal and textile industry had adequate reflection on the services' balance by reducing the net inflows from manufacturing services for further processed goods. Additionally, in the third quarter, higher import of construction services from abroad were registered, compared to the same period last year, which additionally influence the deterioration of the balance in the total category. On the other hand, transport services registered the historically highest surplus and appropriate substantial improvement compared to the third quarter of 2014. The negative annual change in the secondary income is predominantly driven by lower net inflows of government transfers, despite the small increase in private transfers. At the same time, the deficit in primary income has registered a slight increase as a result of higher net outflows based on income from investments, especially the income based on direct investments.

³⁸ The calculations use the projected amount for the nominal GDP.



According to the latest data on the balance of payments, in October 2015 the current account registered deficit of Euro 52.3 million, compared to the surplus registered in the same month of the previous year. Unfavorable annual changes in the current transactions are driven by the reduced surplus in services and lower net inflows in secondary income, particularly evident in the sector Government. **On cumulative basis, in the first ten months of the year signs of improvement in the current account of 0.4 p.p. of GDP was registered, compared to the same period last year,** driven by favorable trends in the balance of goods and services, despite deterioration in the secondary and primary income.

Box 2: Foreign trade of goods and movement of the Nominal and the Real Effective Exchange Rate (NEER and REER)³⁹



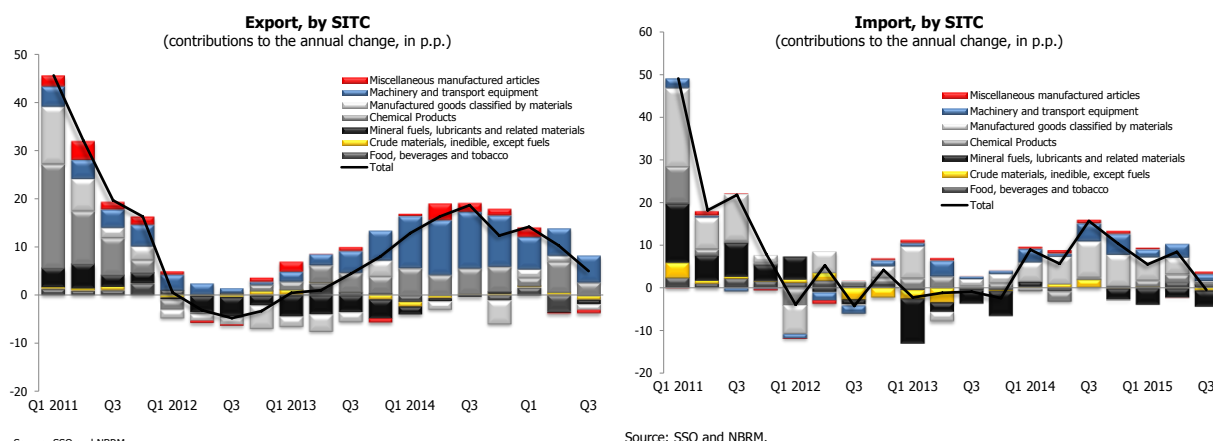
In the third quarter of 2015, the total foreign trade of goods amounted to Euro 2,425.7 million (or 27.1% of GDP), which is a decline of 3.6% compared to the previous quarter. Such movement arises from the downward change in both its components. The import of goods decreased by 5.9% on a quarterly basis, largely due to lower import of raw materials for the new production facilities and for the textile industry, as well as to lower investment imports. The decrease in the export of

goods was more moderate (0.3%) due to weaker exports of the metal industry and new industrial facilities, as opposed to quarterly growth of the traditional export sectors, tobacco and food. **In terms of a more pronounced decrease in imports compared to the decline in export of goods, the trade deficit narrowed by 18.9% on a quarterly basis, resulting from the decrease in the non-energy deficit, amid almost unchanged energy balance.**

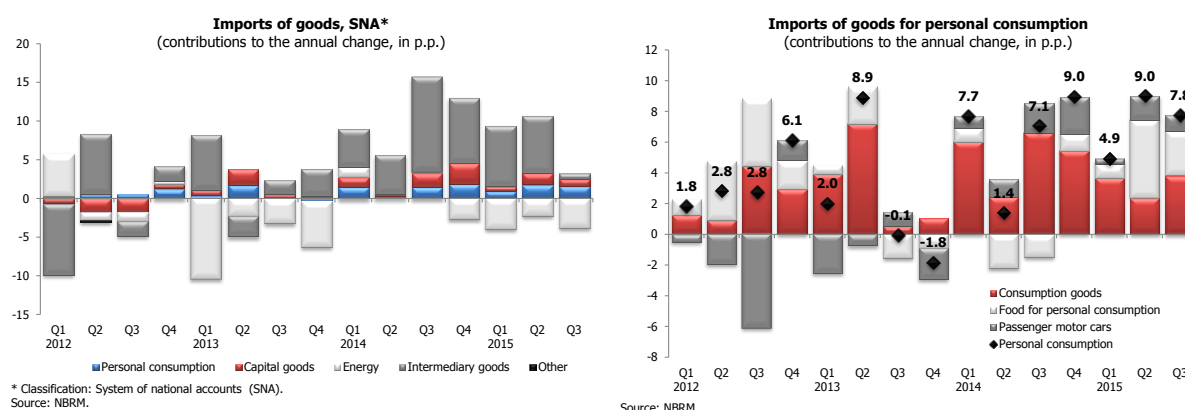
Analyzing on an annual basis, the foreign trade in the third quarter of 2015 grew by 1.7% in terms of export growth and a decline in the import component. **In the third quarter, the exports continued to mount, although at a more moderate pace, rising by 5% annually.** The growth of total export of goods, mostly stems from the further rise in the exports of the new facilities in the economy, which is reflected through increased export of machinery and equipment and chemical products. On the other hand, weaker export activity of some of the economy's traditional sectors was registered, as well as decrease in the export of iron and steel and metal ore, amid unfavorable conditions regarding metals on world markets. At the same time, annual decrease was recorded also in the export of clothing and textile and oil derivatives. **In the third quarter, the import of goods registered an annual drop of 0.5%.** The reduced import demand is primarily due to the fall in

³⁹ 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.

energy imports, primarily import of oil derivatives, coupled with the slower import of electricity and natural gas. The lower value of imported oil derivatives is a result of lower import prices in the domestic economy, which reflects the transmitted effect of further decline in world stock prices of oil. Lower import of metal industry contributed as well to the decrease in import of goods, which partly stems from weaker export performance of this sector. On the other hand, upward import pressures were also caused by the import of input components for the process of manufacturing of the new foreign facilities in the economy, which was reflected by increased import of equipment and machinery. **The enlarged export activity, in circumstances of fall in imports led to a narrowed trade deficit of 13.4% on an annual basis.** The analysis of individual balances shows that the favorable developments in the trade balance primarily result from the narrowing of the energy deficit, and to a lesser extent, from the lower non-energy deficit.



The analysis of the import of goods under the System of National Accounts (SNA) indicates that the annual decrease in the imports in the third quarter is fully caused by the reduced energy imports. On the other hand, minor upward import pressures were caused by the higher import of personal consumption products, capital goods and intermediary products. Within the imports for personal consumption, upward movements were also registered in the import of consumer goods and food for personal consumption and to a lesser extent, import of passenger vehicles. However, the annual growth of this component remains moderate, indicating absence of significant pressures on imports by private consumption.

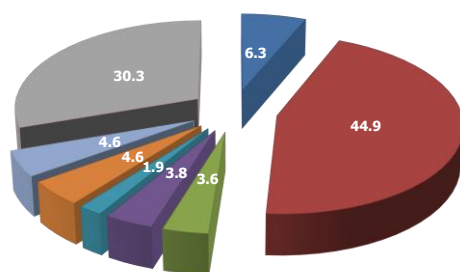


The latest available data on foreign trade for October and November indicate a certain slowdown in both components on annual basis. The export of goods increased by 3.3% as a result of the higher export of the new facilities, amid a decline in export of iron and steel. The imports also register annual growth (of 7.5%), as a result of the increased import of raw materials for the new companies and lower energy imports.

The analysis of foreign trade by trade partners in the third quarter of 2015 shows that the **European Union remains our largest trading partner**, accounting for 67.7% of total trade. In

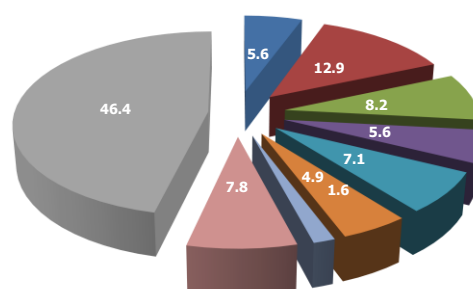
terms of individual countries on the export side, Germany remains the main driver of the annual export growth, reflecting the intensified activity of the new industrial facilities. Within exports by metal processing industry, the significantly lower export of iron and steel to Italy was partly compensated through the higher placement in China. Analyzed from the import side, the annual decrease reflects lower import of non-ferrous metals from the UK, which somewhat reoriented towards South African Republic. In addition, the energy imports from Greece and Serbia reduced on annual basis, as well as the import of iron and steel from Ukraine. On the other hand, there are import pressures by enlarged import of raw materials from Germany, which is intended for the needs of emerging companies with foreign capital. In terms of balances, the largest contribution to the trade deficit reduction on annual basis accounts for the narrowing of the trade deficit with the European Union, due to the reduced deficit in trade with Great Britain and increased surplus with Germany. The narrowing of the trade deficit with Ukraine and China has an additional positive effect on the trade balance, while the deepening of the trade deficit with South Africa has opposite effect.

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



Source: SSO.

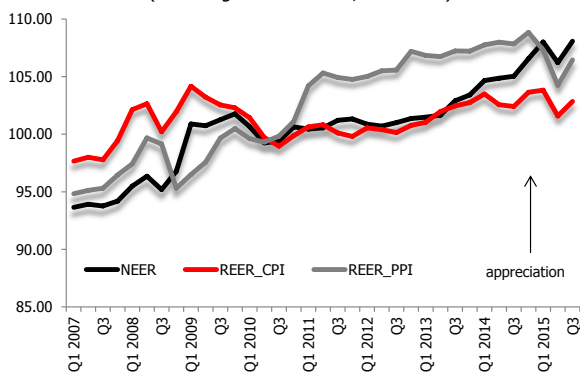
Import of goods, by countries in the third quarter of 2015 (share, in %)



Source: SSO.

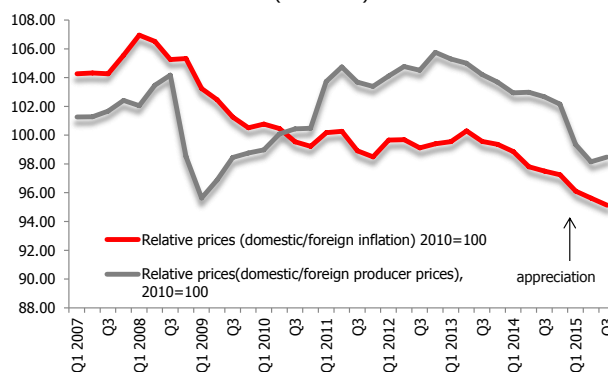
In the third quarter of 2015, the indicators of price competitiveness of the Macedonian economy indicate worsened competitiveness on a quarterly basis. The REER indices deflated by consumer prices and REER calculated by producer prices of industrial products appreciated annually by 1.2% and 2.1%, respectively. The nominal effective exchange rate appreciated on a quarterly basis by 1.8%, due to the depreciation of the Russian ruble against the denar. The relative prices had different influence on the changes with both indices, given the quarterly drop of 0.5% in the relative consumer prices and rise of 0.3% in the relative prices of industrial prices.

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



Source: NBRM.

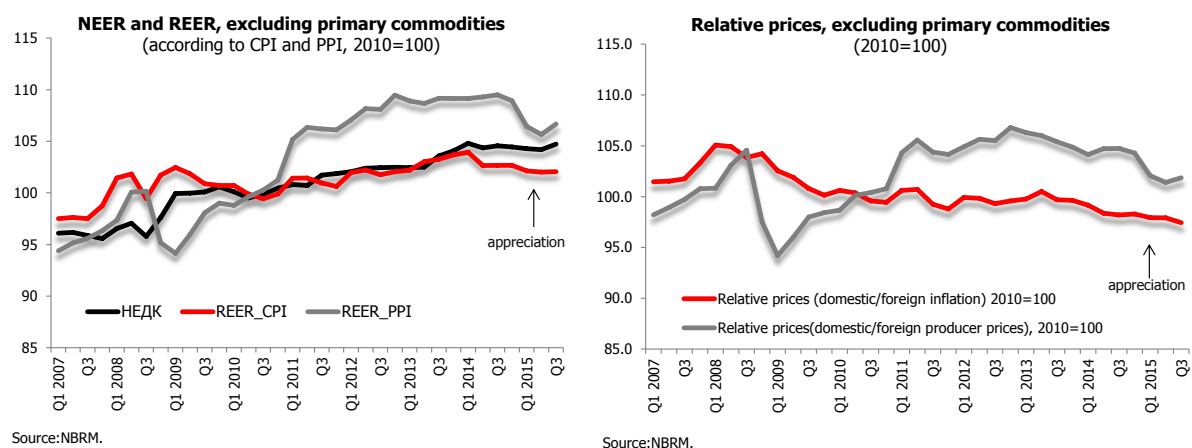
Relative prices
(2006=100)



Source: NBRM.

The analysis of the movement of the REER indices, as measured using weights based on the

foreign trade without primary products⁴⁰ also gives different assessments of the price competitiveness of the domestic economy⁴¹. Namely in terms of quarterly NEER appreciation (of 0.5%), the REER based on producer prices of industrial products appreciated by 1%, while the REER deflated by consumer prices registered no changes compared to the previous quarter. Such movements are affected also by the quarterly changes in domestic relative to foreign prices, given the fall in the relative consumer prices (of 0.5%) and growth in the relative prices of industrial products (0.4%).



According to the data relating to the October - November period, the REER calculated by weights based on total foreign trade leads to divergent changes in price competitiveness. The REER index deflated by producer prices of industrial products recorded a quarterly appreciation of 1.5% (with growth in relative prices of 1.2%), while the index calculated based on the consumer prices depreciated by 0.2% (a decline in relative prices of 0.4%). The nominal exchange rate registered quarterly appreciation of 0.3%. From the viewpoint of REER calculated by trade-based weights without primary products, the index deflated by the prices of industrial products appreciated by 1.5%, compared to the slight depreciation of the index based on consumer prices (by 0.1%). As in the conventional REER, these movements arise from the divergent changes in the relative prices, on the backdrop of the minimal quarterly appreciation of NEER (by 0.1%).

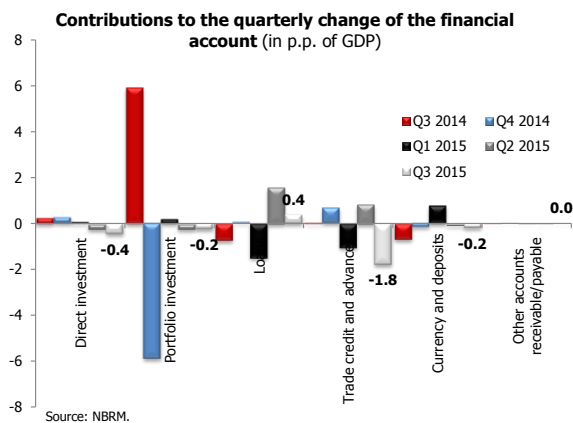
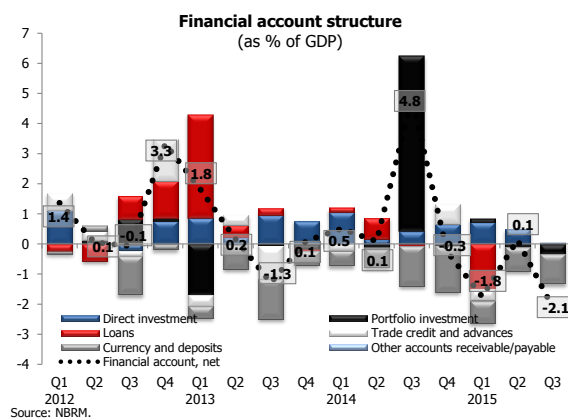
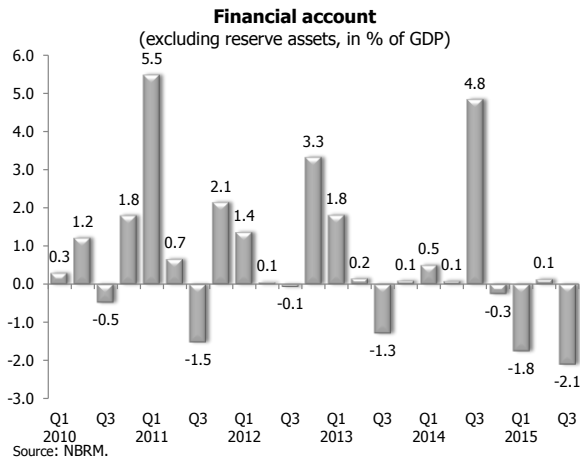
1.6.2. Financial account

In the third quarter of the year, the balance of payments' current account registered net outflows of Euro 188.4 million (or 2.1% of GDP).⁴² Significant net outflows were recorded in trade credits and currency and deposits, despite inflows on the basis of long-term borrowing abroad. Such performance in trade credits and advances are typical for this time of the year, adequately to the

⁴⁰ Primary products that are not included in the calculation are: oil and oil derivatives, iron and steel, ores and imported raw materials for the new industrial facilities in the free economic zones. For more detailed information on the methodology for calculating the real effective exchange rate visit: http://nbrm.mk/WBStorage/Files/Statistika_REDK_Informacija_za_promenite_na_metodologijata_za_presmetuvanje_na_realniot_ef_ektivni_devizni_kurs_na_denarot_mak.pdf

⁴¹ The pronounced depreciation of the Russian ruble in 2014, which was caused by factors that are not only economic, points out some problems in analyzing the indicators of price competitiveness of the domestic economy by including volatile currencies such as the ruble. Therefore, it is more appropriate to analyze the price competitiveness indicators through the real effective exchange rate indices calculated by using weights based on the foreign trade without primary products. In this way, some volatilities related to changes in currencies sensitive to trends in world stock prices are eliminated and appropriate focus is put on structural factors that encourage competitiveness of the economy.

⁴² According to the new methodology for compilation of the balance of payments BPM6, the terms net inflows and net outflows denote net incurrence of liabilities and net acquisition of financial assets, respectively.

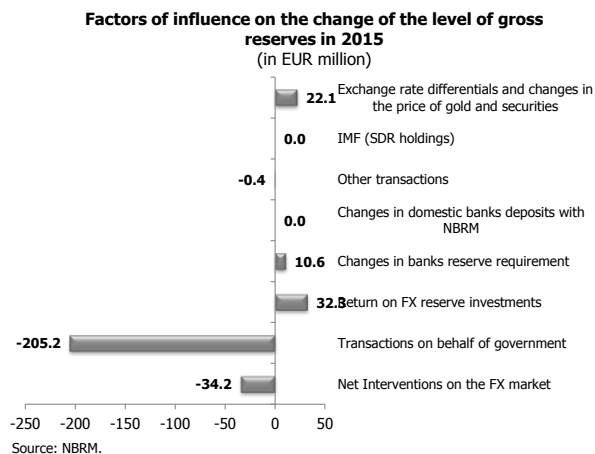
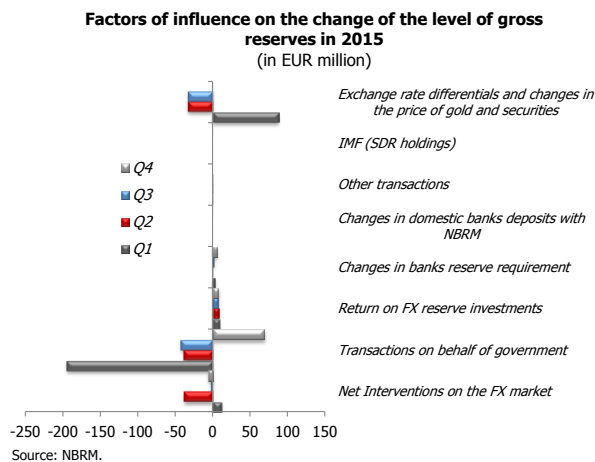
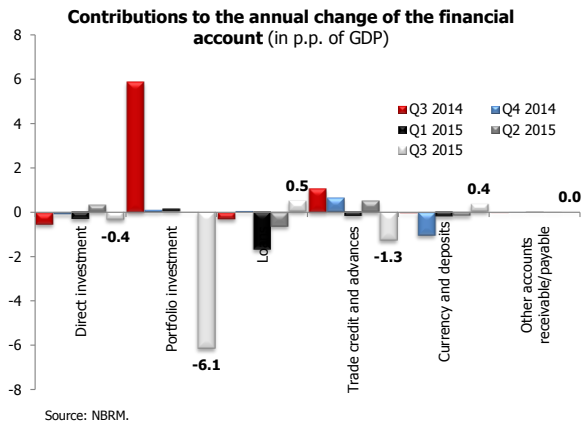


seasonal improvement in the balance of goods and services. Additionally, the currencies and deposits continued to act unfavorably on the financial account during this quarter, simultaneously driven by the outflows registered also in other sectors, and deposit institutions due to decrease in liabilities⁴³. As opposed to the negative flows in the short-term categories in the financial account, the long-term financial loans created net inflows. The sector analysis indicates intensified borrowing of the economy's private sector abroad, through net borrowing of the Government and public enterprises during the third quarter. Additionally, positive flows were registered also in foreign direct investments, although in quite small amount. Equity dominated in their structure, given negative flows in the debt components on a net basis⁴⁴. *The quarterly analysis shows realized net outflows in the third quarter against the financial inflows in the second quarter of the year.* Such trends compared to the previous quarter are mainly due to net outflows in trade loans and advances, despite inflows on a net basis in the previous quarter. The lower inflows of foreign direct investment and larger outflows in currency and deposits against loans where performance pointed to higher inflows on a quarterly basis, driven by intensifying long-term debt of the public sector influenced additionally in this direction.

The analysis on annual basis shows significant change compared to the third quarter of the previous year, when they realized higher net inflows in the financial account. The change is mainly due to the realized outflows in portfolio investment and in trade credits, with the additional effect of lower inflows in direct investment. On the other hand, the loans and currency and deposits registered positive annual developments, registering larger inflows and smaller outflows, respectively. The high base in portfolio investments due to inflows based on the issuance of Euro-bonds in the third quarter of 2014, is the main factor that drives the annual change towards outflows in this category. Higher net outflows in trade loans and advances and the slowdown in direct investment, further affect the worsened position of the financial account. The registered lower inflows of foreign investments on a net basis, results from the debt component of FDI, amid better performances of the non-debt categories. On the other hand, regarding the

⁴³ Decrease in non-residents' deposits.

⁴⁴ The dominance of the non-debt component of foreign direct investment in the third quarter is largely due to the transformation of debt obligations to the parent entity's equity realized in a larger company.



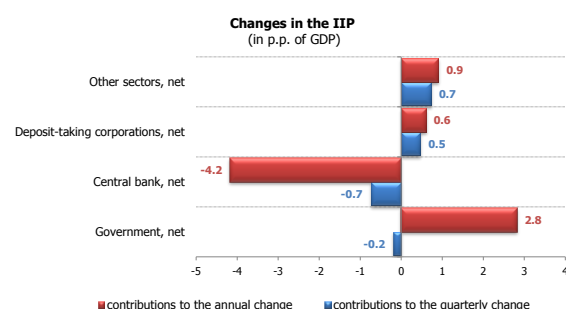
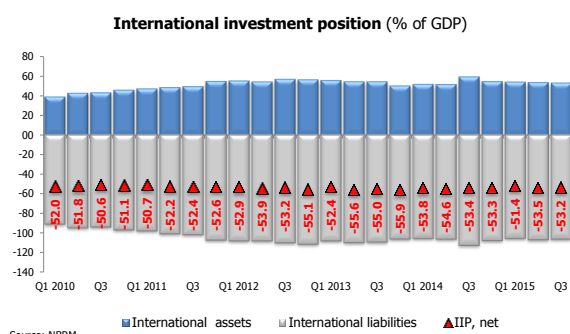
financial loans in this quarter there was a net borrowing, compared to the realized small net repayments in the third quarter of the previous year. In the third quarter, annual decrease in net outflows in currencies and deposits was also registered, as a result of more favorable position of depository institutions. It is important to note that after two years of continuous growth in outflows in currency and deposits for other sectors of the economy, in this quarter, they stagnated on annual basis.

In October 2015, the balance of payments' financial account recorded net inflows of Euro 28.8 million, reflecting inflows in direct investment and trade credits on a net basis. On the other hand, the category "currency and deposits" continued to register outflows. **Summary for the January - October period, the financial account recorded net outflows**, created predominantly by the short-term categories, currencies and deposits and trade loans and advances, as well as the deleverage of the Government abroad.

At the end of the third quarter of 2015, the gross foreign reserves were valued at Euro 2,187.4 million, which is a quarterly fall of Euro 67.5 million. The driving factors for the change are the realized net outflows of funds based on transactions on behalf of the Government and the decrease in the market value of inventories, as a result of calculated negative price and currency differential. *According to the latest available data, at the end of 2015, the foreign reserves amounted to Euro 2261.7 million, which is a decrease of Euro 174.7 million compared to the end of 2014.* The fall in the foreign reserves is mostly due to transactions on behalf of the Government, as a result of realized higher repayments based on foreign liabilities, and far less as a result of the interventions of the NBRM, i.e. the realized net sale of foreign exchange on the foreign exchange market during 2015. More specifically, in 2015, early repayment of Precautionary Credit Line to the IMF was realized, as well as regular repayment of the first euro bond issued in 2005, compared to the fourth issue of euro bonds⁴⁵, which created outflows of foreign reserves on a net basis.

⁴⁵ In December 2015, fourth euro bond in the amount of Euro 270 million was issued.

1.6.3. International investment position⁴⁶ and gross external debt



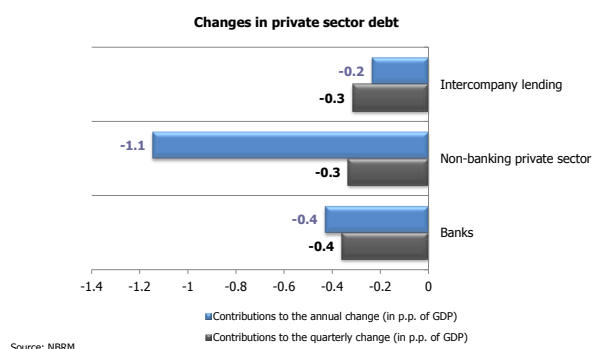
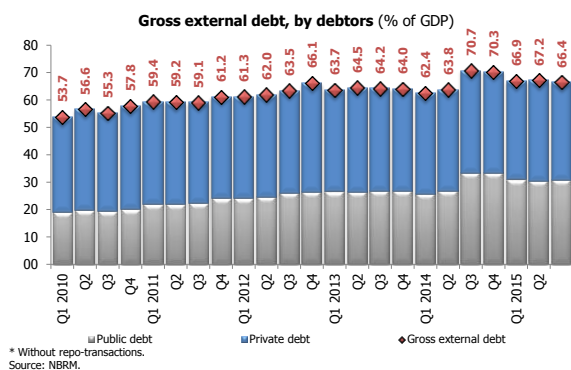
At the end of the third quarter of 2015, the negative international investment position⁴⁷ of the Republic of Macedonia amounted to Euro 4,768.1 million or 53.2% of GDP, which is a quarterly decrease of 0.3 p.p. of GDP on a quarterly basis. Nominally, the improvement of the international investment position equals Euro 22.6 million, amid a larger drop in international liabilities, in terms of the drop in international funding. Sectoral analysis shows that the quarterly decrease was mostly due to lower net position of "other sectors in the economy" (mainly due to higher trade credits given), and then the reduced net liabilities of depository institutions. On the other hand, there is a quarterly decrease in the net assets of the central bank (due to the fall in the foreign reserves), as well as slight increase in net liabilities of the Government (increase in net liabilities based on loans).

On annual basis, the net debt position of the country recorded a slight downward change of only 0.1 p.p. of GDP, given the significant reduction of the international liabilities. The analysis by individual sectors indicates dominant improvement, i.e. decrease in the net liabilities of the Government (based on long-term loans due to the early payment of PCL to IMF in February 2015), and then the annual decrease in net liabilities of depository institutions and other sectors of the economy. Changes in the position of the central bank are aimed at reducing the net assets as a result of the fall in foreign reserves. Nominally, the international investment position registers annual growth of 4.7%

As of the end of the third quarter of 2015, the gross external debt equals Euro 6,231.5 million, or 69.6% of GDP, which is a quarterly decrease of 1.3 percentage points

⁴⁶ 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).

⁴⁷ 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.



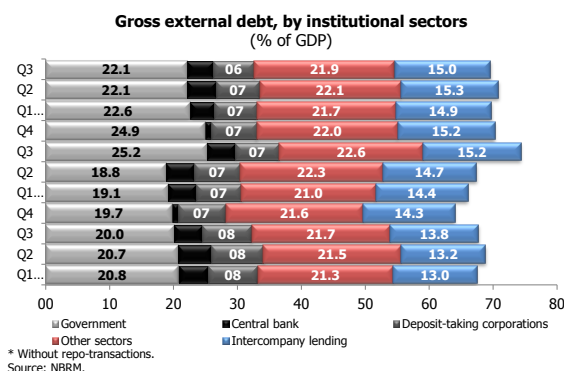
of GDP. If the effect of the repo transactions of the central bank is excluded, the decline would be slightly smaller and would amount 0.7 percentage points of GDP⁴⁸. The reason for the lower gross external debt lies in the significant decrease in the private debt given simultaneous slight increase in the public debt. The reduced private debt is due almost equally to lower liabilities in all three sectors, i.e. reduced liabilities to foreign direct investors, as well as reduced debt of non-banking and banking sector. The growth of public debt is mostly due to the increase in borrowing by public enterprises, primarily in support of road infrastructure.

Annually, the gross external debt, excluding the repo transactions of the central bank, dropped by 1.3%, or 4.3 percentage points of GDP. The annual decrease in gross debt was due both to the reduction of public debt by 2.5 percentage points and the private debt by 1.8 percentage points of GDP. The reduction of public debt is mainly a result of lower debt of the central government, mainly due to the early payment of the precautionary credit line to the IMF in February 2015, amounting to Euro 153.4 million. At the same time, the debt of public enterprises grew as a result of long-term borrowing to support the road infrastructure. Observing the private sector debt, decrease was registered in all three sub-sectors.

Generally, the external indebtedness indicators of the national economy still show that the gross external debt is in the safe zone. The only indicator that classifies the economy in the group of highly indebted countries is the share of the gross external debt in GDP. Dynamically, the analysis of the external indebtedness⁴⁹ indicates favorable developments in all solvency indicators on annual basis, excluding the correlation between debt repayment and export of goods and services and other inflows, which registers worsening. On the other hand, liquidity indicators suggest a slight deterioration (0.1 percentage

⁴⁸ The overall analysis below relates to gross external debt without the central bank liabilities based on repo transactions.

⁴⁹ 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.



points) of the external position, through two of the three indicators. However, the changes are moderate, and the coverage of liabilities based on short-term debt with residual maturity of foreign reserves remains above one.

At the end of the third quarter of the year, the net external debt, as an additional indicator of external position of the economy, amounted to Euro 2,006.5 million, or 22.4% of GDP, which is a quarterly drop of 0.8 percentage points of GDP, i.e. almost identical decrease as the gross external debt. The decrease in the net external debt is a result of the lower private debt, net, on the backdrop of moderate rise in the public net external debt.

Indicators for external indebtedness	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
31.12.2011	3.12	148.4	64.6	16.8	1.78	1.18	25.2
31.12.2012	2.92	141.9	67.6	13.1	1.64	1.03	26.7
31.12.2013	2.51	137.3	67.4	15.8	1.64	1.08	23.3
31.03.2014	3.02	132.8	65.9	17.3	1.41	0.95	25.9
30.06.2014	3.02	135.7	67.4	17.3	1.33	0.90	25.8
30.09.2014	3.02	150.5	74.7	17.3	1.74	1.16	23.2
31.12.2014	3.02	149.4	74.2	17.3	1.82	1.13	22.3
31.03.2015	2.81	138.5	70.2	20.5	1.77	1.13	22.2
30.06.2015	2.81	139.0	70.5	20.5	1.66	1.07	22.7
30.09.2015	2.91	137.6	69.6	21.4	1.69	1.08	21.7
Moderate indebtedness criterion	12 - 20%	165 - 275%	30 - 50%	18 - 30%	1.00		

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

In compliance with "External debt statistics: Guide for compilers and users," published by the IMF.

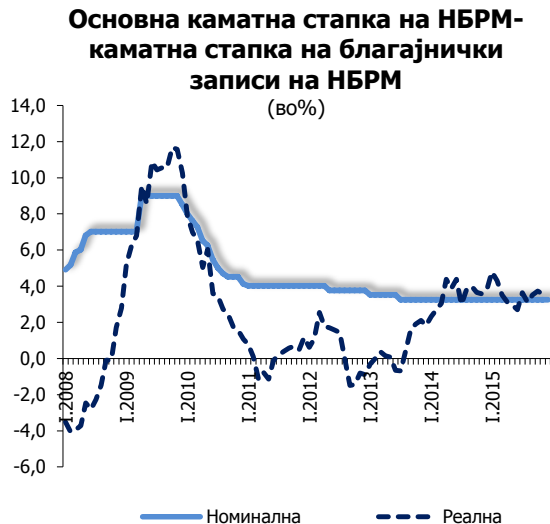
*According to the "Greenspan-Guidotti rule", a country should maintain full coverage of short-term debt at remaining maturity with gross foreign reserves.

Source: NBRM.

II. Monetary policy

During the fourth quarter of 2015, the NBRM kept its policy rate unchanged 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 analyses showed that the recovery pace of the economy is further solid, without price pressures and with adequate level of foreign reserves. In terms of risks, it was assessed that the effects on the domestic economy, linked to domestic political developments and economic and political developments in Greece, continue to be limited. However, at present uncertainty in the environment, the risks for the following period were assessed as largely unfavorable. Despite the unchanged basic interest rate, in December

macroprudential measures were adopted, which aim at preventing potential future risks to financial stability, and thus prevent future macroeconomic imbalances. In December, the NBRM adopted measures for decelerating the fast growth of the long-term consumer loans. In addition, measures which facilitate access to financial services for the corporate sector, including small and medium-size enterprises were adopted. Also, in December the validity of the non-standard measure aimed at supporting lending to net exporters and domestic producers of electricity was prolonged. The NBRM will continue to monitor closely the situation in order to make timely and adequate accommodation of monetary policy.

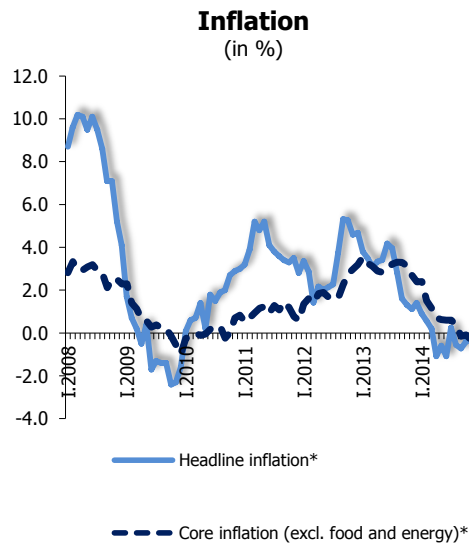


Извор: НБРМ.

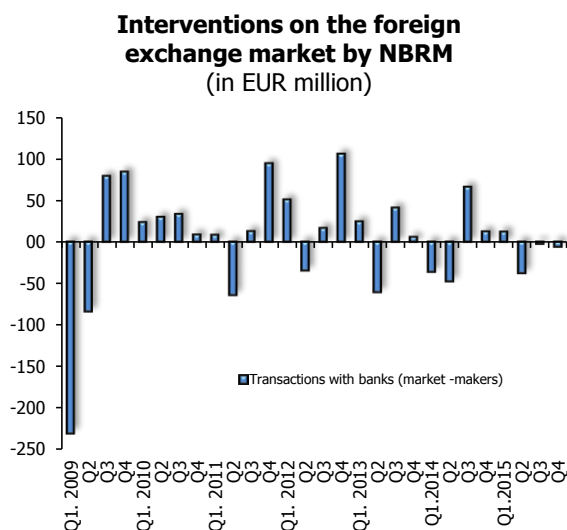
Based on the regular assessment of the recent macroeconomic and financial developments, at the meeting held during the fourth quarter⁵⁰ of 2015, the NBRM Operational Monetary Policy Committee decided to keep CB bill interest rate at 3.25%, given unchanged amount of offered CB bills. The latest reassessment of the NBRM's macroeconomic projections in October indicated no significant changes in the environment for conducting monetary policy compared to the previous estimations. Also the movements in the key macroeconomic indicators that became available during the quarter, basically do not deviate much from the projected dynamics. Thus, in the fourth quarter, the foreign reserves registered an increase, which is mostly due to the borrowing of the Government on the international capital market by issuing a Eurobond⁵¹. The developments on the foreign exchange market remained stable for a longer period, with interventions of the market makers being registered only in mid-December, with relatively small amount of sale of foreign exchange. Reserve adequacy indicators were maintained on appropriate level, which is sufficient for managing any shocks. In the last quarter, the annual inflation rate registered a decrease of 0.4%, on average, as a result of lower energy and food prices. The core inflation registered an increase on annual basis, and on average it equaled 1%. In this period, inflation was within the October projections. The performance in the real sector remained solid. Available high frequency data during the quarter showed continuation of economic growth in the third quarter, as confirmed by the GDP official data, amid continuation of the positive developments in most of the economic sectors. In terms of the credit

⁵⁰ During the quarter, the NBRM's Operational Monetary Policy Committee held three sessions on 13 October 2015, 10 November 2015, and 15 December 2015, when it reassessed the monetary policy setup.

⁵¹ In December, the Government borrowed from the international financial market by issuing the fourth Eurobond in the amount of Euro 270 million with a maturity of 5 years and an interest rate of 4.875%, i.e. a yield rate of 5.125%. In the same month, liabilities based on external debt arising from the previously issued Eurobond of Euro 150 million were also paid.



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



Source: NBRM

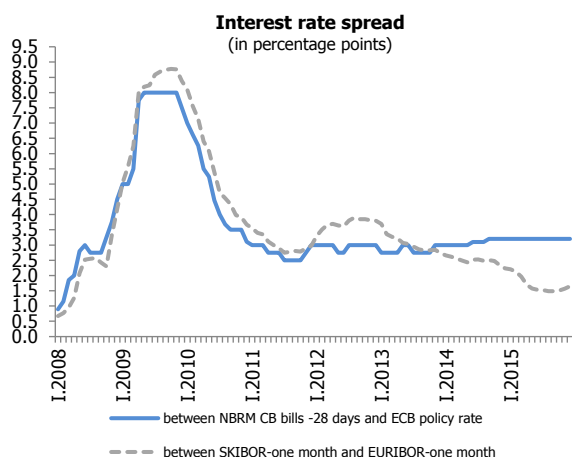
market, in the fourth quarter of 2015 the total loans recorded a significant acceleration, which is mostly due to the intensification of corporate lending (as opposed to quarterly fall in the previous period), amid growth also in loans to households. Such a credit growth dynamics significantly exceeds the October projection for the last quarter. As far as risks are concerned, the latest performance points to slightly less favorable global surrounding, taking into account the slow pace of recovery and slower pace of global growth in the third quarter, the increased uncertainty and pronounced geopolitical risks in this period. However, regardless of this setting, the economic recovery of the euro area continued, with the possibility of its acceleration in the coming period⁵². In terms of domestic risks related to political developments in the country, it was estimated that their effects on the economy remain constrained. Yet, it was assessed that the uncertainty can still be observed in the surrounding, thus creating risks for the period ahead. In order to prevent potential future growing risks to financial and macroeconomic stability, in December the NBRM⁵³ adopted measures for decelerating the high increase in the long-term consumer loans. In addition, measures which facilitate the access to financial services for the corporate sector, including the small and medium-size enterprises were adopted, with the validity of non-standard measure aimed at supporting lending to net exporters and domestic producers of electricity being prolonged. The NBRM will continue to monitor closely the developments in order to make timely and adequate accommodation of monetary policy. **However, leaving the zone of accommodative monetary policy in the next period will depend on the materialization of identified risks and the effects on the external position of the economy and on foreign reserves.**

In the fourth quarter of 2015, the ECB maintained its key interest rate unchanged, after its last reduction in September 2014 to a level of 0.05% and continue with further implementation of the securities redemption program. At the last ECB meeting⁵⁴ on the monetary policy, which was held in early December, reduction of the deposit

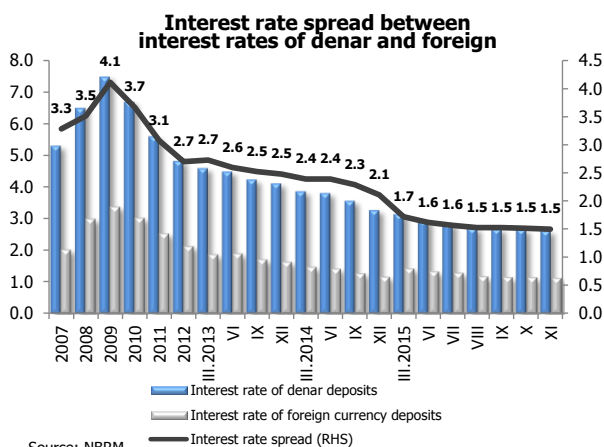
⁵² According to the latest ECB's projections from December 2015, the growth rate of real GDP for 2015, 2016 and 2017 is estimated at 1.5%, 1.7% and 1.9%, respectively. The previous (September) projections estimated that the growth will be 1.4%, 1.7% and 1.8% for 2015, 2016 and 2017, respectively.

⁵³ For more details about the NBRM measures adopted in December, see Box 3.

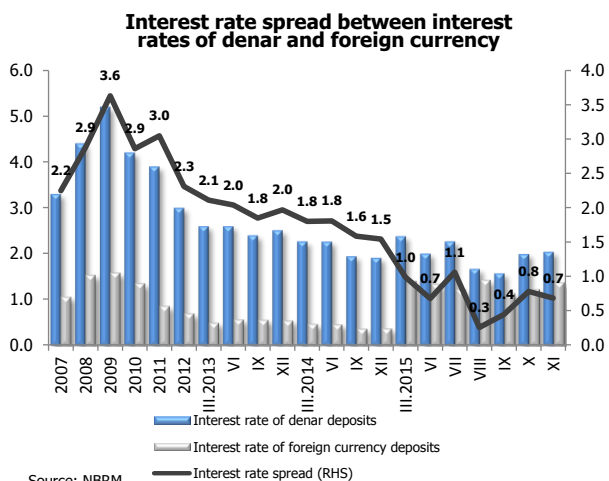
⁵⁴ <http://www.ecb.europa.eu/press/pressconf/2015/html/is151203.en.html>



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



Source: NBRM



Source: NBRM

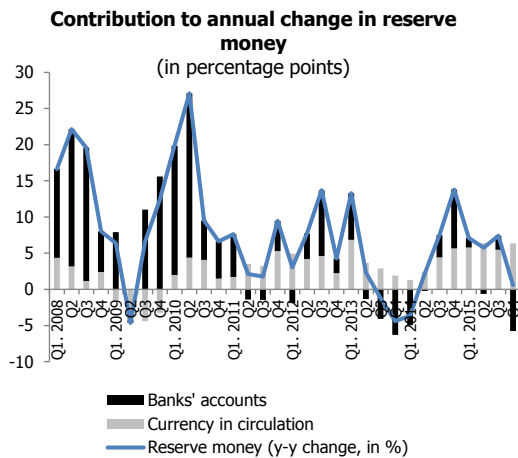
interest rate from 0.2% to 0.3% and further implementation of quantitative easing policy until at least March 2017 was decided, with the possibility of extension, if needed. Thus, the adjustable nature of monetary policy in the euro area continued, where the ECB expressed readiness to take additional measures to relax monetary policy if there is need for such a move in future. In such circumstances, the interest rate spread between the CB bill interest rate and the ECB policy rate in December remained at 3.2 percentage points, the level registered in September 2014. During the fourth quarter, the movements in the short-term market interest rates on the European and the domestic financial market were relatively stable, with the interest rate spread between one-month SKIBOR⁵⁵ and one-month EURIBOR recording a minimum widening and amounts to 1.6 percentage points, compared to 1.5 percentage points in the previous quarter. Within the banking sector, regarding the newly received deposits, the interest rate on denar and foreign currency deposits in November increased by 0.5 p.p. and 0.2 p.p., respectively, which contribute to wider interest rate spread from 0.4 percentage points in September to 0.7 p.p. in November. However, it should be taken into consideration that the interest rates on newly received deposits are volatile⁵⁶, which can result in frequent and temporary adjustments of the interest spread. The interest rate spread between interest rates on total domestic and total foreign currency deposits was stable and in November it equaled 1.5 p.p. retaining the same level as in the previous three months.

⁵⁵ Interbank interest rate on denar deposits, calculated using the quotations of reference banks.

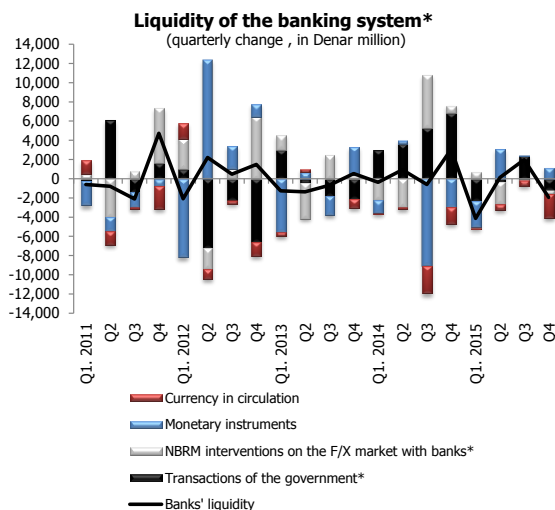
⁵⁶ Volatility of interest rate on newly accepted deposits results from the fact that they are driven by the volume of newly received deposits (which can vary from month to month) and their interest rate.



2.1. Banks' liquidity and interbank money market developments



Source: NBRM.



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

In the fourth quarter of 2015, the bank liquidity⁵⁷ reduced by Denar 1.934 million compared to the end of the third quarter. Thus, in December, the balances of banks' accounts with the NBRM⁵⁸ stood at Denar 15,960 million. At the end of the year, reserve money⁵⁹ increased by 0.6% annually, compared to September 2015, when they registered an annual growth of 7.4%.

During the fourth quarter of 2015, the autonomous factors contributed towards withdrawing net liquidity in the total amount of Denar 3,113 million. This change in the autonomous factors is largely due to cash that in the last quarter acted toward liquidity withdrawal in the total amount of Denar 2.512 million.

Certain contribution to the liquidity withdrawal had both government and the NBRM transactions with the market makers in the total amount of Denar 1,210 and 370 million, respectively.

In the fourth quarter, the NBRM's monetary instruments contributed towards creating net liquidity in the total amount of Denar 1,179 million. The change in the total monetary instruments in this period mainly arises from the changes in the sight deposits with the NBRM, and less to the changes in the CB bills⁶⁰. In the fourth quarter, three CB bills auctions with volume tender and fixed interest rate of 3.25% were held. Moreover, at the auction held in December, there has been lower demand than supply, resulting in a slight decrease in the amount of the CB bills⁶⁰. Consequently to these movements, in the last quarter, the CB bills acted towards liquidity creation in the banking system (amounting to Denar 174 million). Amid reducing of liquidity through autonomous factors, the banks provided the needed liquidity through seven-day deposit facilities, which in this period dropped by Denar 1,619 million. Lower interest of the banks for these instruments can be partly explained by diverting part of the liquidity of banks to the government securities market, where after a longer period securities with shorter maturity were offered.

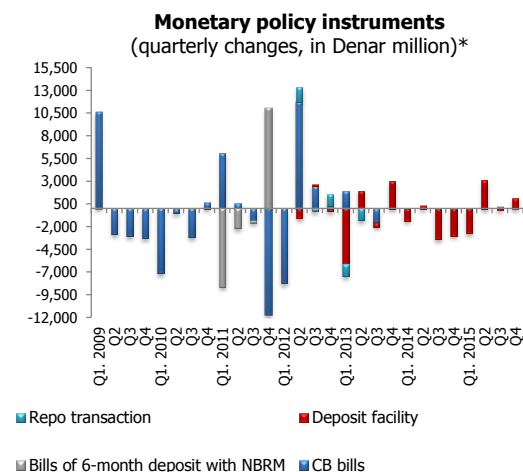
On the other hand, the overnight deposit facility

⁵⁷Refers to the change in banks' account balances with the NBRM.

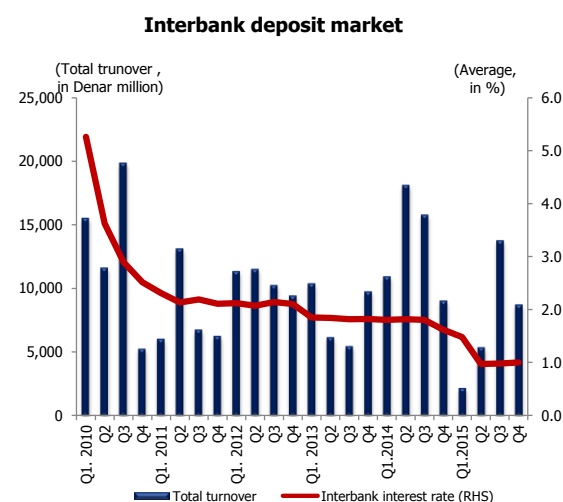
⁵⁸Refers to Denar accounts of banks required to allocate reserve requirement.

⁵⁹Includes reserve requirement in foreign currency.

⁶⁰At the auction of CB bills held in December lower demand than supply of CB bills by Denar 425 million was registered.



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



Source: NBRM.

increased by Denar 614 million compared to the previous quarter. During the last quarter of 2015, banks allocated excess liquid assets over the reserve requirement (in denars) of 1% on average, which is higher than the level of the average of the previous quarter (of 0.5%).

In the fourth quarter of 2015, the interbank deposit market (unsecured segment) reported a total turnover of Denar 8,732 million, which is by 36.6% less compared to the third quarter of 2015. In the fourth quarter of 2015, compared to the fourth quarter of the previous year, the activity at the interbank money market decreased by 3.3%. Analyzed by maturity segment, in the fourth quarter, intraday transactions had a dominant share in the total turnover in the interbank money market, making up 52.1% in the total transactions, followed by transactions of up to seven days, with share of 47.3%. The interbank interest rate on concluded overnight transactions (MKDONIA) registered minimal increase and on average it equaled 1% in the fourth quarter (0.98% on average in the third quarter). The interbank interest rate (MBKS) also decreased and averaged 1.15%, in the fourth quarter (1.08% on average, in the previous quarter). In the fourth quarter of 2015, **the secondary money market** transactions totaled Euro 3,050 million, mostly due to the concluded transactions in treasury bills, as well as CB bills (A share of 33.8% and 29.5% in total transactions, respectively). In addition, repo transactions and transactions with government bonds were also concluded, which accounted for 19.7% and 17%, respectively, of the total transactions.⁶¹ The total amount traded on a secondary market in the fourth quarter of 2015 is higher by 4.2%.

Box 3: Review of the Latest Set of Measures Adopted by the National Bank of the Republic of Macedonia in December 2015

At the NBRM Council meeting, held on 17 December 2015, the NBRM adopted a package of measures aimed at slowing the high growth of the long-term consumer loans, facilitating access to financial services for the corporate sector and prolonging the effectiveness of the non-standard

⁶¹ At the secondary market, CB bills with maturities of 28 and 35 days and a yield of 1.75%, respectively were traded. Regarding the repo transactions up to 1 week, a yield of 1.17% on average, was registered. In the realized transactions with government bonds with residual maturity up to 1 year and 1-2 years, yield of 2.7% and 2.74% (average), respectively was registered. Transactions also with government bonds with residual maturity of 5 to 10 years and yield of 5% were concluded. Regarding the treasury bills, transactions with residual maturity of 1 to 3 months and of 3 to 6 months and yield of 1.55% and 1.73% (on average), respectively, were realized.



measure aimed at supporting the lending to net exporters and domestic producers of electricity.

Due to the fast increase in the consumer loans in the last two years, the NBRM Council adopted the **Decision amending the Decision on the methodology for determining the capital adequacy**, introducing measures to slow the growth of long-term consumer loans. The measure increases capital requirements for banks on long-term consumer loans with maturity equal to or longer than eight years. Thus, the risk weight for claims on consumer loans with a contractual maturity equal to or longer than eight years, increases from 75% i.e. 100% to 150%. To avoid sudden changes on the market of consumer lending, yet the growth rates to be reduced to a moderate level, this measure is aimed only at newly approved long-term consumer loans, i.e. loans with maturity equal, or longer than 8 years approved after 1 January 2016. The measure is focused on long-term consumer loans because they register high growth in the last two years. Moreover, this increase was realized in conditions of growing indebtedness of the current, not new bank borrowers. In such circumstances, the introduction of these measures aims to limit potential future growing risks of accelerated growth in the long-term consumer loans, not only in terms of the quality of banks' loan portfolio, but also on the level of indebtedness of households. For now, the portfolio of the banks' consumer loans shows no materialization of risks due to the rapid growth, i.e. the growth of non-performing consumer loans is relatively low with the participation of non-performing consumer loans to total consumer loans of 5.2%. However, practice shows that almost always the rapid credit growth, usually accompanied by credit terms relaxation, is followed by a period of hampered collection of claims, because of which need to introduce preventive measures in this domain was assessed.

At the same time, this decision introduces higher capital requirement (risk weight of 75%) for the increase of overdrafts and credit cards in relation to 31 December 2015. Defined in such a manner, the measure does not apply to the existing amount of approved and used overdrafts on transaction accounts and credit cards, but affects their possible further increase. The aim of this Decision is to prevent the possibility of redirecting to this type of borrowing as a result of the measure for consumer loans deceleration.

Also, this Decision makes conditions for facilitating access to legal entities, including small and medium-size enterprises to financial services. Namely, the capital requirement for guarantees issued by banks is reduced, which guarantees payment based on a certain business relationship of the client and banks' claims backed by commercial property that meets certain conditions. This way allows banks to allocate lower amount of capital for credit and guarantee operations with legal entities, including small and medium enterprises, which can cause reduction in the cost of banks and therewith, of clients for this type of operation.

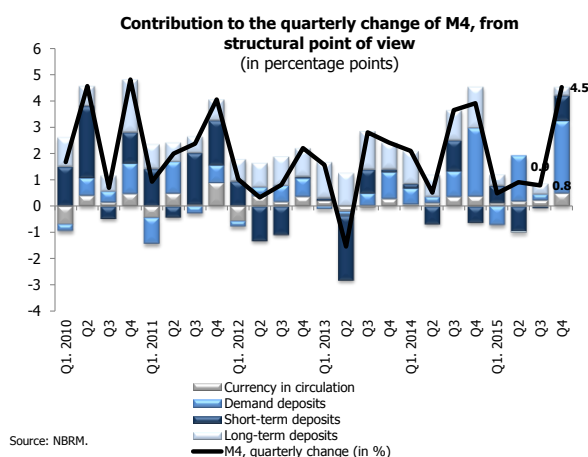
The Council adopted the **Decision on amending the Decision on credit risk management**, according to which, no later than June 30, 2016, banks will perform write-offs of all claims which are fully booked for more than two years, in which at least two years before the bank identified and fully covered the credit risk of non-collection. According to the existing regulations, banks are required to fully reserve claims where the client defaulted at least 1 up to 5 years if there is a specific collateral, and the new measure requires from banks to write them off two years after their full provisioning. In addition, banks will still be allowed and required to take actions to collect these claims, although they are written off. The measure does not incur additional costs for banks since claims which are fully provisioned are written off, at least two years before.

Due to the positive effects on the lending activity of the banks and the overall domestic economy, the Council decided to **extend the application of non-standard measure to reduce the reserve requirement base in denars of commercial banks for the amount of newly approved loans to net exporters and domestic producers of electricity** for additional two years. Consequently, banks are expected to continue active lending support to these companies through a wide range of new loan products and more favorable interest rates aimed at further growth in the contribution of this lending in the expansion of loans to the corporate sector as a whole.

2.2. Monetary and credit aggregates

The fourth quarter of 2015 witnessed significant acceleration in the quarterly growth of the broad money and total deposit potential of the banks. Higher money supply in the economy in this period corresponds to the economic and financial conditions in the domestic economy. The creation of new money supply is primarily due to the growth in the most liquid monetary assets with additional positive contribution from the short- and long-term deposits. Such structure of the quarterly monetary growth is partly explained by seasonal factors, typical for the end of the year when higher demand for money for transaction purposes before the New Year and Christmas holidays was registered. Analyzed by sectors, there is a more dynamic increase in corporate deposits, versus their decline in the previous quarter, amid simultaneous solid growth of household deposits, which corresponds to the developments on the credit market in this period. Thus, in the last quarter of 2015, loans to enterprises were the main engine of the realized quarterly increase, as opposed to the previous three quarters when loans to households were the main generator of growth. For the next period, according to the results of the last Lending Survey, continuation of the favorable developments on the supply side and demand for loans in both sectors is expected.

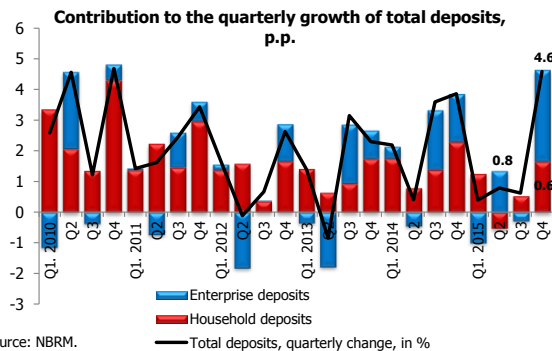
2.2.1. Monetary aggregates



In the last quarter of 2015, the quarterly money supply growth in the economy significantly accelerated from 0.8% in the third quarter to 4.5% at the end of December. As a result of this intensification, the monetary growth realized in the last three months contributes with high 67.8% in the total growth for the entire 2015, which is also above the average contribution in the last 5 years (2010-2014) of about 45%. Positive developments in the monetary base in this period represent combined effect of the fundamental and seasonal factors. Thus, the real economy registered retention of the solid pace of economic growth, further favorable developments in the labor market expressed through higher wages and increased number of employees, as well as continued credit support of banks to the private sector. Also, such changes in the pace of monetary growth also point to a particular mitigation of the effects of domestic political risks on the expectations of economic agents. In terms of seasonal factors, more significant increase in the most liquid components of money supply is characteristic in the last quarter, partly as a result of higher demand for money for transaction purposes in the eve of the New Year and Christmas holidays. Thus, currency in circulation and demand deposits contributed with 71.2% of the total quarterly growth (56.6% in the previous quarter), while term deposits had an additional

Total deposits	2013		2014				2015			
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
	q-o-q growth, %									
Total deposits	2.3	2.2	0.4	3.6	3.9	0.4	0.8	0.6	4.6	
	contributions to quarterly growth, p.p.									
Deposit money	1.1	0.7	0.3	1.1	2.8	-0.8	1.9	0.3	3.2	
Denar deposits	0.9	0.9	0.1	1.3	1.5	0.0	-1.1	0.3	0.3	
Foreign currency deposits	0.3	0.6	0.0	1.3	-0.4	1.2	0.0	0.1	1.1	
Short-term deposits	0.1	0.3	-0.7	1.3	-0.7	0.7	-1.0	-0.1	1.1	
Long-term deposits	1.1	1.3	0.9	1.2	1.7	0.5	-0.1	0.4	0.3	

Source: NBRM.



positive contribution, primarily through short-term deposits, and to a lesser extent long-term deposits. In terms of currency, the fourth quarter registered a simultaneous increase in Denar and foreign currency deposits. However, given the likely certain mitigation of the effects of political developments in the country on expectations, there was a more significant denarization, whereby Denar deposits contributed with 66.6% of the total quarterly growth versus 60.2% in the third quarter. Thus the degree of euroisation measured by share of foreign currency deposits in M4 was reduced to the lowest level since October 2001 and amounted to 37.1% (37.7% in September). **Annually**, at the end of December, money supply was higher by 6.8%, from 6.2% at the end of September.

In the fourth quarter of 2015, the total deposit potential of banks registered a significant quarterly increase of 4.6% versus 0.6% in the previous quarter, which arises from higher household and corporate deposits. **Thus, total household deposits registered acceleration of the quarterly growth rate from 0.7% in the third quarter to 2.3% at the end of December.** The quarterly increase is largely realized in November and especially in December, which in addition to the favorable fundamental factors, in part probably also relates to the payment of higher pensions and usual bonuses for the end of the year. In this regard, further solid credit support to households by banks had an additional contribution. Analyzed in terms of structure, the fourth quarter registered a simultaneous increase in all components of household deposits from maturity and currency aspect. Thus, similar to the previous quarter, short-term and long-term deposits registered further moderate growth, amid slightly more favorable performances in long-term deposits. From currency aspect, following the moderate growth in the previous quarter, Denar deposits accounted for 82.2% of total quarterly growth, versus 16.2% in the third quarter. However, growth intensification of Denar deposits during this period was primarily driven by the increase in deposit money, while time Denar deposits, following the continued reduction in the period from May to August, in the fourth quarter were generally stable. On the other hand, foreign currency deposits continued to grow, but at a moderately slower pace compared to the previous quarter. Despite the acceleration in the quarterly growth, **on an annual basis** the growth dynamics of total household deposits slowed

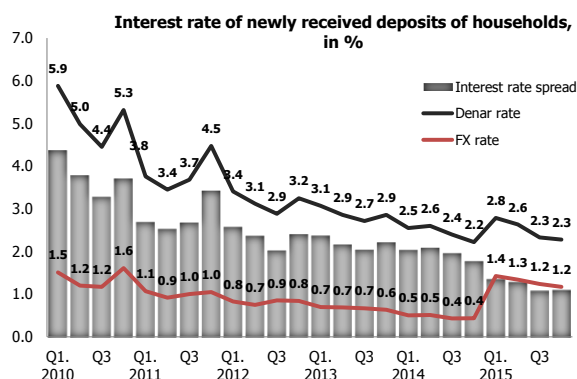
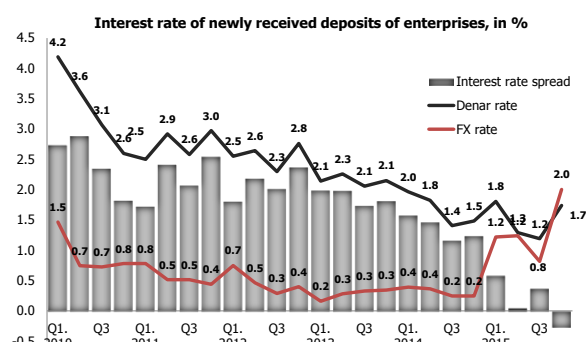
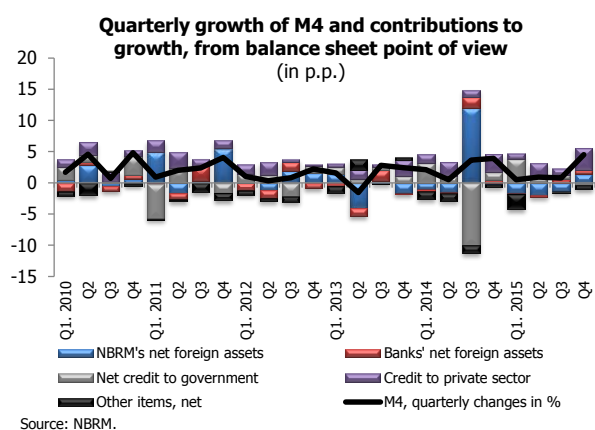
Household deposits		2013		2014		2015			
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
		quarterly change, in %							
Total household deposits		2.4	2.4	1.1	1.9	3.2	1.8	-0.7	0.7
		contribution to quarterly change of total deposits, in p.p.							
Deposit money		1.0	0.5	0.2	0.2	1.9	0.1	-0.2	0.3
Denar deposits		1.1	1.2	0.7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

Source: NBRM.

**Enterprise deposits**

	2013			2014			2015		
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
квартални промени, во %									
Total household deposits	4.1	1.7	-2.0	8.8	6.8	-4.2	5.9	-1.2	12.7
contribution to quarterly change of total deposits, in p.p.									
Deposit money	1.9	1.1	0.2	3.3	7.6	-4.3	8.1	0.6	8.3
Denar deposits	1.6	0.2	-1.8	2.8	1.3	-1.7	-2.6	-0.4	0.7
FX deposits	0.7	0.4	-0.4	2.7	-2.1	1.8	0.5	-1.4	3.7
Short-term deposits	2.1	0.3	-2.0	4.8	-2.4	-1.1	-1.6	-1.2	4.3
Long-term deposits	0.2	0.3	-0.2	0.6	1.5	1.2	-0.6	-0.6	0.1

Source: NBRM.

*refers to November 2015.
Source: NBRM.*refers to November 2015.
Source: NBRM.

Source: NBRM.

down from 5% at the end of September to 4.1% in December.

The retention of favorable performances in the real sector since the beginning of the year, as well as the increased credit support to the private sector by banks in the last quarter, created conditions for more dynamic growth of corporate deposits during the last three months of 2015. **Thus, the quarterly growth rate of total corporate deposits at the end of December amounted to 12.7% versus the decline of 1.2% which was registered in the third quarter.** Moreover, intensification of the growth of deposit money was registered, and solid growth of short-term deposits had an additional contribution to the increase in total corporate deposits, while the contribution of long-term deposits is negligible. In terms of currency, the quarterly growth was mostly due to the growth of deposits in domestic currency, with a significant contribution of deposits in foreign currency (as opposed to the registered decrease in the third quarter). **Annually**, at the end of December, corporate deposits increased by 13%, compared to 7.1% at the end of September.

According to the analysis of the yields from the new savings⁶², interest rates on newly received Denar and foreign currency deposits of households at the end of November remained unchanged compared to the end of September (2.3% and 1.2%, respectively), whereby the interest rate spread between them was stabilized at a level of 1.1 p.p. In terms of newly received corporate deposits, there is a simultaneous increase in Denar and foreign interest rates compared to September by 0.6 p.p. and 1.2 p.p., respectively, which resulted in a negative interest rate spread between new savings in domestic and foreign currency⁶³. In terms of total deposits, interest rates on Denar and foreign currency deposits of households in November amounted to 2.7% and 1.1% respectively, while in enterprises 2.4% and 1.4%, for Denar and foreign interest rates, respectively.

The analysis of the structure of money supply, from balance sheet perspective, shows that the realized money supply growth in the last three months of the year

⁶² As of January 2015, interest rate data of banks and savings houses have been collected under the new interest rate methodology, while data for the previous period were collected under the old methodology. For more detailed information see Quarterly Report, May 2015, p 53.

⁶³ The negative interest rate spread between Denar and foreign exchange savings is typical in certain months since the beginning of the year. Thus, in February for the first time, minimal negative spread between new Denar and foreign exchange savings of - 0.1 p.p. was registered, then in May the interest rate spread amounted to -0.5 p.p., while in August -1.4 p.p.



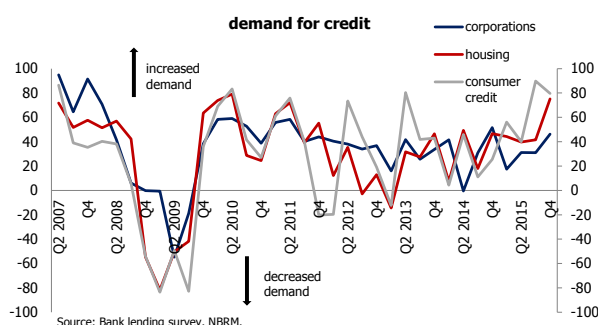
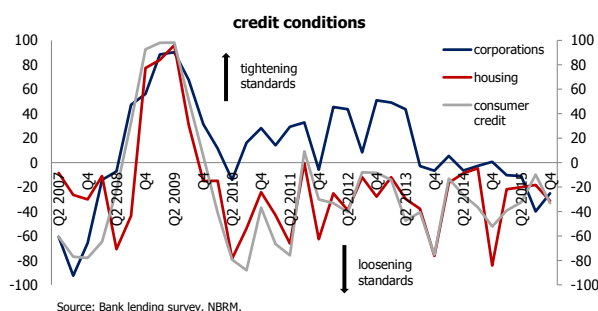
is mainly due to loans to the private sector and net foreign assets of the NBRM⁶⁴. Additional moderate contribution to the expansion of the money supply arises from the net foreign assets of banks, while net loans of the government act in the opposite direction.

2.2.2. Lending activity

The banking sector intensified credit support to the private sector in the last quarter of 2015. The quarterly growth rate of total loans to the private sector was 4.2% at end of December, compared to the realized rate of 1.2% in September. Credit growth in the last quarter amounted to 46.9% of total growth in the year and it is a common movement dynamics in the last two years. The Lending Survey shows that these movements of lending activity are the effects of higher supply and higher demand for loans.

Total credits of private sector									
quarterly change, in %	2013		2014				2015		
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Total credits of private sector	3.0	1.8	2.9	1.4	3.6	1.1	2.7	1.2	4.2
Contribution in quarterly change of total credits (in p.p)									
Denar credits	2.9	1.6	2.7	1.3	3.1	0.7	3.2	1.6	3.7
Foreign currency credits	0.1	0.2	0.1	0.1	0.5	0.4	-0.5	-0.3	0.5
Short-term credits	0.7	0.7	0.4	0.0	1.7	-0.5	0.0	-0.4	1.8
Long-term credits	2.3	1.2	1.3	0.9	2.4	1.2	2.5	0.3	2.9
Households	1.2	0.9	1.6	1.2	1.0	1.0	1.8	1.4	1.1
Corporations	1.9	0.9	1.2	0.2	2.6	0.1	0.9	-0.2	3.2

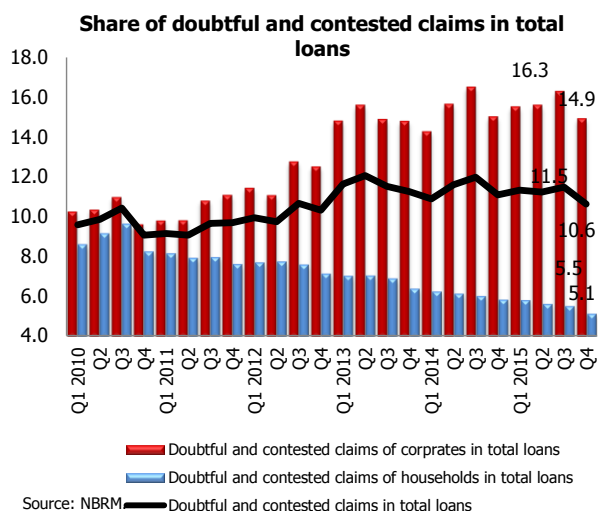
Source: NBRM.



Amid solid solvency and liquidity position of banks, amid favorable developments in the real sector of the economy, in the last quarter further easing of credit conditions was registered. Also, the propensity to borrow continues to grow, which is evident from the continued increase in demand for loans. Observed by sector, credit flows in the last quarter are largely due to the increased lending to enterprises. Thus, enterprises contributed with 74% of total quarterly growth, which is a change relative to the previous three quarters, when loans to households were major growth generator. In terms of doubtful and contested claims, improvement in the quality of banks' credit portfolio in both sectors - households and enterprises was registered in the last quarter of 2015. The share of doubtful and contested loans in total loans was 10.6% and decreased by 0.8 percentage points compared to September. From currency and maturity aspect, it can be noted that Denar and long-term loans have dominant contribution to the growth of lending. The dynamic growth of the credit market activity is expected to continue in the next period taking into account the results of the latest Bank Lending Survey that suggest a net easing of overall credit terms and increased demand for loans in the next period.

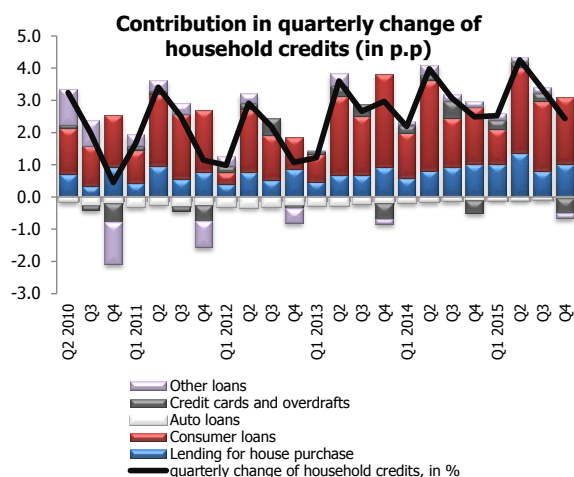
Annually, in December, total loans

⁶⁴ The growth in the NBRM net foreign assets in the fourth quarter is mainly explained by the inflows of the Eurobond issued by the government in December.



Total credits of households									
	2013				2014				2015
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
quarterly change, in %									
Total credits of households	2.8	2.1	3.9	2.9	2.4	2.4	4.2	3.3	2.5
Contribution in quarterly change of household credits (in p.p)									
Denar credits	2.8	2.1	3.9	3.0	2.3	2.3	3.9	3.2	2.4
Foreign currency credits	0.0	0.0	0.1	0.0	0.1	0.1	0.2	0.1	0.1
Short-term credits	-0.6	0.2	0.3	0.4	-0.4	0.2	0.2	0.2	-0.3
Long-term credits	3.8	1.8	3.5	2.5	2.8	2.0	3.9	3.0	3.0

Source: NBRM



increased by 9.5% (8.8% at the end of September). The utilization of the deposit potential for lending to the private sector declined despite the fast growth of total loans. Thus, at the end of December, the loans/deposit ratio⁶⁵ was 91.9% versus 92.2% at the end of September.

The lending to the household sector continued to grow in the last quarter, but the pace of growth continued to decelerate.

In the fourth quarter of 2015, loans to households increased by 2.5% compared to the end of the previous quarter (quarterly growth of 3.3% at the end of September and 4.2% at the end of June). Observed by structure, similar to total loans, Denar and long-term loans are major generators of growth of loans to households. Observed by certain categories of loans, the realized growth is still mainly driven by the increase in consumer loans, followed by housing loans. According to the results of the Bank Lending Survey, fast growth in demand for housing loans and further growth in demand for consumer loans was registered, albeit at a slower pace compared to the previous quarter. Also, from aspect of credit terms, the results of the Survey indicate a net easing of credit terms with stronger intensity compared to the previous Survey. According to the answers by the banks in the Survey, their expectations for the next period are in direction of moderate easing of total credit terms. However, within the individual types of loans, a moderate net tightening of credit terms in consumer loans is expected in the next period, which is the first such change since 2009.⁶⁶ **Annually**, at the end of December, total loans to households increased by 12.9%, similar to the previous quarter (12.8% at the end of September).

In terms of loans to the corporate sector, they registered strong quarterly growth of 5.7%, as opposed to the fall of 0.4% in the previous quarter. Favorable movements in lending to companies, according to the Bank Lending Survey are mostly due to the increase in demand for loans and further retention of eased credit terms by banks has positive contribution. Similar to households, banks expect a further easing of credit terms for

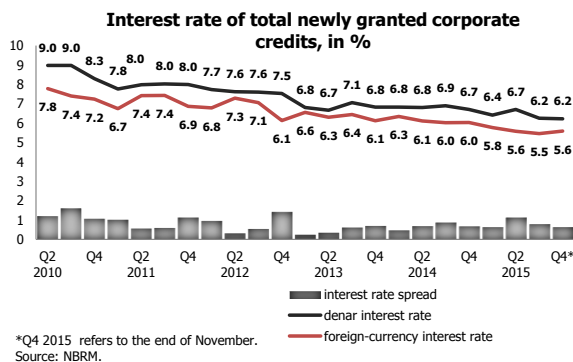
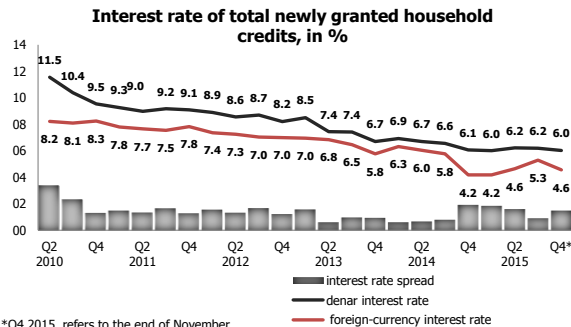
⁶⁵ According to monetary statistics data.

⁶⁶ Such movements in the banks' expectations in part could be explained by the measures introduced by the NBRM to slow the growth of long-term consumer loans. Namely, the Bank Lending Survey for the fourth quarter of 2015 was conducted in the period from 15 December to 25 December 2015, while the Decision of the NBRM Council on amending the Decision on the methodology for determining the capital adequacy (introducing measures to slow the high growth of long-term consumer loans) was adopted on 17 December 2015. This timeline indicates that the possible effects of this measure are probably incorporated in the banks' answers about their expectations for the direction of change in credit terms in the next period.

**Total credits of corporations**

	2013				2014				2015			
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
quarterly change, in %												
Total credits of corporations	3.2	1.5	2.0	0.3	4.5	0.1	1.6	-0.4	5.7			
Contribution in quarterly change of corporation credits (in p.p)												
Denar credits	3.0	1.2	1.9	0.1	3.7	-0.5	2.7	0.3	4.7			
Foreign currency credits	0.2	0.3	0.2	0.2	0.8	0.6	-1.1	-0.7	0.9			
Short-term credits	1.6	1.0	0.6	-0.3	3.2	-1.1	-0.1	-0.9	3.4			
Long-term credits	1.3	0.7	-0.2	-0.2	2.2	0.6	1.4	-0.1	2.8			

Source: NBRM.



companies in the next period. In order to ensure continuity of existing positive effects, the NBRM decided to extend the application of non-standard measure to reduce the reserve requirement base in denars of commercial banks for the amount of newly approved loans to net exporters and domestic producers of electricity by 2017. Also, the Decision on amending the Decision on the methodology for determining the capital adequacy created conditions to facilitate access of enterprises to financial services of banks. The withdrawn funds from the EIB 4 credit line had an additional impetus to the growth of corporate lending in the last quarter of 2015, amounting to Euro 13.7 million in support of 75 investment projects. The data on the maturity structure showed simultaneous increase in short-term and long-term loans. In terms of currency, Denar loans have dominant contribution to the growth. **Annually**, at the end of December, loans to enterprises increased by 7.1%, compared to 6.0% at the end of September.

According to the latest data on interest rates on newly approved loans as of November⁶⁷, interest rates on households decreased in both Denar and foreign currency loans, while interest rates on newly approved loans to enterprises were at the approximately same level as the previous quarter.

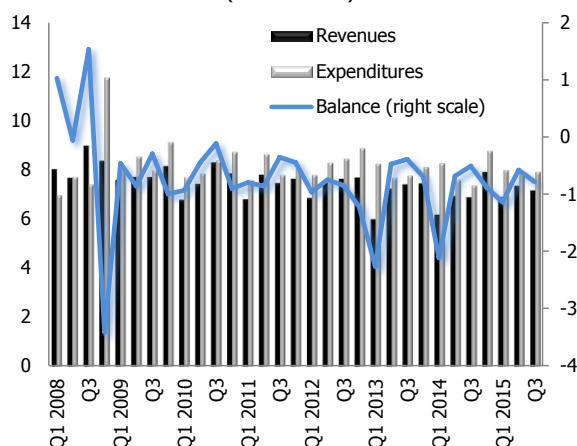
III. Public finances

In the third quarter of 2015, the growth of Budget revenues of the Republic of Macedonia (central budget and budgets of funds) was 9.2% on an annual basis, compared to 11.3% in the previous quarter. The solid growth on the revenue side is still largely associated with the positive trends in the collection of profit tax, which resulted from the abolition of the anti-crisis measure that exempted retained earnings of the companies from taxation. On the other hand, budget expenditures were carried out with increased dynamics this quarter, registering an annual growth of 12.8% (9.3% in the previous quarter). Given that the share of expenditures in GDP remained at the level of the previous quarter, while the share of revenues decreased, the budget deficit was higher in the third quarter and amounted to 0.8% of GDP (0.6% in the second quarter). The budget deficit in this quarter was financed mainly through government deposits, and less through net external borrowing. In the period from October to November, increased performance of total revenues by 8.5% on an annual basis was registered, with simultaneous growth of budget expenditures of 10.2%. The budget deficit in this period amounted to 0.4% of GDP.

⁶⁷ As of January 2015, interest rate data of banks and savings houses have been collected under the new interest rate methodology, while data for the previous period were collected under the old methodology. For more detailed information see Quarterly Report, May 2015, p 53.

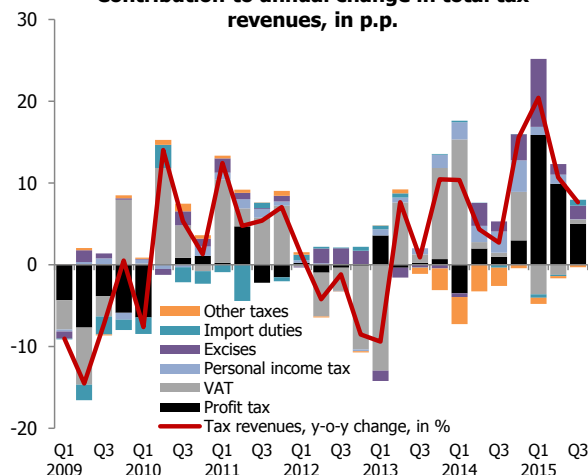


Budget revenues and expenditure
(in % of GDP)



Source: Ministry of Finance

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

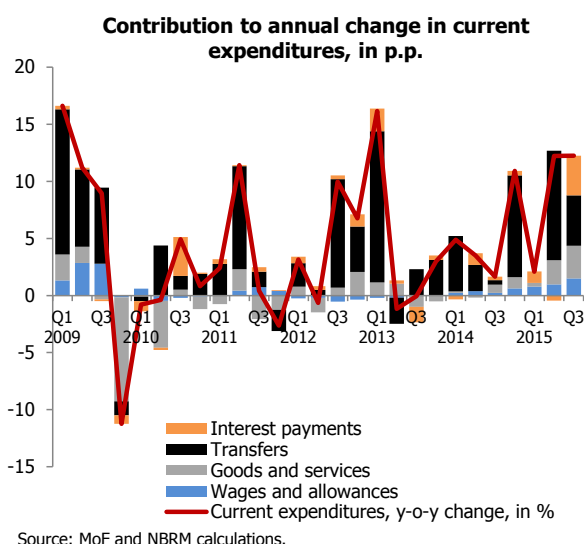
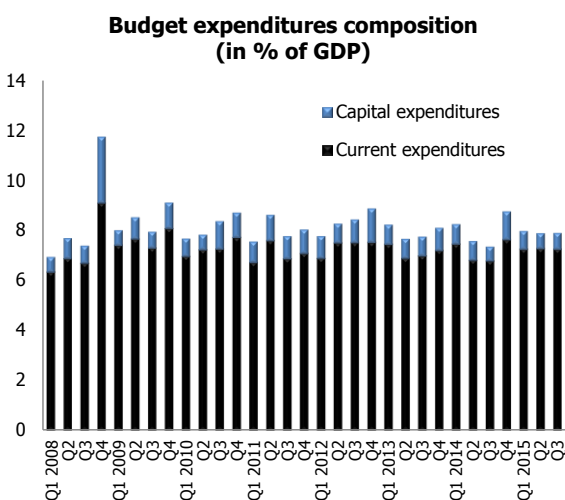
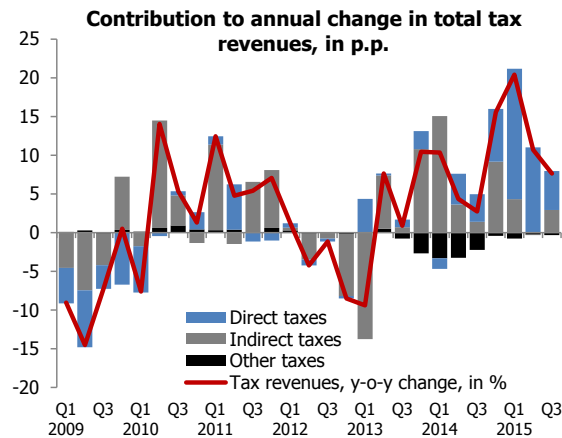


Извор: Министерство за финансии.

In the third quarter of 2015, total revenues in the Budget of the Republic of Macedonia⁶⁸ registered solid growth of 9.2% on an annual basis, amid growth in all key income categories. However, regarding the dynamics, the trend of a gradual slowdown also continued in this quarter, taking into account the growth of 11.3% in the previous quarter. The share of budget revenues in GDP⁶⁹ increased compared to the same quarter of the previous year, from 6.9% to 7.1%, but decreased compared to the second quarter of 2015 by 0.2 p.p.. Tax revenues remained the main driver of growth in total budget revenues, although during the year there was a tendency of gradual slowdown of their growth, at the expense of increased realization of social contributions. Nevertheless, with growth of 7.6% and contribution of 4.4 p.p. they remain the dominant item in the structure of budget revenues, primarily as a result of increased collection of direct taxes in this quarter. In accordance with the change in tax policy by re-taxation of undistributed profits of companies, revenues from profit tax continued to realize high growth rates (change by around 2 times annually), although at a slower pace. Given that the personal income tax recorded insignificant change in this quarter, the growth of revenues from direct taxes entirely resulted from higher collection of profit tax. At the same time, the increased importance of indirect taxes was characteristic for this period, which followed by slight decline in the previous quarter registered moderate growth, mainly driven by higher performance in excise revenues (7%). Moreover, in this quarter, this tax rate is probably influenced by the favorable effects associated with the collection of excise duties on tobacco products. In addition, after the negative growth rates registered in the first half of the year, in the third quarter VAT revenues registered an annual growth of 1%, which had a positive contribution to the growth of total tax revenues. The positive trends in collection of VAT revenues are probably associated with the intensification of consumption in this quarter. Significant growth of 15.7% was registered in the collection of import duties. In the third quarter, revenues from social contributions continued to increase, whereby the growth reached 9.7% on annual basis (9.3% in the previous quarter). Moreover, faster growth in the collection of contributions was recorded in all

⁶⁸ Central budget and budgets of funds.

⁶⁹ All shares in GDP were based on the October projection of the NBRM for the annual nominal GDP for 2015.



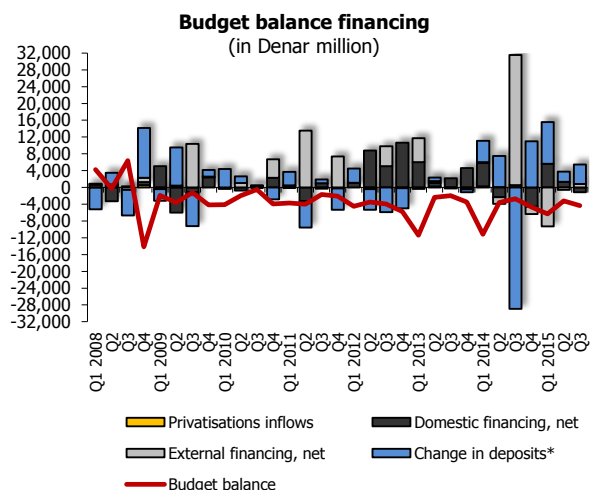
funds, which corresponds to the positive trends in the labor market in the third quarter. Non-tax revenues had a significant contribution to the growth of total revenues, which in this period grew by 30%.

In the third quarter of the year, the growth of total budget expenditures continued to increase, reaching 12.8% on an annual basis, compared with 9.3% in the previous quarter. As a share in GDP, budget expenditures remained at the same level as in the previous quarter (7.9%) but higher compared to the same quarter of the previous year (7.4%). Given that the annual growth of current expenditures was unchanged compared to the previous quarter, the accelerated growth of total expenditures was due to higher performance in the part of **capital expenditures**. Thus, after the fall in the first half of the year, in the third quarter capital expenditures registered significant annual growth of 19.1%, which resulted in a certain increase in their share in GDP (by 0.7%) and total expenditures (by 8.6%). In terms of **current expenditures**, growth of 12.2% was recorded, which was mainly due to the higher performance of transfers (by 6.2%). Within their framework, social transfers registered faster growth (especially social⁷⁰ and health care transfers), while other transfers including subsidies registered a slight decline. This quarter is specific because of the interest payments which have the second largest contribution to the growth of current expenditures, which is solely due to the commencement of repayment of interest on the Eurobond issued in 2014. As in the previous quarter, the costs of goods and services continued to be realized at faster pace, registering again double-digit annual growth rate (of 30.1%). The growth of current expenditures was additionally driven by more intensive increase in the cost of wages and benefits, which in this quarter increased by 9.3% on an annual basis.

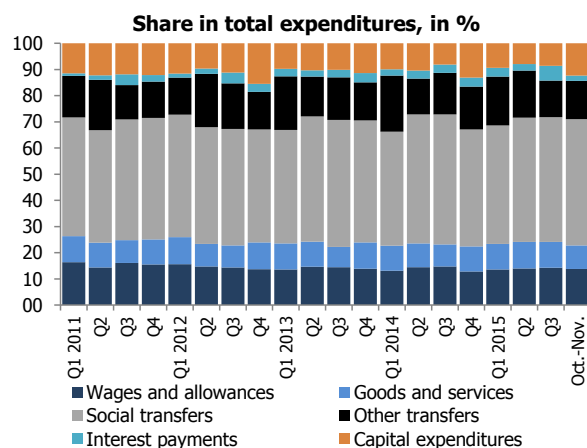
Given the fact that budget expenditures in the third quarter were higher than budget revenues, budget deficit was again realized, amounting to Denar 4.353 million or 0.8% of GDP⁷¹. Compared with the previous quarter, this represents a higher deficit by 0.2 percentage points, whereby the percentage of realization in this quarter was around 22% of the total deficit planned in the

⁷⁰ In July 2015, welfare increased by 10%.

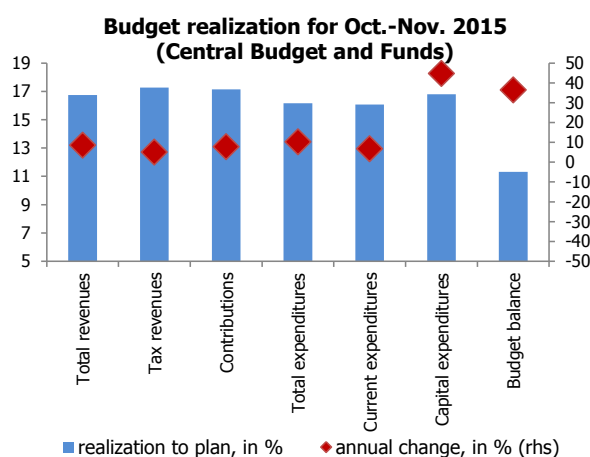
⁷¹ The calculation uses the October projection of the NBRM for the nominal GDP for 2015. The deficit is the same if the projection of the Ministry of Finance is used.



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



Source: MoF and NBRM calculations.



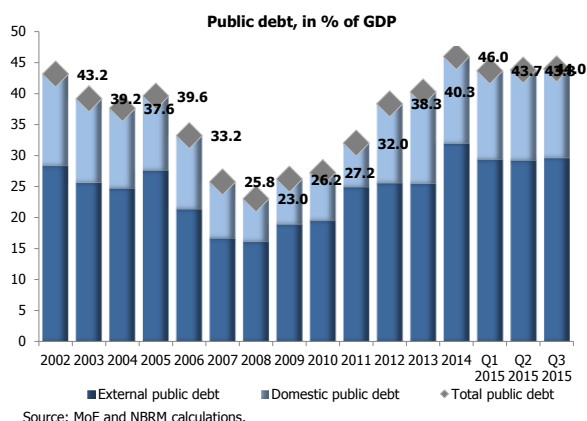
* With respect to the Budget revision for 2015.
Source: Ministry of Finance and NBRM calculations.

Supplementary Budget. The negative budget gap is largely funded through the use of government deposits with share in the total budget financing needs of around 50%, and additional funds were provided through external borrowing. On the other hand, in the third quarter government deleveraging on the basis of issued government securities in the domestic market was made, in the net amount of Denar 1.109 million.

In two months of the fourth quarter total budget revenues continued to register growth at an annual rate of 8.5%, again as a result of positive trends in collection of taxes, and especially in direct taxes. The growth of direct taxes continued to be mainly conditioned by profit tax, which increased by 45.8% compared to the same period last year, taking into account tax changes performed in this domain at the beginning of the year. On the other hand, revenues from personal income tax registered minimal upward changes on an annual basis. Indirect taxes also increased, amid increased collection of VAT revenues (by 2.5%), excises (by 2.8%) and import duties (by 9.6%). Moreover, the trend of higher collection in contributions for pension, health insurance and insurance in case of unemployment continued, compared to the same period last year. As in the previous quarter, non-tax revenues again registered significant growth (of 30.8%), this time as a result of high growth of the item "other non-tax revenues". **In the period from October to November total budget expenditures continued to be performed at a solid pace, registering growth of 10.2% on an annual basis.** The rise in total expenditures during this period was mostly due to the higher performance of current expenditures, primarily in the area of transfers for payment of pensions⁷² and health care transfers. Additionally, the increased performance of capital expenditures in the two months of the fourth quarter continued, which registered high growth of 44.7%, whereby significantly contributing to the growth of total expenditures. The period October-November registered a budget deficit of Denar 2,279 million, which represents 0.4% of GDP⁷³. Thus, the overall budget deficit on cumulative basis (January-November) is around 3% of GDP, compared to 3.6% as projected for the entire year with the Supplementary Budget. The only source of financing the budget deficit in October and

⁷² In October 2015, pensions increased by Denar 621 were paid.

⁷³ Also, 0.4% of GDP according to the GDP projection of the Ministry of Finance.



November was government borrowing on the domestic market of securities, while on the basis of foreign borrowing net repayments were made. These months registered a moderate increase in the government deposits with the NBRM.

As of 30 September 2015, total public debt⁷⁴ equaled 44% of GDP⁷⁵, which is an increase of 0.2 percentage points of GDP compared with the previous quarter. The increase in total public debt in this period is mainly due to higher external public debt, whose share in GDP increased from 29.2% to 29.6%, as opposed to the share of domestic public debt, which decreased (from 14.6% to 14.4%). In terms of debt holders, the growth of total public debt relates to the debt of public enterprises⁷⁶, which increased to 7.9% of GDP (7.7% in the previous quarter), compared to government debt⁷⁷ which at the end of the third quarter remained at the level of the previous quarter (36.1% of GDP).

BUDGET OF REPUBLIC OF MACEDONIA (Central budget and budgets of funds)

	Supplementary Budget for 2015	Q1	Q2	Q3	Oct.-Nov.	y-o-y changes, 2015 period over the same period of the previous year, in %				Contribution to y-o-y change, 2015 period over the same period of the previous year, in p.p.			
	planned, in Denar million	realized, in Denar million				Q1	Q2	Q3	Oct.-Nov.	Q1	Q2	Q3	Oct.-Nov.
TOTAL REVENUES	166,842	37,779	40,352	39,314	27,935	17.0	11.3	9.2	8.5	17.0	11.3	9.2	8.5
Tax revenues and contributions	142,527	33,326	35,378	34,837	24,484	16.1	10.3	8.4	6.1	14.3	9.1	7.5	5.5
Taxes	93,516	21,935	23,119	22,331	16,146	20.4	10.7	7.6	5.0	11.5	6.2	4.4	3.0
Contributions	47,189	10,932	11,900	12,125	8,091	7.1	9.3	9.7	7.7	2.2	2.8	3.0	2.3
Non-tax revenues	16,433	3,240	2,672	3,439	2,540	24.7	9.7	30.0	30.8	2.0	0.7	2.2	2.3
Capital revenues	2,880	350	1,286	332	134	101.1	23.5	-4.6	5.5	0.5	0.7	0.0	0.0
Foreign donations	4,202	784	846	608	713	28.1	58.4	-20.6	50.4	0.5	0.9	-0.4	0.9
Revenues from repayments of loans	800	79	170	98	64	-61.1	3.0	-11.7	-47.1	-0.4	0.0	0.0	-0.2
TOTAL EXPENDITURES	186,981	44,080	43,572	43,667	30,214	1.5	9.3	12.8	10.2	1.5	9.3	12.8	10.2
Current expenditures	164,747	39,936	40,106	39,919	26,481	2.1	12.2	12.2	6.7	1.9	11.0	11.2	6.0
Capital expenditures	22,234	4,144	3,466	3,748	3,733	-3.8	-16.3	19.1	44.7	-0.4	-1.7	1.6	4.2
BUDGET DEFICIT/SURPLUS	-20,139	-6,301	-3,220	-4,353	-2,279								
Financing	20,139	6,301	3,220	4,353	2,279								
Inflow	48,958	16,709	5,142	9,300	3,180								
Privatisation receipts	0	0	0	0	0								
Foreign loans	4,339	1,018	362	1,483	230								
Deposits	20,973	9,928	2,414	4,575	-1,973								
Treasury bills	5,137	5,762	2,356	3,240	4,923								
Sale of shares	50	1	10	2	0								
Outflow	28,819	10,408	1,922	4,947	901								
Repayment of principal	28,819	10,408	1,922	4,947	901								
External debt	22,664	10,276	923	596	740								
Domestic debt	6,155	132	999	4,351	161								

Source: Ministry of Finance and NBRM calculations.

⁷⁴ The public debt is defined under the Law on Public Debt (Official Gazette of the Republic of Macedonia No.165/14) , according to which it is the sum of the government debt and the debt of public enterprises established by the state or municipalities, municipalities within the city of Skopje and the city of Skopje, and companies that are wholly or predominantly owned by the state or by the municipalities, the municipalities within the city of Skopje and the city of Skopje, for which the Government has issued a state guarantee.

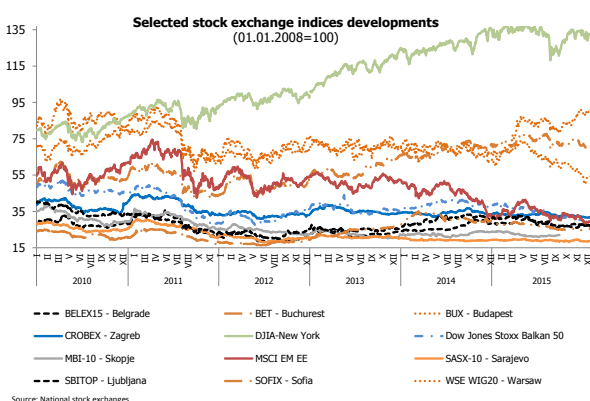
⁷⁵ The calculation uses the October projection of the NBRM for the nominal GDP for 2015. The debt amounts to 43.9%, if the projection of the Ministry of Finance is used.

⁷⁶ Refers to guaranteed debt of public enterprises and joint stock companies owned by the state, according to the public debt definition under the Law on Public Debt (Official Gazette of the Republic of Macedonia No. 165/14).

⁷⁷ Government debt is defined as a sum of debts of the central and the local government.

IV. Stock exchange indices and real estate prices

In the fourth quarter of 2015, the Macedonian MBI-10 registered quarterly growth, and an upward trend was registered also in the OMB index in the third quarter. Similar to the MSE, most regional stock indices increased in value, mainly due to the improved situation on the European capital market, coupled with positive specific factors in individual countries. In the fourth quarter, real estate prices in the domestic market registered an annual growth, versus the fall in the previous quarter. These prices were volatile in 2015, without pronounced trend in the movement, whereby they remained relatively stable on average for the year while retaining the level of 2014.



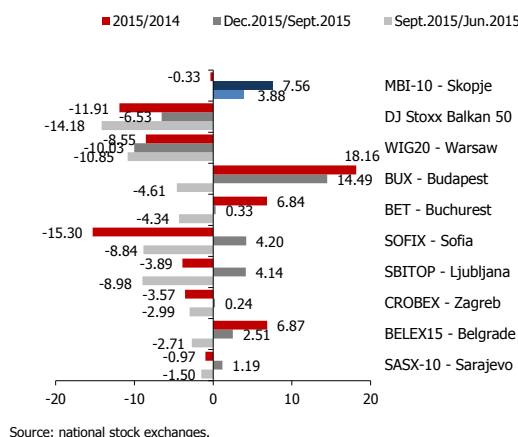
During the fourth quarter of 2015 the value of the Macedonian MBI-10⁷⁸, registered quarterly growth of 7,6%, whereby the index reached the value of 1833.26 at the end of the quarter (compared to 1716.49 as it was at the beginning of the quarter). Analyzing the dynamics of movement, the index generally followed an upward trend eight consecutive months. However, the downward trend conditioned lower value of the index in 2015 since the beginning of the year, compared to 2014. Favorable developments in the market correspond with the good economic performances and expectations for their extension until the end of the year. 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 this movement of the stock exchange index will continue, or it is a temporary trend. The total stock exchange turnover increased by 2.3 times compared to the previous quarter, mainly resulting from the majority block transactions, followed by solid growth in conventional trading. At the end of December 2015, the OMB index increased by 0.5% compared to the end of September 2015, (slightly more moderate compared to the previous quarter, when the growth amounted to 1.5%). The second half of the year was generally characterized by moderate upward movements in the value of the index, while the index had variable movement in the first half of the year.

At the end of the fourth quarter of

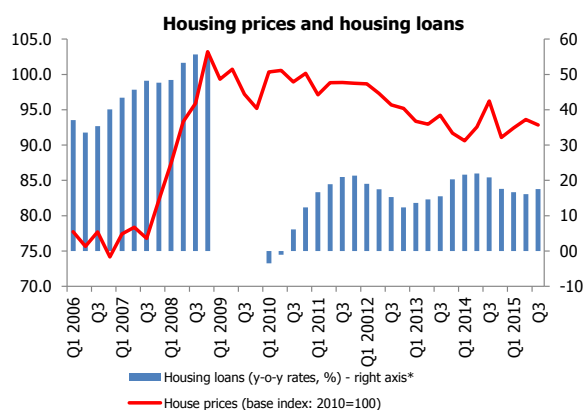
⁷⁸ On 15 December 2015, the MBI-10 index was revised, and as of 30 December 2015, the index includes the following companies: Komercijalna Bank AD Skopje, Granit AD Skopje, Alkaloid AD Skopje, Stopanska Bank AD Bitola, Makpetrol AD Skopje, Makedonijaturist AD Skopje, Stopanska Bank AD Skopje, Macedonian Telecom AD Skopje, NLB Tutunska Bank AD Skopje and Skopski Pazar AD Skopje.



Changes of the regional stock exchange indices, eop
December 2015/eop September 2015, eop September 2015/
eop June 2015 and 2015/2014, (in %)



2015 the values of all regional stock indices, with the exception of Warsaw, increased. In global terms, despite the uncertainty and increased volatility in stock markets, primarily as a result of the slowdown in the Chinese economy and strong quantitative easing in Europe, however, European stock markets ended the year with profit⁷⁹. In conditions of present financial integration of regional economies with developed economies in the euro zone, these conditions of European stock markets, together with certain specific local factors⁸⁰ contributed to the upward movement of the indices in the region. Observed for the entire 2015, growth on the stock markets in Budapest, Belgrade and Bucharest was recorded, and other registered decline.



In the fourth quarter of 2015, the index of housing prices⁸¹ increased by 0.9%, on an annual basis (compared to the annual decline of 3.5% in the third quarter). However, considering that during the year real estate prices registered little changes in a different direction, it is difficult to conclude whether the change in the fourth quarter is of a permanent or temporary character. This statement is additionally supported by the pronounced downward trend in the previous years, on average for 2015, housing prices remained relatively stable while retaining the level of 2014. Regarding the stock of supply and demand for real estate indicators do not point to significant changes. Namely, the construction of apartment buildings continued to register growth (an annual growth of construction of apartment buildings in the first nine months of the year by almost 17%), and data show similar dynamics in building permits. In terms of demand for apartments, the permanent solid growth in home loans continued in the fourth⁸² quarter of 2015 and suggests further strengthening of demand.

⁷⁹ <http://www.marketwatch.com/story/european-stocks-set-for-fourth-straight-year-of-gains-2015-12-31>

⁸⁰ <http://wire.seenews.com/>

⁸¹ 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.

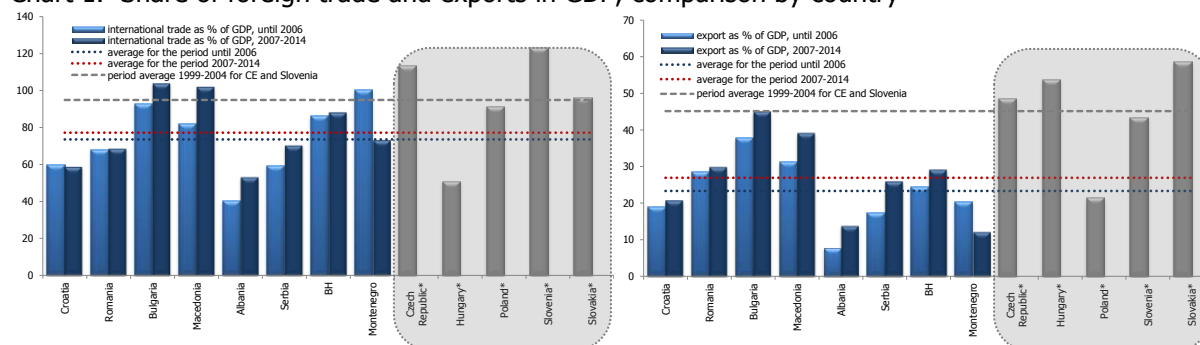
⁸² Available data for the first two months of the quarter.

V. Analytical appendices

Box 1: Trade connection between the countries of Central and Southeastern Europe with the European Union, with particular focus on the connection with Germany

The transition process through which the countries of Central and Southeastern Europe passed also meant their greater trade and financial integration, particularly with the EU countries. **The purpose of this appendix is to make a brief overview of the dynamic changes in trade exposure of the countries of Southeastern Europe to the European market, in particular to the German economy.** Also, the appendix makes comparison with the Visegrad Four countries and Slovenia (hereinafter: Central Europe), as economies that relatively quickly and successfully passed the process of trade integration with the European markets.

Chart 1. Share of foreign trade and exports in GDP, comparison by country⁸³



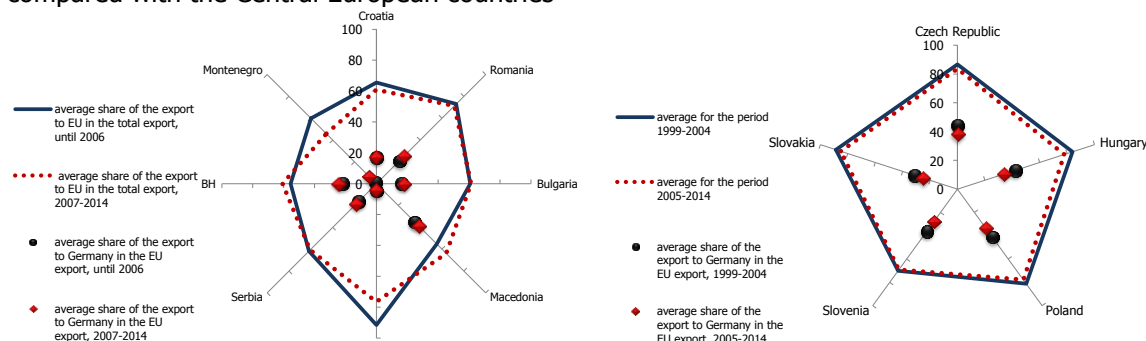
Source:EUROSTAT and national statistical offices.

In light of the foreign trade, a significant feature of the Central European countries is the high degree of trade openness and the particularly high export orientation, which is further increased after their entry into the European Union. The rapid economic and political reforms carried out by these economies, made them interesting markets for foreign investments, attracting direct investments, predominantly in the export-oriented manufacturing sectors. Geographical proximity to the European Union countries naturally imposed this market as the priority trading partner, whereby the share of the EU in the total foreign trade in the period prior to 2004 averaged 74.3% of GDP, and after the membership the trade importance of this market rose to 94.8%. **The trade importance of the European market is largely due to the export component of foreign trade, whose share in GDP in the period 1999-2004 averaged 37.3% of GDP, registering an increase of 49.5% in the period after the EU accession.** The IMF Report⁸⁴ dedicated to the 25 years since the beginning of transition in post-communist Europe, states that the economies of Central Europe, the location factor, i.e. proximity to the EU played a key role in export growth movement, contributing to faster real convergence of this group of countries compared to other transitional economies. The strong trade connections with the EU, especially the importance of the export sector, is largely due to the high degree of relation with the German market, that starting from the early nineties has emerged as the dominant export market for Central European economies. By the late nineties, the concentration of foreign investments in the manufacturing sectors, particularly in the automotive sector, created a trade network for supplying the Germany automotive industry with products from these countries. **The share of exports toward the German market in the Central European countries in the period before the EU membership moved up to one third of total exports, on average.** In this period, the sectoral structure of the exports to Germany shows **high concentration on the automotive industry, with an average share of 30% in the total export** placed on this market.

⁸³ For the SEE countries the analysis is focused on two periods, the period from 2000 to 2006, whereby for certain countries latter data are used depending on availability, and the period 2007-2014. For the CE countries the focus is on the period 1999-2004, i.e. the period immediately prior to the accession of these economies in the EU, whereby certain comparability between the two groups of countries would be achieved.

⁸⁴ IMF, Regional Economic Issues Special Report (October 2014), 25 Years of Transition Post-Communist Europe and the IMF.

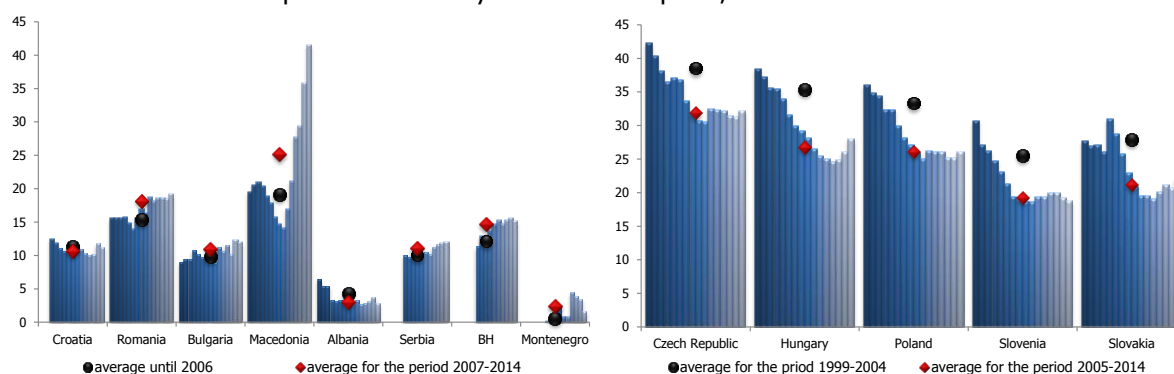
Chart 2 Importance of the EU market for the export sector in Southeastern European countries, compared with the Central European countries



Source:EUROSTAT and national statistical offices.

The analysis of the export performances of the SEE countries indicates a lower relative share of exports in GDP compared to the four Central Europe economies, but as well as the Central European countries these economies directed their exports predominantly to the EU market, which is their most important export partner. Export exposure of these countries to the EU is relatively stable with share in total exports of nearly **65% for the period before 2006⁸⁵** and **63% in the period from 2007 to 2014**. However, unlike the Central European countries, where certain unification in terms of the high level of exposure to this market exists, the SEE countries show larger variations as a result of the individual specificities and differences in terms of the degree of integration with the EU⁸⁶ and dynamics at which EU markets for trade and financial integration became available to these economies. Albania and Romania are two economies whose average export exposure to the EU approaches the Central European countries. In the case of Albania, the importance of the European market is more pronounced in the period until 2006 (accounting for 91.6% of total exports), followed by a period of gradual reorientation of exports to closer Balkan countries and China and a corresponding reduction of exposure to EU (to 76.3%). In the case of the Romanian economy the European market continually keeps the high share of the total exports of over 70%. Montenegro deviates in the opposite direction, economy with significantly lower export orientation towards the European Union countries and trend of gradual decline, so in 2014 only 25.8% of Montenegro's export was placed on the European market. Among **the rest of the Southeastern European countries, export exposure to the EU is more stable and during the entire analyzed period amounts to 60%, on average.**

Chart 3. Share of the exports to Germany in the total exports, in %



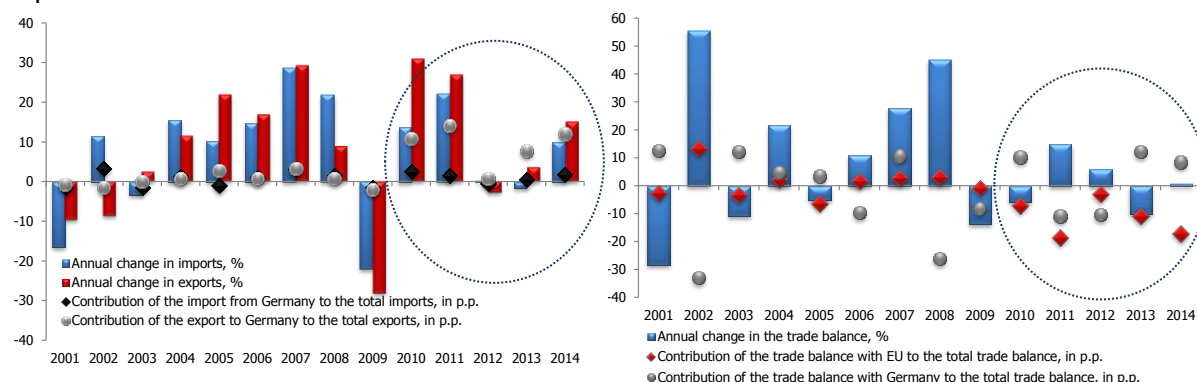
Source: EUROSTAT and national statistical offices.

⁸⁵ The period prior to 2006 is analyzed separately in order to isolate the period before the entry of Bulgaria and Romania into the EU, and the signing of the Stabilisation and Association Agreement with Serbia and Bosnia and Herzegovina.

⁸⁶ Namely Bulgaria and Romania are member states of the EU since 2007, Croatia is the last member state (since June 2013), while Macedonia, Montenegro, Serbia and Albania are candidate countries for membership. Bosnia and Herzegovina currently has the status of potential candidate.

Regarding the German market, as one of the economically strongest within the European Union, it has an important role in absorbing exports of Southeastern European economies, although compared to Central European countries exposure to Germany is considerably smaller and varies significantly between individual economies from the region. Albania and Montenegro are both economies where deviations are particularly pronounced, and for various reasons. In the case of Albania, the geographical location and historical connections contributed to the high concentration of Albanian exports on the Italian markets, whereby the modest share of exports to Germany in total exports in the period until 2006, declined further in the latest period to an average of 3%. On the other hand, in the case of Montenegro, another economy with low share of the export sector in GDP, strong connections with the economies from the region are evident, where the modest exports of this economy is mainly placed. Other countries⁸⁷ show a more uniform image in terms of exposure to the **German market, with a share that follows a predominantly upward trend for the entire analyzed period, from an average 13% in the period until 2006 to 15.1% between 2007 and 2014.** Dynamically speaking, in some of the countries, such as Croatia, Bulgaria and Serbia, the relative importance of this trading partner remains stable in both periods, while in the remaining three countries an increase in export connection with Germany is present, particularly evident in the period from 2010 onwards. Analyzing in terms of quantity, in the case of Bosnia and Herzegovina, Germany is the second important export partner, with an average share of 12.1% in total exports for the period until 2006 and an increase of 2.6 percentage points, to 14.7% in the period from 2007 to 2014. In the latest period, the German market accounted for 18.2% in total exports of Romania, on average, which was an increase of 2.8 percentage points compared to the period before the membership in the EU.

Chart 4. The effect of foreign trade with Germany on exports, imports and trade balance of the Republic of Macedonia



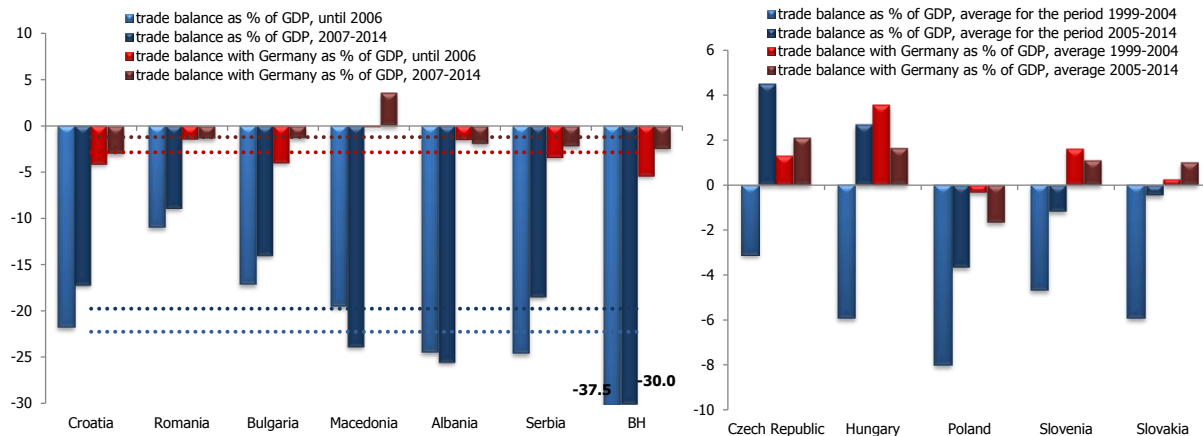
Source: SSO and NBRM calculations.

Macedonia is the most striking example of the increasingly pronounced importance of Germany for the export sector in the region, where in 2014 exports to this European market reached 41.5% of total exports, increasing the share by 22.3 p.p. compared to the average share in the period before 2006, whereby it is the only country in the region where the German market has the largest share in exports. Tax reforms aimed at stimulating foreign investment in the country, coupled with competitive labor market and favorable geographic location, resulted with intensification of direct investments entry, predominantly concentrated in the manufacturing sectors of the economy, especially in the automotive industry. The new companies created additional export facilities for the domestic economy, aimed at the European markets and mostly toward Germany, especially the companies whose core activity is production of auto parts and equipment. **The effects of the structural changes resulted in exports toward this trading partner in 2014 increased by 12.6 percentage points of GDP compared to the performance in 2006⁸⁸.** Given the fact that the import component of these companies does not come predominantly from Germany, starting from 2010 the trade balance registered positive values that register trend of growth. Thus, in 2014 the export activity toward Germany contributed with 79.1% to the growth of total exports, and at the same time trade surplus reached 11% of GDP.

⁸⁷ Without Albania and Montenegro.

⁸⁸ In nominal terms the change is more than 400% growth.

Chart 5. The effect of the balance of trade in Germany on the overall trade balance as a percentage of GDP



Source: EUROSTAT, national statistical offices and WEO.

In fact, observed from a viewpoint of the entire region, trade with Germany has a positive effect on the overall balance. Thus, the average for the region⁸⁹, the improvement in the trade balance in the period 2007-2014 was mostly due to the positive developments in the balance with Germany, i.e. even 68% of the change is explained by this factor, as a combined effect of the improved export performances and cyclical downward adjustment by imports. Analytically speaking for the region as a whole the improvement between the two periods was 1.8 p.p. of GDP on average, although there are differences between individual economies. Positive changes are particularly visible in Bosnia and Herzegovina and Bulgaria, where the improvement of the trade balance in the trade with Germany amounted to 2.9 p.p. and 2.7 p.p. of GDP, respectively, and the Republic of Macedonia as a unique example of economy that for the last eight years has created a positive balance in the trade of goods with Germany.

In summary, the European Union represents a key trading partner for the countries of Central and Southeastern Europe, which is naturally taking into account the location factor and the process of European integration, characteristic for all these countries. The comparison of the two groups of countries showed greater exposure toward the EU countries of Central Europe, as well as their greater homogeneity in terms of the extent of this trade connection. On the other hand, the Southeastern European countries have specificities, and therefore the differences in the degree of trade integration with the EU are more pronounced within the same group of countries. The same statement applies when a comparison of trade integration with Germany is made, given that in the group there are countries with insignificant relation (like Montenegro and Albania) and countries with large exposure to Germany (e.g. Macedonia). However, on average for the entire region the importance of trade connections with the European Union is great and there is a growing tendency, whereby exports toward the German market, especially exports of automotive industries is one of the major channels that increases trade integration with the EU.

⁸⁹ With the exception of Macedonia.

Box 2: CompNet Competitiveness Indicators - novel perspective of the export competitiveness

The increase of competitiveness is one of the main objectives of the macroeconomic policy. The modern concept of competitiveness exceeds traditional measures of comparative advantage of countries in terms of prices and costs, putting increasing emphasis on other factors that significantly affect the competitiveness, such as firm-level productivity, structural and macroeconomic factors in each country and integration into global value chains. Empirical estimates of the major determinants of export performance in the euro zone countries show that even 60-70% of export growth can not be explained by traditional measures of competitiveness⁹⁰. Non-price factors become significant determinants of export growth, which is why focusing exclusively on price competitiveness can lead to macroeconomic policies that will leave out the quality impact of export products. Also, given the growing contribution of the services sector, the relevance of the competitiveness of non-trading sectors when explaining changes in trade flows is gradually increasing.

Identifying the competitiveness as one of the top priorities for the euro zone, the ECB in 2012 founded the Competitiveness Research Network - CompNet, which brings together economists from the banks of the Eurosystem and is engaged in comprehensive research activity on various aspects of competitiveness. The aim of the CompNet is determining the drivers of competitiveness and productivity in the EU countries, as well as their impact on macroeconomic performance. The competitiveness is defined as a multidimensional concept, covering *macroeconomic*, *microeconomic* and *cross-country analysis*. The macroeconomic dimension provides knowledge about the institutional and overall macroeconomic environment in which export companies operate. Based on these conditions, individual companies make a decision whether to export, so that the analysis of micro-level is important for understanding the drivers of export activity. Also, the involvement in global value chains has macroeconomic implications because of the possibility of spillover of shocks between individual countries and increased external vulnerability.

Within its activity, the Research Network published the paperwork "Compendium on the Diagnostic Toolkit for Competitiveness"⁹¹ which summarizes more than 80 indicators of competitiveness, introducing ten new and innovative indicators of competitiveness with regard to their calculation and interpretation. Additional contribution is the database for all indicators for the euro zone countries (as well as other countries, including Macedonia) calculated on the basis of disaggregated trade data (HS six-digit) from Comtrade. In terms of policy makers, the Compendium should contribute to designing appropriate macroeconomic policies in order to improve economic performance by identifying the drivers of competitiveness. In accordance with the accepted definition of competitiveness, the Compendium contains indicators based on macro, micro and data concerning the involvement in global value chains. The export performance indicators as well as price and non-price competitiveness indicators, which are calculated based on innovative methodologies, prevail. Furthermore, the Compendium covers indicators derived from trade with value added, which indicate the real contribution of the trade for one country. Also, indicators based on firm-level data in the euro zone are included, which are important given the skewed distribution of productivity and competitiveness, making exports of each country to be determined by the export activity of a small number of companies⁹². In that context, the basic advantage of microdata consists of their comparability between the euro zone countries, considering the application of a harmonized protocol in their processing. Overall, the Compendium addresses in detail the following ten innovative indicators of competitiveness:

1. Revealed comparative advantage indices
2. Intra- and inter- industry trade

⁹⁰ Karadeloglou, P., Benkovskis, K., and the CompNet Task Force (2015), "Compendium on the Diagnostic Toolkit for Competitiveness", ECB, Occasional Paper Series, No.163, pg. 64.

⁹¹ The paperwork is available at the following link: <http://www.ecb.europa.eu/pub/pdf/scpops/ecbop163.en.pdf?4c0c0aeb9206a0e1c318ee329f6f9d8b>

⁹² Lopez-Garcia, P. et al (2015), "Assessing European Competitiveness: the new CompNet micro-based database", ECB, Working Paper Series, No. 1764.

3. Relative export prices adjusted for quality and taste
4. Market share decomposition
5. Exports sophistication
6. Dynamic Trade Link Analysis
7. Trade-weighted unit labour cost
8. Export assortativity metrics: Network-based measures for relative export prices and specialization
9. Firm-level based indicators
10. Indicators of global value chains

The purpose of this appendix is to present part of the innovative indicators of CompNet and briefly explain the theoretical background on which their construction is based. Also, according to the database of CompNet, the developments of these indicators are shown, comparing the results for Macedonia with selected countries from the Western Balkans and Central and Eastern Europe (CEE), as more advanced transition countries⁹³. Four indicators that examine competitiveness from macroeconomic aspect are subject to further analysis, as follows: the revealed comparative advantage indices, relative export prices adjusted for quality and taste, market share decomposition and export assortativity metrics. These indicators are selected according to the availability of data for Macedonia, in order to offer information about several different dimensions of competitiveness of the Macedonian exports.

The revealed comparative advantage indices (RCA) are widely used in the analysis of trade flows in order to establish the revealed advantage or weakness of one country in the exports of a particular product group. Regarding the method of calculation, these indices compare the share of exports of the given group of products from the country in total exports from that country with the share of world exports of that group of products in total world exports. Therefore, if the index has a value higher than 1 it points to comparative advantage in exports of the given products. The Compendium calculates the indices of revealed comparative advantage for products which according to the classification of the OECD (2003) belong to the group of high-technology⁹⁴ and medium-high-technology products⁹⁵. Such disaggregation should give additional information about the nature of traded goods, focusing on different levels of technological processing.

The analysis of Macedonia shows that the country registered significantly improved performance in exports of medium-high-technology products in the last four years, while in 2013 it registered revealed comparative advantage in their exports, for the first time. These favorable developments in exports of medium-high-technology products correspond to the entry of new industrial facilities in foreign ownership and the intensified exports of machinery and equipment. On the other hand, data show no significant advantage in terms of exports of high-technology products. Analyzing the overall period on average, it can be registered that Macedonia and other countries from the region do not have a revealed comparative advantage in exports of both product categories. Analyzed for individual countries in the Western Balkans, Croatia and Bulgaria registered better performances in exports of medium-technology products, while Albania has significantly weaker results⁹⁶. In contrast, the CEE countries hold a comparative advantage in exports of medium-high-technology products, and they show relatively better results in exports of high-technology products. The analysis by individual countries in CEE confirms that comparative advantage in exports of

⁹³ Within the Western Balkans countries Macedonia, Serbia, Croatia, Bulgaria and Albania are included, while within the CEE countries Slovenia, Romania, Czech Republic, Slovakia, Poland and Hungary are included.

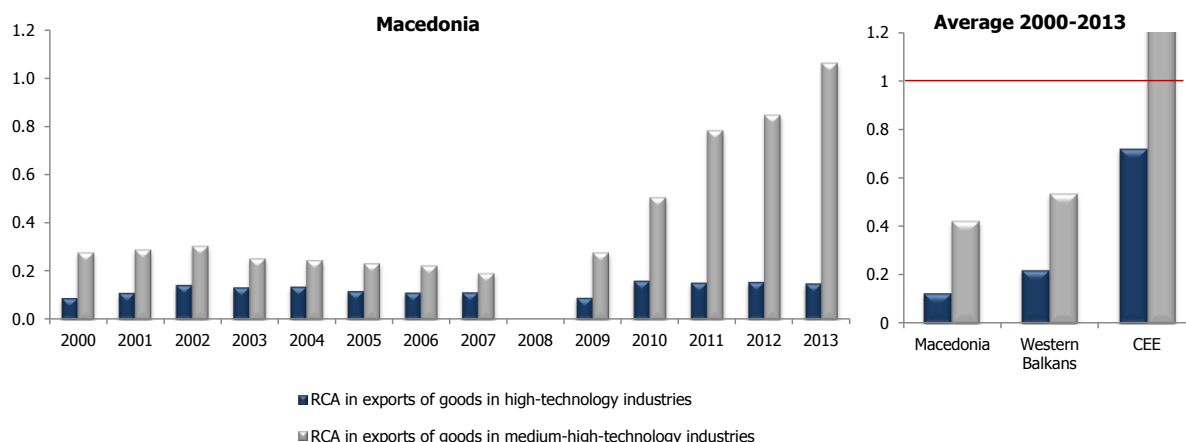
⁹⁴ High-technology products include: air and spacecrafts, pharmaceutical products, computer equipment, radio, TV and communication equipment.

⁹⁵ Medium-high-technology products include: electric machinery and aircrafts, motor vehicles, chemical products (excluding pharmaceuticals), railway and transport equipment.

⁹⁶ Within medium-technology products, Croatia and Bulgaria mostly exported electrical machinery and equipment. On the other hand, Serbia, like Macedonia, for the first time registered revealed comparative advantage in exports of medium-technology products in 2013.

medium-high-technology products is present in all observed countries, while Hungary is the only country that shows comparative advantage in exports of high-technology products⁹⁷.

Chart 1 Revealed comparative advantage in exports of high-technology and medium-technology products (indices)



Source: CompNet Compendium Toolkit Database.

The index of **relative export prices adjusted for quality and taste** overcomes the main weakness of traditional indices of REER, so that in addition to price, it is also a measure of non-price competitiveness, i.e. the quality and taste of consumers of export products. Relative export prices (RXP) are ratio between domestic and world export prices. They are calculated on the basis of highly disaggregated trade data⁹⁸, by using the unit values. The individual unit values are aggregated through weighting and weights are calculated at product level. Individual weights are adjusted by the elasticity of substitution, according to the market in which the products are placed, so that they are higher in the markets with a higher elasticity of substitution, where price competitiveness is relatively more important. This enables a more realistic view of the competitiveness of the products that are exported. Furthermore, RXP can be adjusted for changes in the relative quality and taste, which are implicitly determined on the basis of relative unit values and relative export quantity at product level⁹⁹. The total RXP of a particular country is obtained with the aggregation of all product level indices. In terms of interpretation, the depreciation of RXP adjusted for quality and taste indicates an increase in price and non-price competitiveness. Changes in the non-price competitiveness can be assessed indirectly, by comparison with the movement of the conventional RXP (*unadjusted for quality and taste*)¹⁰⁰. At the same time, the indirect way of assessing non-price competitiveness is a major drawback of this indicator, due to the danger to include the effect of other, unidentified factors.

The CompNet database contains data on these two indices of RXP, whose movement is depicted in the charts below. In the case of Macedonia, the RXP adjusted for quality and taste continuously depreciated since 2003 onwards, and it is also lower than the conventional RXP. According to the normative interpretation of the results, it is an indication of the favorable developments in non-price competitiveness of the Macedonian exports. A similar trend in the movement of both indices of relative export prices is observed in the data for the Western Balkans countries as a whole, and for all countries, separately.

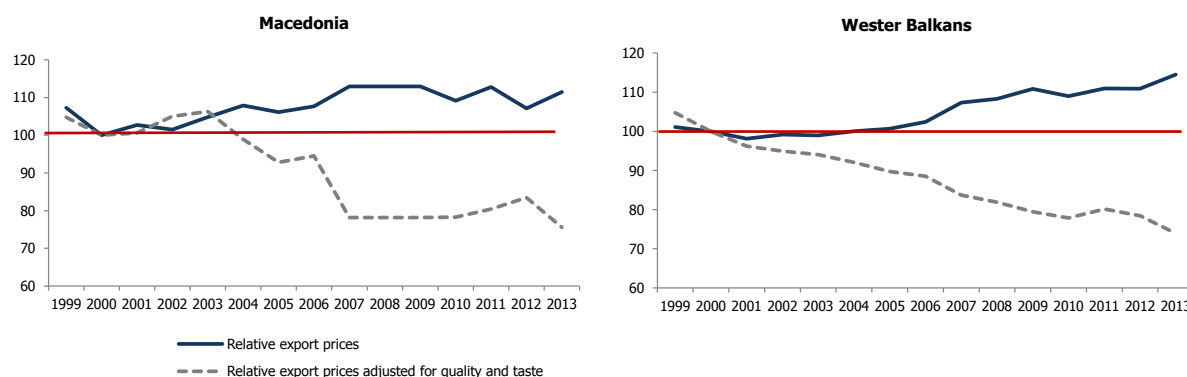
⁹⁷ The revealed comparative advantage in exports of high-technology products from Hungary comes from exports of pharmaceutical products, computer equipment and TV and communication equipment.

⁹⁸ Based on data on foreign trade of Comtrade, disaggregated at six-digit level.

⁹⁹ Namely, the higher price is considered to be an indication of a higher quality, while higher export quantity is an indication of favorable changes in taste and preferences of consumers.

¹⁰⁰ The conventional index of relative export prices (unadjusted for quality and taste) is actually an indicator of price competitiveness.

Chart 2 Relative export prices adjusted for quality and taste (indices, 2000=100)



Source: CompNet Compendium Toolkit Database.

The assessment of export performance based solely on changes in market share has limited informative value when analyzing competitiveness. In order to identify the driving factors behind these changes, CompNet represents the indicator - **market share decomposition**¹⁰¹. It shows how much of the changes in market share results from exports to new markets, i.e. new products (so-called extensive trading margin¹⁰²), and how much is due to the intensification of the traditional export lines (so-called intensive trading margin). The intensive margin can be analyzed in detail through its further decomposition, reflecting the effect of price and cost factors¹⁰³, changes in the set of competitors¹⁰⁴, non-price factors¹⁰⁵ and shifts in demand¹⁰⁶.

Graphical analysis of the data shows that during the entire analyzed period, price competitiveness is a key factor with a positive impact on the market share developments of Macedonia. In contrast, non-price factors, such as changes in the relative quality and taste, have a negative contribution. According to the data for other countries from the region, on average, in 2013 they registered an annual growth of market share, of which the improvement of price competitiveness contributes the most¹⁰⁷. On the other hand, despite the price, non-price features of export products are almost equally important for the increase of the market share of the CEE countries.

Analyzed for Macedonia, although the index of RXP adjusted for quality and taste points to favorable developments in non-price competitiveness, it is not reflected in the indicator of market share decomposition, according to which non-price factors have a negative effect on the market share. The inconsistency in the conclusions arising from these two indicators may be due to their construction, given that non-price factors related to quality and taste are estimated implicitly, i.e. as a residual. Hence, in order to obtain more realistic indications for export competitiveness, the Compendium recommends these two indicators to be compared with the movements of the global value chains indicators¹⁰⁸.

¹⁰¹ In detail about the method of calculation: Karadeloglou, P., Benkovskis, K., and the CompNet Task Force (2015), "Compendium on the Diagnostic Toolkit for Competitiveness", ECB, Occasional Paper Series, No.163, pg. 79.

¹⁰² The contribution of the extensive margin is estimated by comparing the share of traditional export lines in total exports in two consecutive periods. Moreover, if their share is reduced, it implicitly indicates relative growth in the share of newly established export lines, thus positively contributing to the extensive trading margin.

¹⁰³ The contribution of price competitiveness represents the cumulative effect of the changes in export prices of the country compared to the prices of competitors, for each export line separately.

¹⁰⁴ The contribution of changes in the set of competitors is estimated by comparing the market share of exports that serve certain market in two consecutive periods. Moreover, if their share is reduced, it indicates a relatively greater entry of new exporters, and therefore stronger competition in the given market.

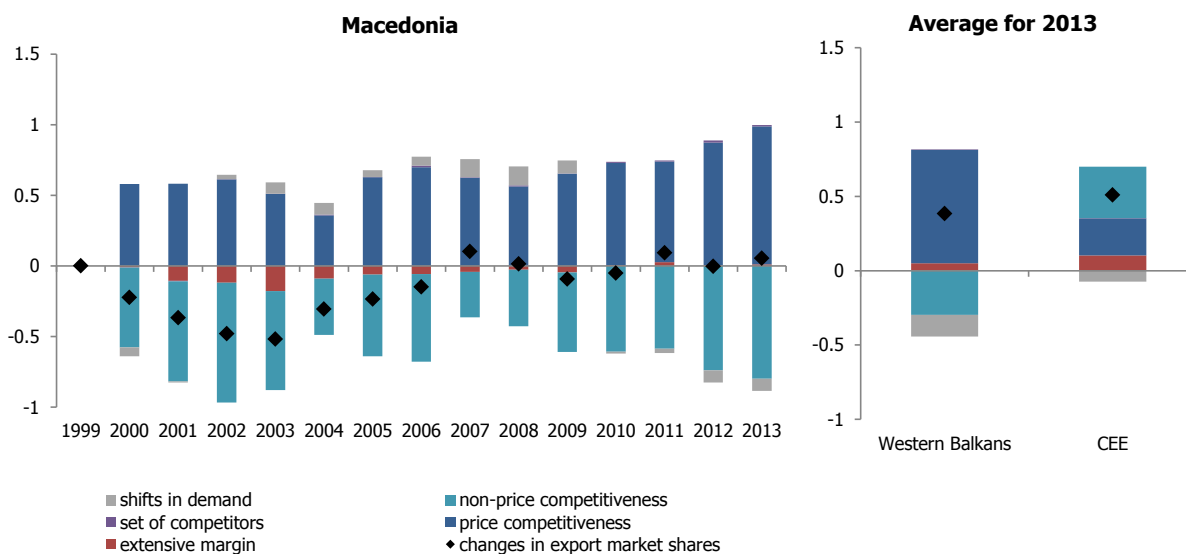
¹⁰⁵ The contribution of non-price factors (changes in taste and quality) is calculated as a residual between changes in market share and contributions of price factors and the set of competitors.

¹⁰⁶ Changes in demand reflect the effects of fundamental factors in the economic structure, calculated as the ratio between the growth of imports of certain country and total world imports.

¹⁰⁷ Serbia is an exception, where the non-price factors have positive, and the price factors have a negative contribution to the market share, as well as Bulgaria (price and non-price factors have positive contribution).

¹⁰⁸ Karadeloglou, P., Benkovskis, K., and the CompNet Task Force (2015), "Compendium on the Diagnostic Toolkit for Competitiveness", ECB, Occasional Paper Series, No.163, pg. 31.

Chart 3 Market share decomposition*



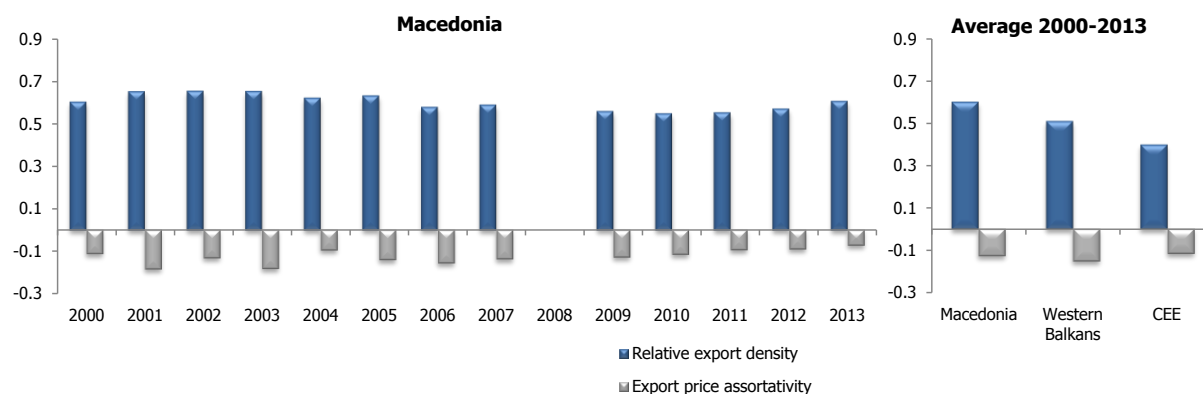
* The chart represents the cumulative log changes in the market share of countries.
Source: CompNet Compendium Toolkit Database.

International trade can be analyzed in terms of its network structure, by using the **export assortativity metrics**. Each trade link of one country is analyzed separately, by examining the exports structure in terms of export prices and export products and its comparison with the exports structure of other trade partner countries. Through aggregation of the entire export basket, the indices of relative export density (RED) and export price assortativity (EPA) are obtained. These two indices are indicators for the two dimensions of exports: relative specialization of exports of one country, as well as relative export prices relative to other trade partners. In terms of interpretation, if RED has a value higher than 1, it points to the relative advantage in terms of specialization, while the value smaller than 1 is an indicator of price advantage for EPA. In this way one can determine how the relative export prices and specialization by products are conditioned by the market in which products are placed, which gives an additional dimension in assessing the competitiveness position. However, as indicated in the Compendium, in order to make a comprehensive analysis of the exports structure it is required to gain additional information of individual countries¹⁰⁹.

According to the graphic representation of the movement of these two indicators, the Macedonian exports is characterized by somewhat higher concentration compared to the average for the countries from the region and the CEE countries. It shows that the export activity in Macedonia is more concentrated in products for which owns a relative advantage in terms of specialization. In terms of relative export prices, although this indicator for Macedonia registered a slight increase in the last period, it continued to move around the average for the countries from the region. In line with economic logic, it has a negative value for all surveyed countries, confirming that countries export products which have a relative price advantage depending on the market they serve.

¹⁰⁹ In their construction, these indices are obtained by aggregation at level of the entire export basket, whereby important information about the export structure is covered up. For instance, although the export price assortativity indices are comparable between individual countries, there may be significant differences between them in terms of technological structure of exports.

Chart 4 Relative export density and export price assortativity (indices)



Source: CompNet Compendium Toolkit Database.

This brief analysis presented part of the innovative indicators of the CompNet, which complements the analytical framework for monitoring short-term and medium-term trends in export competitiveness. The availability of diverse, and often alternative indicators enables to cross-check the conclusions they imply. As stated in the Compendium, it is not possible to make empirical ranking according to the explanatory power of each of them, and therefore it is necessary the competitiveness analysis to be adjusted to the economic conditions in the particular country. These innovative indicators complement the traditional REER indices by which the price competitiveness of the Macedonian exports is assessed. These indicators point to positive developments in several aspects of the competitiveness of the Macedonian exports. The export of medium-technology products had the most significant improvements whereby in 2013, for the first time, a revealed comparative advantage was registered. It reflects the positive changes in the Macedonian export structure arising from the activity of the new foreign-owned companies, whose increased activity and higher value added are fundamental drivers of export growth in the last four-year period. Hence, although at the moment the database is consisted of data up to 2013, positive effects on competitiveness can be expected in the next period. Furthermore, according to the results of EPA and the positive impact of price competitiveness on the increase in market share, export products registered price advantage. On the other hand, reliable indications for non-price competitiveness can not be obtained, given the inconsistency of the results obtained through the index of RXP adjusted for quality and taste and the contribution of non-price factors in the market share decomposition¹¹⁰.

The importance of continuous monitoring of competitiveness and macroeconomic policies in the area of competitiveness is acknowledged by the latest initiative of the European authorities for the establishment of national competitiveness boards in the euro zone countries¹¹¹. The increase in competitiveness should contribute to overcoming economic vulnerability, adaptation to external shocks and economic convergence. At the same time, competitiveness is defined more broadly, so that apart from price and cost competitiveness, non-price factors related to productivity, innovation and economic conditions for doing business are included. By providing independent expertise for assessment of competitiveness¹¹², these boards should contribute to better implementation of macroeconomic policies at country level and give an additional impetus for the implementation of structural reforms in the euro-zone countries¹¹³.

¹¹⁰ In the absence of data on the value added trade for Macedonia, it can not make cross-check of these indices with indicators based on global value chains.

¹¹¹ The Commission's proposal for establishing national committees for competitiveness is included in the "Communication to the European Parliament, the European Council and the European Central Bank", published on 21 October 2015. This report includes a set of measures that should contribute to improving the management framework and strengthening the European Economic and Monetary Union. For more details see: http://ec.europa.eu/priorities/economic-monetary-union/docs/single-market-strategy/communication-emu-steps_en.pdf.

¹¹² It is envisaged that national committees for competitiveness to conduct analysis and give recommendations for the movements in competitiveness, the mechanisms for establishing wages and the effectiveness of economic policies with an impact on competitiveness, which will be sublimated in their annual reports.

¹¹³ The national committees for competitiveness should be functionally independent and with a broad mandate, and under the coordination of the European Commission.