

National Bank of the Republic of Macedonia



Quarterly Report
January, 2014

**Contents:**

Introduction	3
I. Macroeconomic developments	6
1.1. International economic environment	6
1.2. Domestic supply	11
1.3. Aggregate demand	14
1.3.1. Private consumption	15
1.3.2. Public consumption	16
Box 1. Fiscal policy	17
1.3.3. Investment consumption	18
1.3.4. Net export demand	20
Box 2. Revision of GDP quarterly data	21
1.4. Employment and wages	25
Box 3. Sector analysis of the labor productivity	27
Box 4. Summary of the active labour market programs and measures in the Republic of Macedonia..	32
1.5. Inflation	37
Box 5. Survey on Inflation Expectations	40
1.6. Balance of payments	41
1.6.1. Current account.....	41
Box 6. Foreign trade of goods and movement of the nominal and real effective exchange rate (NEER and REER)	43
1.6.2. Capital and financial account	46
1.6.3. International investment position and gross external debt	48
II. Monetary Policy	51
2.1 Bank liquidity and developments on the interbank money market	54
Box 7. Changes in the monetary instruments of the NBRM in November 2013.....	55
2.2. Monetary and credit aggregates	56
2.2.1. Monetary aggregates	57
2.2.2. Lending activity	60
Box 8. Sector perspective of economic activity and credit growth	64
III. Stock exchange indices and prices of real estate	71



Introduction

During the fourth quarter of the year, the interest rate at the CB bill auctions remained 3.25%. Although some economic and financial conditions indicated more relaxed monetary environment, certain risks were still registered during the quarter, which created a need for cautiousness in the conduct of monetary policy. **Inflationary pressures** are still decreasing, with the reduction being slightly more intensive in the recent months as compared to expectations. Besides the headline inflation, the core inflation also slowed down, as projected. However, it is still relatively elevated as a result of certain temporary factors, and also as a reflection of the spillover effects of the rise of food and energy prices (in the second half of 2012). As expected, the foreign reserves declined in the last quarter, but the decrease was less than expected. The foreign reserves adequacy ratios remain favorable, with assessments for a comfortable level to absorb potential contingent shocks. As of the third quarter, the data on **economic growth** reaffirmed the expectations for gradual and continuous recovery of the growth. The **lending** speed up and was slightly higher than projected, but risks related to the credit support for the period ahead remain and arise from the conservative strategies of large banking groups operating in the Macedonian banking system and the uncertainty about the recovery of the domestic economy. Despite the positive signals coming from the external environment (two subsequent quarters of growth in the euro area), the recovery is still slow, with these risks further dominating, thus limiting the stronger growth in the domestic economy. The conditions in the international metal market, which are continually deteriorating, also suggest vulnerability, particularly that of the external position of the economy. **While the policy rate remained the same, changes were made in other instruments during the quarter, which can ease the monetary conditions.** Thus, in October, amendments were made to the Decision on managing the banks' liquidity risk, reducing the obligation of banks to hold liquid assets, while in November, the reserve requirement remuneration for the banks was cancelled, which could be a stimulus for the banks to invest available assets in higher yielding instruments.

Key macroeconomic parameters in the domestic economy are largely in line with the projections from the October cycle and no major changes are observed in the input assumptions to the projections. The global environment has not changed significantly compared to the October projections, with assessments for a small decline of the foreign demand in 2013 and its gradual recovery in 2014. Despite the slow recovery of external demand in the first three quarters of the year, **the domestic economy has still been recording a solid growth (an annual growth rate of 3.3% in the third quarter)**, based on specific factors such as the entry of new foreign investments and fiscal stimulus. The growth in the third quarter entirely results from the net exports, amid decline in the domestic demand. The positive contribution of net exports is due to the favorable movements in both components. Thus, exports had the greatest positive individual contribution to the growth, with simultaneous reduction in the imports, largely owing to reduced demand for energy. Private consumption was the only component of domestic demand that made a positive contribution to the growth, reflecting the continuous favorable trends in the labor market, especially evident through the increased number of employees. Notwithstanding the significant fiscal stimulus and the strong growth of construction, investments in the third quarter made a negative contribution, probably explained by the movements in inventories. The public consumption had the same effect, only less strong than investment. Past performances of the real economy (annual GDP growth of 3.2%, cumulatively for the first three quarters of the year) and the latest available data show that the economy still dwells in the area of solid annual growth and achieves the projected GDP growth of 3.3% for the entire 2013. According to the October projection, the expectations



for the next period (2014 and 2015) still apply. However, the economy is projected to grow further, but at an accelerated pace, with an expected GDP growth rate of 3.7% and 4.4% respectively. The export sector and investments are still expected to drive the growth, triggering positive spillover effects on the labor market and further stimulating household consumption.

In the fourth quarter, lending considerably stepped up, amid solid growth of the banks' deposit base, with these movements being particularly pronounced in the last month of the quarter. At the end of the year, the annual growth rate of loans equaled 6.5%, which shows slightly improved performance than expected in the October projection (5.2%), with somewhat more favorable performance of the deposits (4.7% vs. 4.6% as projected). Moreover, there was a change in the credit structure in favor of the credits to the corporate sector. These favorable developments might be the first sign of stabilization of the banks' perceptions of the risks arising from investments in this sector, but are probably the effect of the monetary easing. However, the risks surrounding the expected loan activity in the period ahead (estimated growth of 6.4% and 8.5% in 2014 and 2015) are still present, given the conservative strategies of major banking groups in the Macedonian banking system and the uncertainty about the growth of the domestic economy.

The inflation continued to decelerate, with the rise of consumer prices in the fourth quarter being reduced to 1.3%, on an annual basis. The reduction results from the slowing growth or the accelerating fall of all three components of inflation, with a more pronounced slowdown being registered in the food component. Thus, **the average annual inflation rate for 2013 equals 2.8%, which fully coincides with the projections.** However, given that in recent months, inflationary pressures were lower than expected, with possible further alleviation of import price pressures than previously assessed, there are downward risks to the inflation forecast for the next period (in October projections, it was estimated at 2.3% and 2% in 2014 and 2015, respectively).

Analyzing the external sector, in the third quarter of the year, the current account reported a surplus of Euro 133.5 million, or 1.8% of GDP, which is more favorable than expected, given the larger surplus in services and lower trade deficit. Meanwhile, during the third quarter, high net outflows were generated in the capital and financial account of Euro 108.2 million, or 1.4% of GDP, which was above expectations, mainly due to the repayments of trade credits and outflows based on currency and deposits (with banks and other sectors). However, despite the capital outflows, the surplus was sufficiently high and led to further accumulation of foreign reserves in the third quarter. In the last quarter, **the gross foreign reserves** (adjusted for price and exchange rate differences) declined slightly slower than expected, **indicating favorable trends in the balance of payments.** The available indicators for some external sector categories (for October and November) assume that the improved current account is the reason for the positive deviation in the foreign reserves, taking into account the still improved performances in the trade balance and balance of services, despite the little weaker performance in current transfers. At the same time, the performance of capital and financial flows suggests that lower net inflows were most probably generated during the fourth quarter. However, given that the available external sector indicators are limited, it is difficult to identify what flows are the main reason for the deviation. The favorable developments indicate unchanged upward trajectory of foreign reserves for 2014-2015, maintaining the reserves adequacy ratio at an appropriate level. However, due to the increased uncertainty in the external environment and the constant downward revision of metal prices, the downward risks to the projection of foreign reserves are further pronounced.



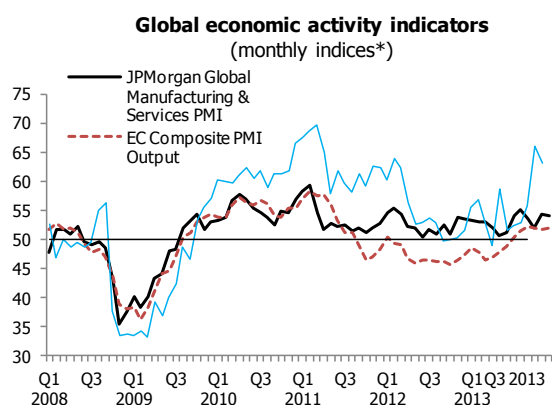
Generally speaking, the recent developments suggest that the macroeconomic outlook remains as projected in October, with a balance of payments position that provides growth and further maintenance of the foreign reserves at an adequate level. The risk surrounding this macroeconomic scenario continues to be primarily external and associated with the possible changes in the dynamics of the recovery of the global economic growth and the movements in prices of primary products in the world markets. The NBRM will keep on closely monitoring the developments in the forthcoming period and make necessary changes in the monetary policy for successful achievement of the monetary objectives.



I. Macroeconomic developments

1.1. International economic environment¹

Indicators for global economy suggest constant but slow recovery, amid different growth rates of individual economic regions. The developed economies have grown faster compared to the previous quarter, while emerging economies grew slowly. The growth of developed countries resulted from the increase of domestic demand, especially private consumption as a result of the improved labor market conditions. On the other hand, growth of emerging economies slowed down because of the reducing confidence of businesses and households, as well as the weaker labor market performance. Expectations for the future period show that the global economy will continue to grow in 2014 and 2015, but faster than in 2013. Inflation in advanced and emerging economies slowed down in the second half of the year due to the spillover effects of the reduction of food and energy prices in the previous period. In 2014 and 2015, it is expected that inflation will continue to decline, in line with the reduction of energy and food prices.



*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: Bloomberg.

The global economy continued recovering in the second half of 2013, although the pace of growth is still different from one economic region to another. Advanced economies grew faster compared to the previous quarter, while the pace of growth in emerging economies slowed down. Within the group of advanced economies, the United States and the Great Britain grew rapidly, while the euro area and Japan registered some slowing of activity. According to the high frequency survey indicators - Global PMI², the economy continues recovering in the fourth quarter, but at a more moderate pace. While the global composite PMI decreased to 53.4 index points in the fourth quarter compared to 54.2 in the previous quarter, the index still indicates an economic growth for 15 consecutive months. The data suggest that the global growth comes from the manufacturing sector, given the growth of industrial production, with a growth being registered in the service sector, as well. According to PMI, in December, the industry in the euro area registered the fastest pace of growth in the last two years. The global economy will continue to grow, with certain acceleration in 2014 and 2015. The revised growth equals 3.7% and 3.9% for 2014 and 2015, respectively, due to the

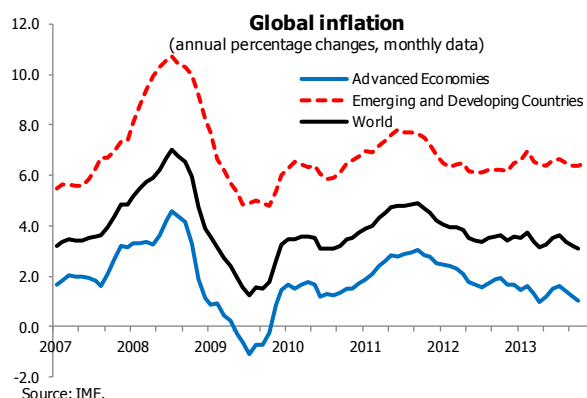
¹ The analysis is based on the November and December 2013 World Economic Outlook of the IMF, update January 2014, European Economic Forecast Winter 2013, November 2013, Roubini Global Economics, December 2013, Capital Economics, Bundesbank monthly reports and the weekly reports of the Bank of Greece.

² PMIs (Purchasing Managers' Index) are 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.

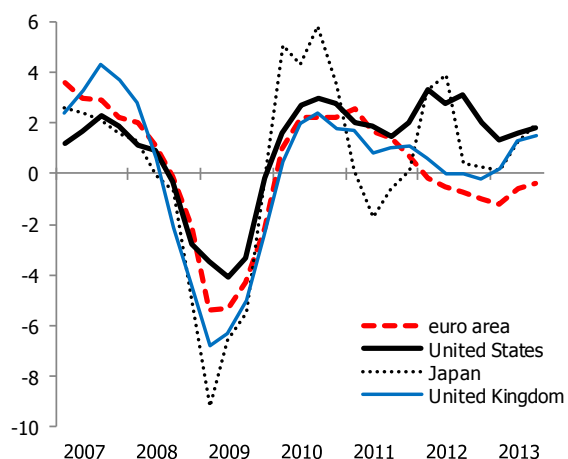


recovery of advanced economies. The U.S. economy has still been heavily influenced by the start of tapering of quantitative easing since January 2014. According to the latest forecasts of the Fed, the tapering of quantitative easing will be adjusted according to the sustainability of economic targets, i.e. the adjustment will be made according to the incoming information about the trends in the employment and inflation rates.

In the fourth quarter of 2013, global inflation³ registered a minimal quarterly slowdown. In the fourth quarter of 2013, the inflation equaled 3.1%, down 0.3 percentage points compared with the previous quarter. Slowing global activity and reducing prices of oil and non-energy primary commodities have contributed to reducing inflation globally. Moreover, advanced economies reported a moderate slowdown of inflation of 0.4 percentage points, with inflation of 1% in the first month of the fourth quarter, versus 1.4% in the previous quarter. The emerging and developing economies also reported a minimum slowdown of inflation, where in the first two months of the quarter, it equaled 6.5% versus 6.6% in the previous quarter. Global inflation is low, partly reflecting the still low demand, high unemployment, financial deleveraging and lower prices of primary commodities.



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

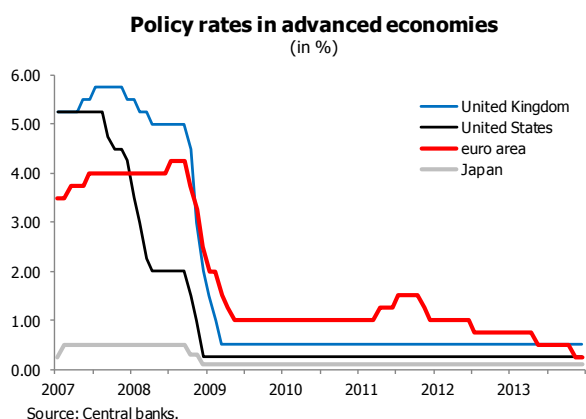
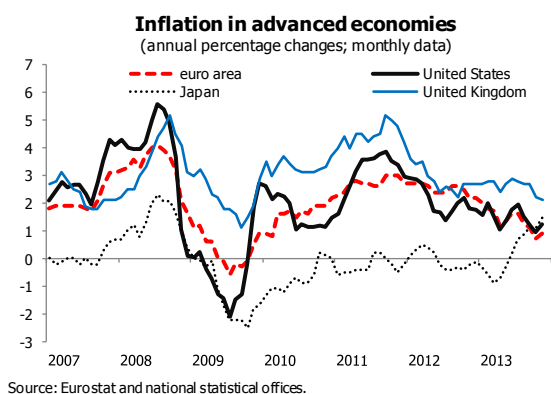


In the third quarter of 2013, the economy of the euro area keeps on recording a growth. Although the pace of growth has slowed down, the economy of the euro area increased quarterly for the second quarter in a row (0.1% versus 0.3% in the second quarter). However, the annual economic activity keeps on registering a negative growth, although compared with the previous quarter it slowed down and reduced from -0.6% to -0.4%. Regarding the situation in major economies, Germany reported a relatively strong growth, while the Netherlands and Spain reported a moderate growth. In the case of Spain, the minimum quarterly increase of 0.1% interrupted the trend of permanent decrease in economic activity, and thus the country emerged from nine-month recession. On the other hand, in France and Italy, GDP decreased quarterly. Observing the GDP structure of the euro area, the growth of domestic demand contributed to the quarterly increase (by increasing all of its components), while net exports made a negative contribution with a significantly slower growth of

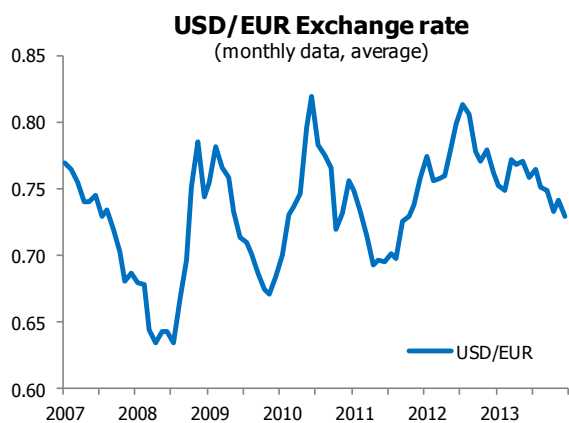
³ IMF' International Financial Statistics database is a source of data.



exports compared to imports. **The labor market conditions in the euro area remain unfavorable.** Despite the stabilization of the situation, yet the unemployment rate remained at the highest level ever. Thus, in the first two months of the fourth quarter, the unemployment rate equals 12.1%. **The annual inflation in the euro area remains below the target of 2% and in the fourth quarter of 2013, it equals 0.8% annually, which is a decrease compared to the previous period (1.3%).** In terms of the consumer price index components, this is mainly due to the decline of food and energy prices. Core inflation had the same effect and hit the record low of 0.7%, making the inflation the lowest in the last five years.

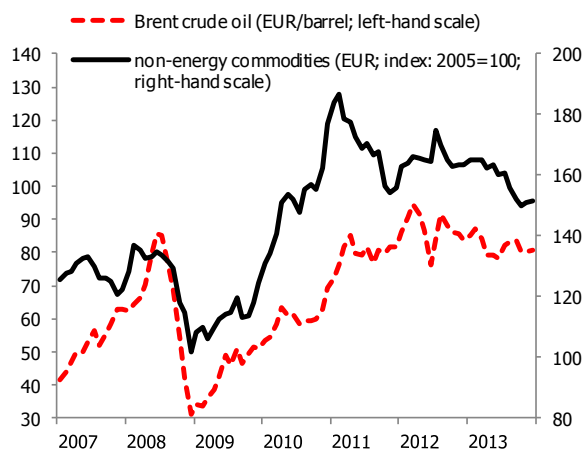


Central banks of developed countries kept on applying stimulating monetary policy in the fourth quarter of 2013. Fed, Bank of England and Bank of Japan kept their policy rates at the current low levels (0.25%, 0.50% and 0.10%, respectively). On the other hand, the ECB decided to cut further the interest rate on main refinancing operations by 0.25 percentage points, reaching a record low of 0.25%. This change is supported by assessments for retention of the suppressed inflationary pressures and should contribute to the process of economic recovery. As an incentive for banks to manage actively their liquidity positions between two weekly monetary operations, the ECB also decided to cut the interest rate on marginal lending facility by 0.25 percentage points, to 0.75%. In addition, the ECB decided to carry on conducting refinancing operations, as fixed rate tender procedures with full allotment, at least until the end of the second quarter of 2015, which is by a year longer than the previous schedule. Regarding the Fed, at the December meeting, the Federal Open Market Committee (FOMC) began implementing the exit strategy from quantitative easing. It was also decided to reduce the monthly purchase of long-term government bonds and mortgage bonds to U.S. Dollar 40 billion (from U.S. Dollar 45 billion) and to U.S. Dollar 35 billion (from U.S. Dollar 40 billion), respectively. This decision was taken in accordance with the observations for moderate acceleration of economic activity, improving labor market conditions and alleviating price pressures. In addition, the Fed stated that it will keep on implementing accommodative monetary policy, and the future pace of repurchase of securities will depend on the assessments of the economic situation.



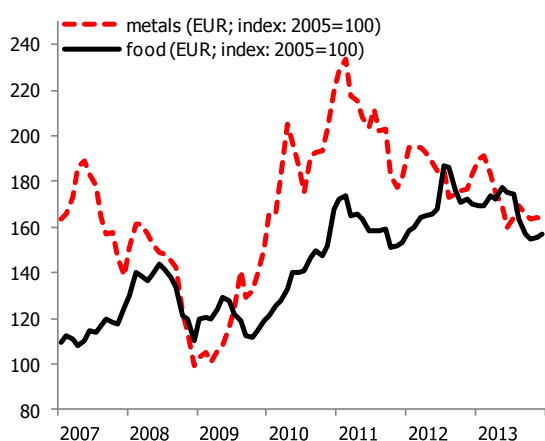
Source: Eurostat.

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



Source: IMF monthly database.

Prices of food and metals
(monthly data)



Source: IMF monthly database.

During the fourth quarter, the nominal exchange rate of the euro against the U.S. dollar was volatile, on average, registering an appreciation of the euro against the U.S. dollar, both quarterly and annually. On a monthly basis, in October and December, the euro appreciated by 2.2% and 1.6%, respectively, while in November it depreciates by 1%. Exchange rate fluctuations relate to changes in expectations about the future movement of interest rates, the uncertainty regarding the future monetary policy setup and the adjustment of market expectations about the prospects for economic growth in the euro area. In December, 1 euro was traded for 1.37 U.S. Dollar on average, up 4.5% compared to its value in December 2012, which is consistent with the improvement of the condition of the economy in the euro area.

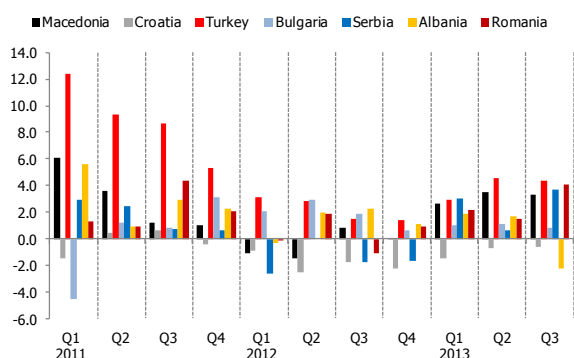
In the fourth quarter, the prices of primary commodities (in euros) decreased quarterly, both in oil and non-energy primary commodities. Thus, during this period, the average Brent crude oil price was down 3.3% on a quarterly basis, to Euro 80.4 per barrel. The oil price dropped given the weaker seasonal demand and the increased supply from the United States and Canada. However, the lack of oil in Libya and the weak production in OPEC countries as a whole caused upward pressure on oil prices in November. The index of prices of primary non-energy commodities⁴ dwells in the zone of negative quarterly change for third quarter in a row, with a 3.4% decline in the fourth quarter. Relative to the previous quarter, the decline in food prices equaled 5.8%, reflecting the downward movement in cereal prices, with an increased global supply because of the fruitful harvest in Canada, Australia and the United States. In addition, the metal prices also dropped from 1.8% on a quarterly basis, thereby extending the annual decline to 8.4%. The factors on the supply side, i.e. increased output and growing supply on the aluminum, copper and nickel markets are found to be major factors for such price movements.

In the third quarter of 2013, most countries in the region reported prevalence of favorable economic developments, with the exception of Croatia and Albania. In the third quarter, Serbia's economy grew at a rate of 3.7% annually, which is an increase of 3.1 percentage points compared with the previous

⁴ The price index of primary non-energy commodities includes prices of food, beverages, agricultural raw materials and metals.



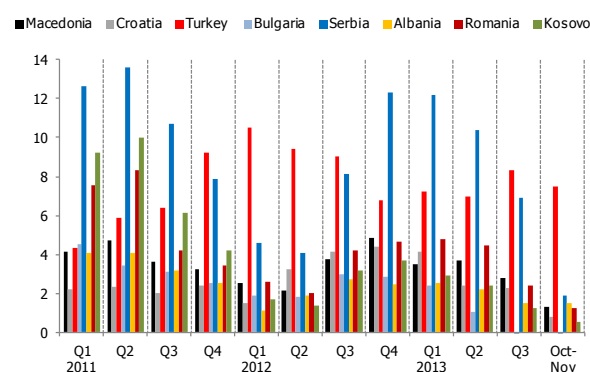
Real GDP growth in countries from the region (annual percentage changes, quarterly data)



Source: Eurostat and national statistical offices.

quarter. The growth of net exports and government consumption were the main factors for the positive performance of Serbia's GDP, vis-à-vis the decline in investments and private consumption. The Romanian economic activity significantly accelerated, as well. The annual growth rate of 4.1% is due to the increase of private consumption, fueled by the higher income from agriculture and the slower inflation and net exports. Turkey reported a high annual economic growth rate of 4.4% given the boosting domestic demand, although the public spending significantly slowed down, whereas the net exports made a negative contribution to the overall growth, amid slowing imports and declining exports. After bottoming out in the second quarter by 0.2%, in the third quarter, the Bulgaria reported an economic growth of 1.5%, supported by domestic demand and net exports, while strengthening the both trade components. On the other hand, the two-year trend of negative growth rates of GDP continued in Croatia, reaching -0.6% in the third quarter, while Albania reported the largest annual decline in the economy of -2.3%, affected by the fall of activity in all economic sectors, except agriculture.

Inflation in countries from the region (annual percentage changes)



Source: Eurostat and national statistical offices.

In the first two months of the fourth quarter, the general price level in all countries from the region significantly decreased, with Bulgaria reporting deflation for second quarter in a row. Fall in food prices is considered an essential factor for the downward inflation developments in most countries. Serbia reported the fastest decline in the general price level, where the inflation in the first two months of the fourth quarter reached 1.9%, representing a 5 percentage points decrease relative to the third quarter⁵. The negative rates of growth of the food and beverage prices, as well as the slowing growth of the energy component were the main drivers of these price movements in Serbia. In Romania and Albania, the negative or reduced growth rates of food component and the stagnant level of core inflation, contributed to achieving average annual inflation rate of 1.3%. Inflation slowed down in Turkey, with the consumer price index in October and November on average, reduced to 7.5% on an annual basis. Bulgaria reported higher deflation given the negative annual growth of consumer

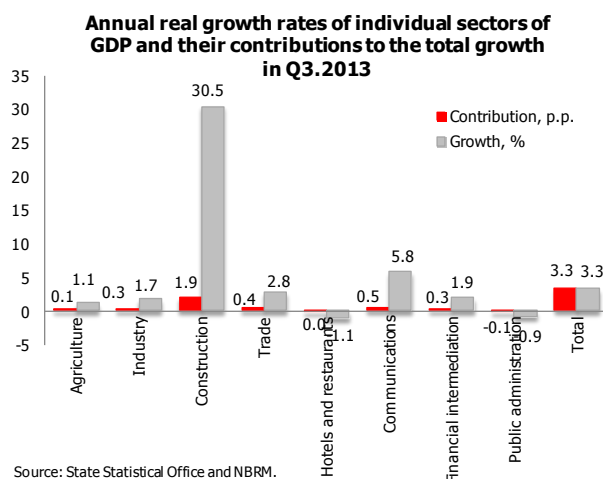
⁵ The consumer price index in Serbia actually dropped below the lower limit of the inflation target, which is set at 4% (with a deviation of +/-1.5 percentage points), once the annual inflation rate was above the upper limit of the target for more than a year.



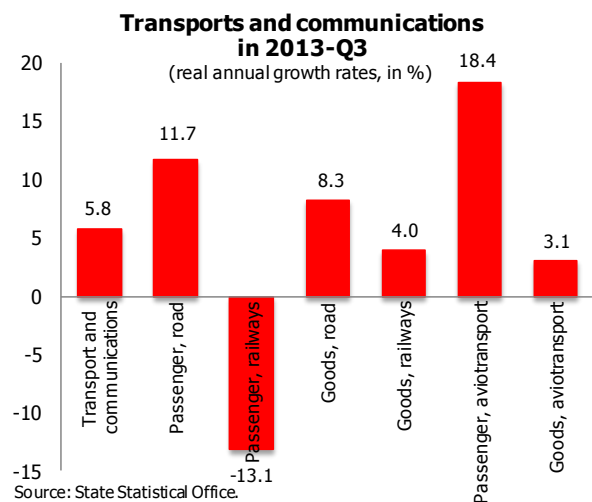
price index of 1.1%⁶, versus the fall of 0.7% in the previous quarter.

1.2. Domestic supply

The domestic economy continued to grow in the third quarter of 2013, thus registering a quarterly growth of 1.1%. Economic activity remains with its solid annual growth, with a growth rate of 3.3%. As in the previous quarter, the growth resulted from the construction, with positive results being registered in the other activities, except public administration. In the third quarter, the construction was a significant driver of economic growth, partly aided by the positive momentum from domestic and foreign investments, as well as the fiscal stimulus in the form of public infrastructure projects. In the third quarter, despite the increase in activity of some domestic and foreign export-oriented facilities, the industry registered a significant slowdown of annual growth. This slowdown is largely explained by the lower hydropower and electricity production. The assessment for the economic situation and the level of utilization of industrial capacities in the third quarter also decreased. However, the latest assessments in recent business tendency surveys in October and November indicate an improvement in the manufacturing industry and are more optimistic for the next three months, about the output volume and the number of employees.



Source: State Statistical Office and NBRM.



Source: State Statistical Office.

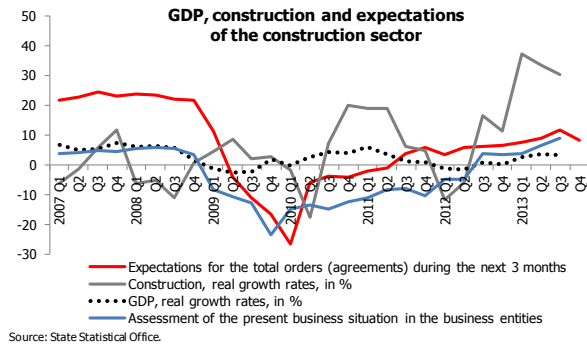
In the third quarter of 2013, the quarterly GDP⁷ growth accelerated from 0.8% to 1.1% (seasonally adjusted), with the economy still being in the zone of positive changes for five consecutive quarters. On annual basis, the growth of domestic output somewhat slowed down to 3.3%. As in the previous quarter, the better quarterly performance in the third quarter is mainly due to the growth of the value added of **construction**, with a smaller contribution of the **agriculture, transport and communications and financial intermediation**. On the other hand, the quarterly decline of the value added of **industry, trade and public administration** made an adverse contribution to the quarterly performance of the national economy. In view of the annual dynamics, the construction sector is one of the main drivers of growth in the domestic economy for five consecutive quarters. At the same time, a smaller positive contribution to the growth was made by the **transport and communication, trade, financial intermediation and industry**, with a minor positive contribution of the agriculture. In the third quarter, only the value added of **public administration and hotels and restaurants** decreased on an annual basis.

⁶ Average for October and November 2013.

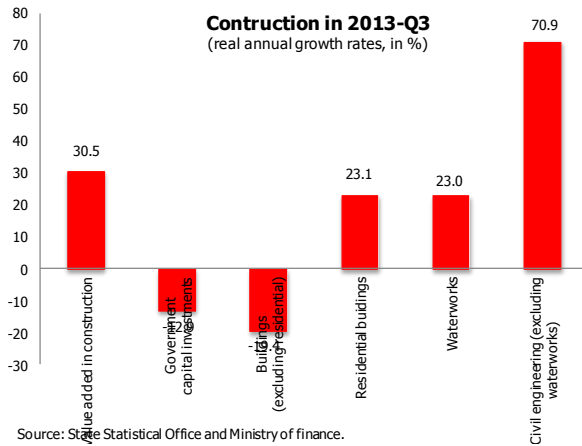
⁷ Data on annual changes, by quarter, for 2013 are based on preliminary data for 2012.



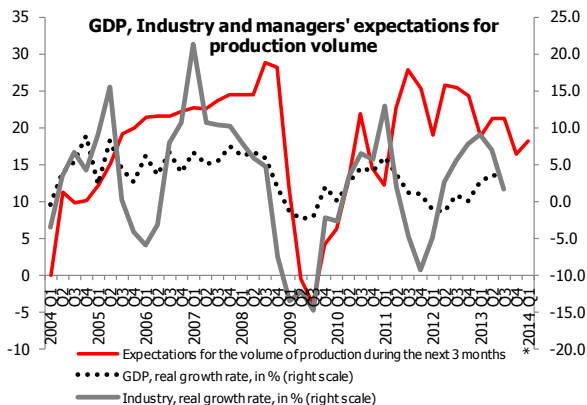
	annual growth rates, in %					contributions to GDP growth (in p.p.)										
	Q1 2012	Q2 2012	Q3 2012	Q4 2012	2012	Q1 2013	Q2 2013	Q3 2013	Q1 2012	Q2 2012	Q3 2012	Q4 2012	2012	Q1 2013	Q2 2013	Q3 2013
Agriculture	-7.1	-7.0	0.0	-10.1	-6.2	-3.1	-0.4	1.1	-0.6	-0.6	0.0	-1.2	-0.6	-0.2	0.0	0.1
Industry	-5.0	2.6	5.6	7.8	2.8	9.1	7.0	1.7	-0.9	0.4	0.9	1.2	0.5	1.6	1.2	0.3
Construction	-11.7	-5.7	16.5	11.3	4.8	37.3	33.7	30.5	-0.4	-0.3	0.9	0.7	0.3	1.2	1.7	1.9
Trade	-2.6	-6.7	-4.2	-5.1	-4.8	-0.7	-1.1	2.8	-0.4	-1.1	-0.6	-0.7	-0.7	-0.1	-0.2	0.4
Hotels and restaurants	-0.8	3.1	3.4	2.4	2.3	4.2	2.3	-1.1	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Communications	4.7	-2.9	0.2	-4.2	-0.8	0.7	6.6	5.8	0.5	-0.3	0.0	-0.4	-0.1	0.1	0.6	0.5
Financial intermediation	3.4	3.3	0.6	0.7	2.0	1.4	0.9	1.9	0.6	0.5	0.1	0.1	0.3	0.2	0.2	0.3
Public administration	0.5	0.3	0.2	1.0	0.5	-0.2	-0.2	-0.9	0.1	0.0	0.0	0.1	0.1	0.0	0.0	-0.1
Value Added	-0.8	-0.9	1.5	0.0	0.0	2.8	3.9	3.9	-0.7	-0.8	1.3	0.0	0.0	2.5	3.4	3.3
Net taxes on products	-2.0	-5.1	-3.5	-1.0	-2.8	1.0	1.1	0.2	-0.2	-0.7	-0.5	-0.2	-0.4	0.1	0.1	0.0
Gross Domestic Product	-1.1	-1.5	0.8	0.0	-0.4	2.6	3.5	3.3	-1.1	-1.5	0.8	0.0	-0.4	2.6	3.5	3.3



Source: State Statistical Office.



Source: State Statistical Office and Ministry of finance.



Source: State Statistical Office.

* average of expectations for 10 and 11 month of 2013.

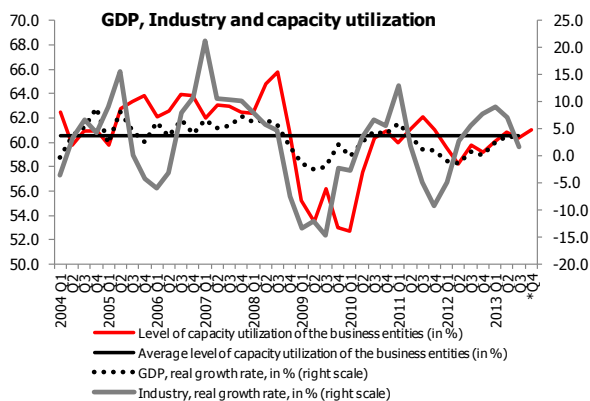
The steady quarterly⁸ and annual growth of construction activity continued in the third quarter of this year. The quarterly growth of construction accelerated, with this activity making the greatest individual contribution to the overall growth of the economy in the third quarter. Strong double-digit annual growth is still largely due to the construction works, i.e. public and private investments in the field of civil engineering, hydro and residential buildings. The managers also confirm the positive climate in the construction sector, through the historically highest rating for the economic situation of companies in the Business Tendency Survey in **construction**⁹. According to the survey, the positive perceptions of companies derive from the reduced impact of certain limiting factors for improving construction activity. The estimated impact is less restrictive than the cost of materials, financial costs, the lack of demand, and less difficult securing of bank loans. Under such favorable assessments and solid performance of the construction sector, the managers expect significant influence of the competition factor. This effect can be also perceived through their evaluation regarding the financial position of companies, which although positive, slightly decreased compared with the previous quarter. In terms of the expectations of the managers of construction companies for the next three months, compared to the previous quarter, there is a lower optimism in the expectations of concluding new contracts and the number of employees, and lower expectations for rise of selling prices.

After the positive quarterly industrial performance in the first half of the year, the industry decreased¹⁰ in the third quarter, leading to a significant slowdown of the annual growth of the value added of industry. The slow industrial growth is associated with the deteriorating hydrological conditions during the third quarter, which largely contributed to the significant slowdown of the annual growth of electricity production. Despite the slow growth

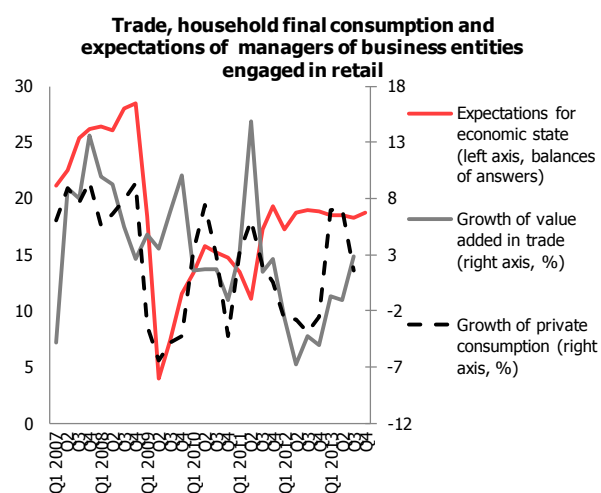
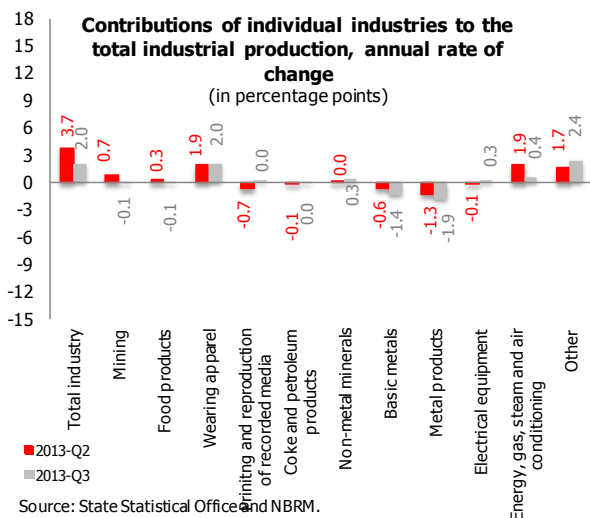
⁸ Analyzed on a seasonally-adjusted basis.

⁹ Refers to the third quarter of 2013.

¹⁰ Analyzed on a seasonally-adjusted basis.



Source: State Statistical Office.
* average for 10 and 11 month of 2013.



Source: State Statistical Office.

of the economies of the euro area and the further decline of the foreign effective demand, the activity of export-oriented domestic and foreign facilities positively contributed to the growth of the value added of industry. The greatest contribution to the annual growth in the third quarter was made by the manufacturing industry, where the growth of manufacturing of clothing apparel, machinery and equipment, and textiles largely contributed to the growth of value added of industry. Mining activity declined on an annual basis. The industrial performances are consistent with the estimates given in the Business Tendency Survey in the **manufacturing industry**. The average capacity utilization in the third quarter registered a quarterly fall and an annual growth. Thus, the average utilization is slightly lower than the historical average of the past eight years. Moreover, compared to the previous quarter, companies evaluated the current economic situation and the current production volume less favorably. In terms of the factors that limit the increase of output, the survey suggests lower impact of the insufficient domestic and foreign demand, financial problems, and lack of equipment and raw materials. The assessments of the surveys for the first two months of the last quarter of 2013 indicate a return of the companies' optimism in terms of output volume, with simultaneous increase of the average capacity utilization. The limiting impact of financial problems, uncertain economic environment, lack of raw materials and insufficient domestic demand has alleviated. These findings have created more optimistic expectations of managers for the next three months, for both the output volume and the number of employees, as well as expectations for lower average purchase prices of production inputs.

The value added of trade in the third quarter of 2013 decreased quarterly¹¹, while the annual trade grew after six quarters of shrinkage. This growth corresponds to the growth of consumer spending, amid an annual growth of trade in motor vehicles and decline in wholesale and retail trade. Unfavorable developments in retail trade are also noted in the survey of **retail trade managers**¹² whose assessments, compared with the assessments of the previous quarter, indicate deterioration of the current financial standing of these companies. According to their findings, there is an increasing influence of the limiting factors for borrowing, higher competition and a lack of trained staff.

¹¹ Analyzed on a seasonally-adjusted basis.

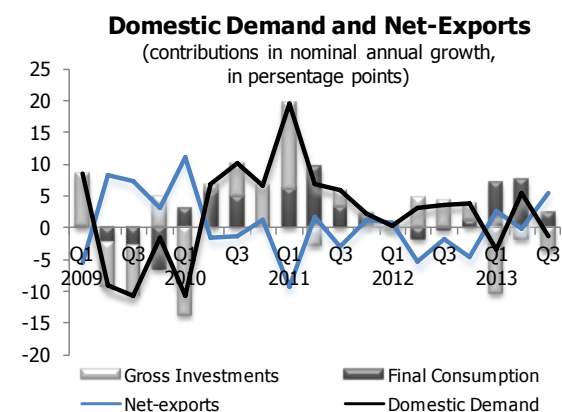
¹² Business Tendency Survey in retail trade for the third quarter of 2013 conducted by the SSO .



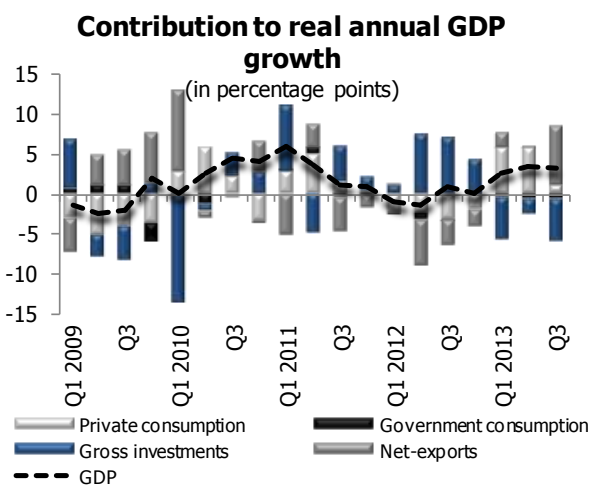
Compared with the second quarter, expectations of managers of trade companies are more positive in terms of the business situation in the next six months, but they are less optimistic regarding the increase of purchasing prices and orders in the next three to four months.

1.3. Aggregate demand

In terms of demand, in the third quarter of 2013, the solid growth of domestic economic activity is merely due to the positive contribution of net export demand, given the simultaneous growth of exports and decline of imports of goods and services. The export is a component with the largest individual contribution to the GDP growth. Foreign investments in technological industrial development zones, and the first signs of recovery of foreign demand had a positive effect on the domestic industry and export sector. However, the still unfavorable conjuncture on the metal market has limited the recovery of exports of the metal industry, which contributed to a decrease of imports of raw materials for its needs. Moreover, there was a reduced demand for energy, leading to a reduction of imports. Domestic demand made a negative contribution to economic activity, mainly due to the strong decline of investments and the decline of public consumption. Household consumption, amid further favorable trends in the job market resurged, being the only component of domestic demand that positively contributes to the overall growth in the third quarter of 2013.



Source: State Statistical Office and NBRM calculations.



Source: State Statistical Office and NBRM calculations.

GDP analysis in terms of demand

shows that the annual growth in the third quarter solely results from the positive contribution of the net exports, while the domestic demand made a negative contribution. Analyzing by component, export of goods and services is the main driver of growth. The export growth has significantly accelerated, mainly due to the positive contribution of new production facilities in the technological industrial development zones. Meanwhile, the foreign effective demand grew for the first time, despite the fall in the previous six quarters. On the other hand, world metal prices still have a discouraging effect on the domestic metal industry, which lowered the demand for imports of raw materials for the export segment. Moreover, given the reduced export of oil derivatives to our northern neighbor, the energy imports also reduced. Hence, imports registered a significant decline and thus contributed positively to the GDP growth. Positive contribution was also made by the household consumption, which registers a steady annual growth, three quarters in a row. The positive trends in the export sector contributed for further positive developments on the labor market, with the number of employees growing six quarters in a row. In contrast, the other two components of domestic demand made a negative contribution to the growth, which is mainly due to the decline of investments and to a lower extent,



to the public spending. Given the strong resurgence in construction, the decline of gross capital formation is likely due to the reduced inventories.

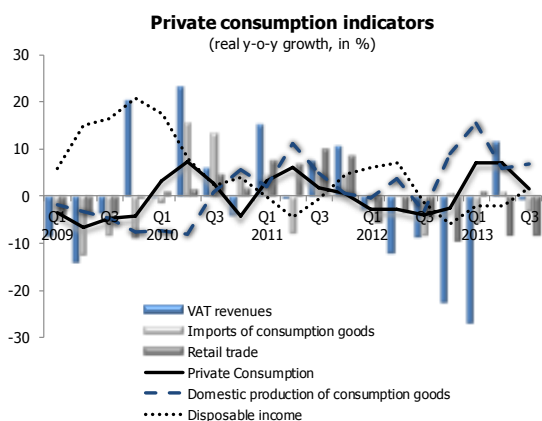
Real annual growth rates (%)

	2010-Q1	2010-Q2	2010-Q3	2010-Q4	2010	2011-Q1	2011-Q2	2011-Q3	2011-Q4	2011	2012-Q1	2012-Q2	2012-Q3	2012-Q4	2012	2013-Q1	2013-Q2	2013-Q3
Private consumption	3.3	7.4	2.8	-4.3	2.1	3.2	6.1	1.9	0.5	2.9	-2.7	-2.7	-3.9	-2.6	-3.0	7.0	7.1	1.6
Government consumption	-0.6	-7.1	0.7	-0.8	-2.0	0.7	4.9	-2.7	-0.2	0.6	-1.1	-4.7	-0.6	0.8	-1.4	-2.2	-4.3	-4.4
Gross investment	-47.6	-3.1	15.1	9.0	-6.7	55.4	-20.0	21.9	5.6	9.6	4.8	39.1	28.0	12.7	20.0	-23.2	-6.5	-16.4
Exports of goods and services	10.0	17.7	24.8	40.1	23.6	36.3	12.0	2.6	-0.4	10.5	0.2	0.7	-1.3	0.6	0.0	-3.0	2.5	8.8
Imports of goods and services	-10.2	12.8	18.8	16.0	9.5	33.3	3.6	8.6	2.2	10.4	-0.3	9.5	3.9	3.8	4.2	-4.9	1.6	-4.7
Domestic demand	-8.3	3.0	4.5	-0.6	-0.3	9.2	0.7	4.8	1.8	3.9	-1.2	3.6	3.1	2.0	2.0	0.0	2.7	-3.8
Net exports*	-35.1	3.6	2.9	-16.3	-13.8	27.1	-14.1	28.1	7.9	10.1	-1.2	33.8	17.4	10.5	14.2	-9.1	-0.2	-34.1
GDP	0.0	2.5	4.5	4.0	2.9	6.1	3.6	1.2	1.0	2.8	-1.1	-1.5	0.8	0.0	-0.4	2.6	3.5	3.3

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

1.3.1. Private consumption

In the third quarter of 2013, personal consumption registered a quarterly decrease of 5.8% (seasonally adjusted), which led to a slowdown of the rate of annual growth. Following the solid annual real growth in the first half of the year (7% on average), the growth of household consumption in the third quarter reduced to 1.6%. This deceleration of growth corresponds with the decline in import of consumer goods, compared to the annual real growth in the previous quarter, as well as with the retail trade, which decreased at the same pace as in the previous quarter. Consequently, adverse changes were noted in net VAT income, which show an insignificant real annual decline, despite the rapid growth in the previous quarter. On the other hand, domestic production of consumer goods increased strongly, which places this category in the zone of positive annual growth for four consecutive quarters. Regarding the financing of consumption, all factors record favorable developments. Thus, after four quarters of decline, in the third quarter, the disposable income went up for the first time. The wage bill made the largest contribution, which under further favorable conditions on the labor market, registered an identical growth as in the previous quarter. The number of employees recorded almost the same annual growth as in the previous quarter. However, the real net wage still decreases on an annual basis, given the slower nominal annual growth and slower annual inflation. Besides the wage bill, pensions also record a real annual growth, at an accelerated pace, while private transfers record a significant slowdown of the annual decline. Loans to households, as an additional source of funding, show significant acceleration of their real growth, mainly due to the



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



increased amount of marketed consumer and residential loans. However, these favorable trends do not fully add to the consumption, most likely due to the savings, given the acceleration of the annual growth of household deposits.

The latest available data¹³ for the last quarter of 2013 give a different picture of the trend of personal consumption. Domestic production and import of consumer goods show a significant annual decrease. The fall of production comes after four quarters of growth, while the annual decline of import accelerates. Retail trade continues recording an annual real decline, at a slower pace though, which is partly in line with the expectations of the retail trade¹⁴ managers. On the one hand, managers have less favorable expectations regarding orders for the last quarter, but on the other hand, they have more favorable expectations in terms of the number of employees and the business situation of the companies in the next six months. Paid pensions, which register slower annual growth, also indicate somewhat slower growth of consumption. On the other hand, the net VAT income registers high annual growth and the household lending accelerates, suggesting higher household consumption. These developments are in line with the banks' expectations, showing greater optimism about developments of the lending terms and the demand for residential and consumer loans in the last quarter of 2013¹⁵. Moreover, the rate of decline of real wages decelerates, amid identical nominal growth and slowdown of annual inflation.

1.3.2. Public consumption

In the third quarter of 2013, public spending registered an annual decline of 4.4%, i.e. at almost the same pace as in the previous quarter. On a quarterly basis, this component of domestic demand registered an insignificant growth of 0.4% (seasonally adjusted). The available data for the period October-November 2013 point to further **downward trend of annual public spending in the last quarter of 2013.** However, given the slower decline of wages and cost of goods and services, the fall of public spending would be expected to slow down.

¹³ Data on wages are as of October, while other data are as of November.

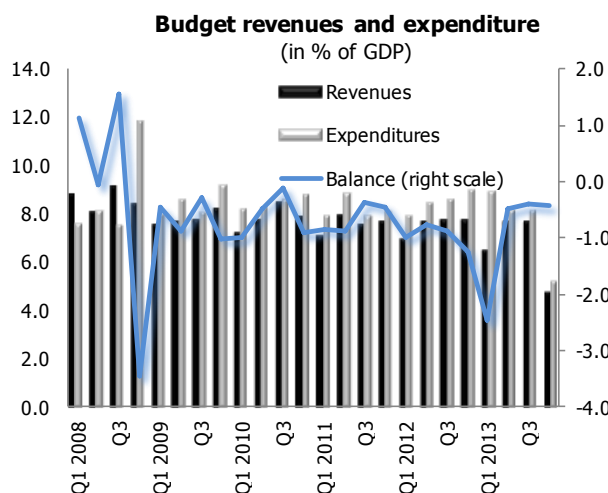
¹⁴ Business Tendency Survey in retail trade conducted by the SSO in the third quarter of 2013.

¹⁵ Bank Lending Survey conducted by the NBRM in November 2013.

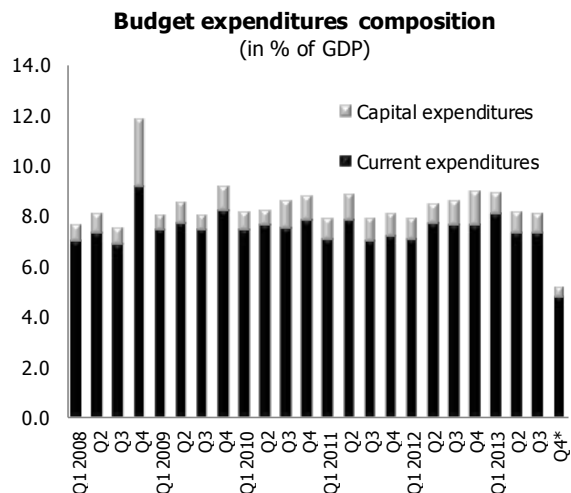


Box 1. Fiscal policy

During the third quarter of 2013, the budget of the Republic of Macedonia (central budget and budgets of funds) generated total revenues of 7.7% of GDP¹⁶, which is identical to the same period last year. In nominal terms, in the third quarter, the budget revenues increased by 4.3%, annually. The structural analysis of total budget revenues shows an annual increase of tax revenues (0.9%), with the largest contribution being made by the increase of VAT income, which went up by 2%, annually. Income tax and corporate income tax also rose (6.5% and 7.1%, respectively), while revenues from excise and import duties decreased annually by 1.4% and 0.5%, respectively. The total annual contributions were higher by 5.3%, adding 1.5 percentage points to the growth of total revenues, amid growth of non-tax revenues of 21.6%, annually.

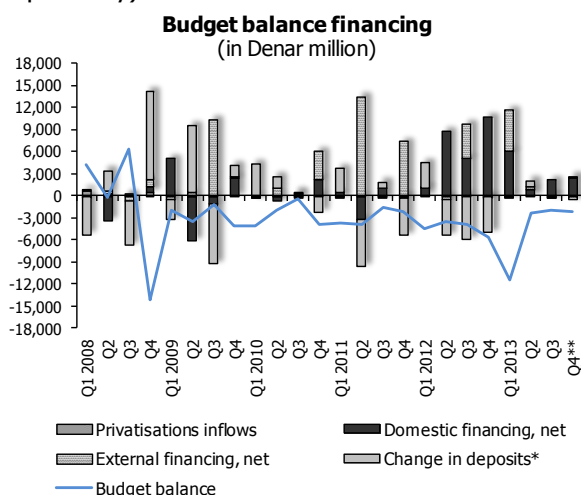


*Refers to October and November 2013
Source: Ministry of Finance

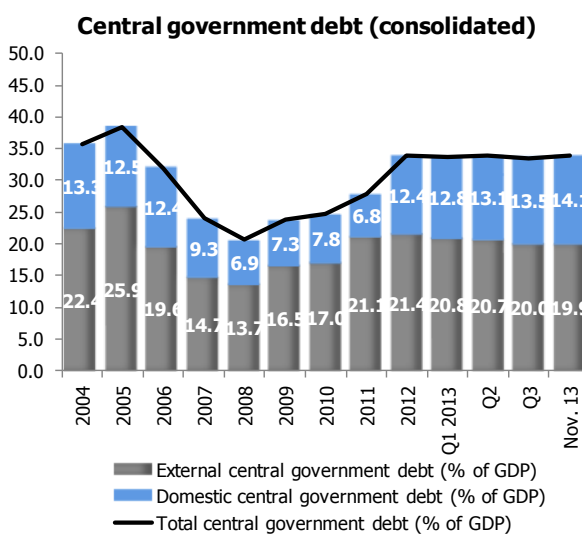


*Refers to October and November 2013.
Source: Ministry of Finance

During the third quarter of 2013, the total budget expenditures amounted to 8.1% of GDP as compared to 8.6% of GDP, in the same period last year. In nominal terms, in the third quarter, the total budget expenditures were lower by 1.2%, annually. The reduction of budget expenditures fully results from the lower level of capital expenditures (down 10.5%, annually). The level of current expenditures remained the same as in the third quarter of 2012, given the lower expenditures for wages and for goods and services (of 0.2% and 9.9%, respectively) and increase of transfers of 3.3% annually.



* Positive change- deposits withdrawal; negative change-deposits accumulation.
** Refers to October and November 2013.
Source: Ministry of finance of the Republic of Macedonia.



Source: Ministry of Finance

¹⁶ The analysis uses annualized GDP.



During the third quarter of 2013, the budget deficit amounted to Denar 1,963 million, or 0.4% of GDP. In this period, the budget deficit was financed through domestic sources in the form of new issues of government securities of Denar 2,197 million, on a net basis. Through foreign borrowing, slight net outflows were made in the amount of Denar 43 million. In the third quarter, inflows exceeded outflows of funds, thus increasing the deposits on the Government account with the NBRM by Denar 191 million.

In the period October-November 2013, total budget revenues continued to grow at a faster pace and compared to the same period last year, they went up by 5.8%. The largest contribution to the acceleration of the growth of total revenues in this period was made by the higher tax revenues (annual growth of 8.1%). Contributions also increased (5.4% annually), while non-tax revenues decreased annually by 16.4%. **In this period, the total expenditures went up by 3.3% annually,** due to the 5.2% higher annual current expenditures. Capital expenditures dropped by 13.3% annually. **The period from October to November registered a budget deficit of Denar 2,136 million,** which was mainly financed from domestic sources through government's borrowing on the domestic market of securities. According to the latest available data, as of 30 November 2013, the central government debt (consolidated) totaled 34% of GDP.

Table 1
Budget of the Republic of Macedonia (Central budget and budgets of funds)

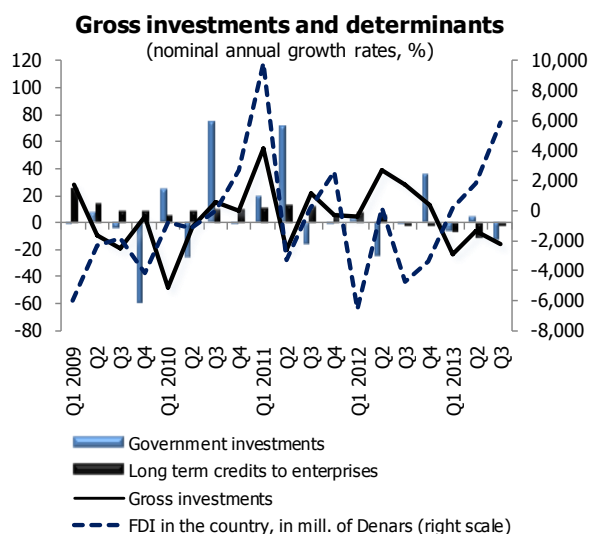
	Budget 2013	Supplementary Budget 2013	Q1	Q3	Q4	Oct-Nov	Jan-Nov 2013	Y-o-Y changes, 2013 period over the same period of the previous year, in %				Contribution to annual change, 2013 period over the same period of the previous year, in p.p.			
	planned, in Denar million	planned, in Denar million	realized, in Denar million					Q1	Q2	Q3	Oct-Nov	Q1	Q2	Q3	Oct-Nov
TOTAL BUDGET REVENUES	147,958	149,291	29,901	36,151	36,983	23,295	126,330	-6.0	2.9	4.3	5.8	-6.0	2.9	4.3	5.8
Revenues base on taxes and contributions	125,555	125,752	26,476	30,665	31,075	20,432	108,648	-5.0	5.9	2.3	6.4	-4.4	4.8	2.0	5.6
Tax revenues	81,685	81,700	16,507	20,015	20,194	12,907	69,623	-9.4	7.7	0.9	8.1	-5.4	4.1	0.5	4.4
Contributions	42,842	42,624	9,720	10,436	10,671	7,378	38,205	2.9	2.5	5.3	5.4	0.9	0.7	1.5	1.7
Non-tax revenues	13,836	14,094	2,570	2,165	4,479	1,773	10,987	-7.6	-29.7	21.6	-16.4	-0.7	-2.6	2.2	-1.6
Capital revenues	4,432	4,444	299	2,461	293	197	3,250	-59.9	-8.8	-53.0	-4.8	-1.4	-0.7	-0.9	0.0
Donations from abroad	3,535	4,401	456	752	1,008	818	3,034	62.9	154.1	69.4	133.0	0.6	1.3	1.2	2.1
Revenues of recovered loans	600	600	100	108	128	75	411	-15.3	11.3	-27.7	-48.3	-0.1	0.0	-0.1	-0.3
TOTAL BUDGET EXPENDITURES	165,653	168,541	41,348	38,509	38,946	25,431	144,234	13.8	-0.4	-1.2	3.3	13.8	-0.4	-1.2	3.3
Current expenditures	146,944	148,387	37,303	34,526	34,989	23,222	130,040	16.2	-1.2	0.0	5.2	14.3	-1.1	0.0	4.7
Capital expenditures	18,709	20,154	4,045	3,983	3,957	2,209	14,194	-4.0	7.2	-10.5	-13.3	-0.5	0.7	-1.2	-1.4
BUDGET DEFICIT / SURPLUS	-17,695	-19,250	-11,447	-2,358	-1,963	-2,136	-17,904	152.7	-33.0	-50.7	-17.5				
Financing	17,695	19,250	11,447	2,358	1,963	2,136	17,904								
Inflow	33,464	35,030	23,234	4,413	2,570	2,779	32,996								
Revenues based on privatisation	0	273	30	240	0	27	297								
Foreign loans	17,758	19,150	17,322	1,025	432	49	18,828								
Deposits	12,022	5,497	-297	847	-191	112	471								
Treasury bills	3,589	9,840	6,111	2,116	2,329	2,591	13,147								
Sale of shares	95	270	68	185	0	0	253								
Outflow	15,769	15,780	11,787	2,055	607	643	15,092								
Repayment of principal	15,769	15,780	11,787	2,055	607	643	15,092								
External debt	13,896	13,907	11,655	592	475	511	13,233								
Domestic debt	1,873	1,873	132	1,463	132	132	1,859								

Source: Ministry of Finance of the Republic of Macedonia.

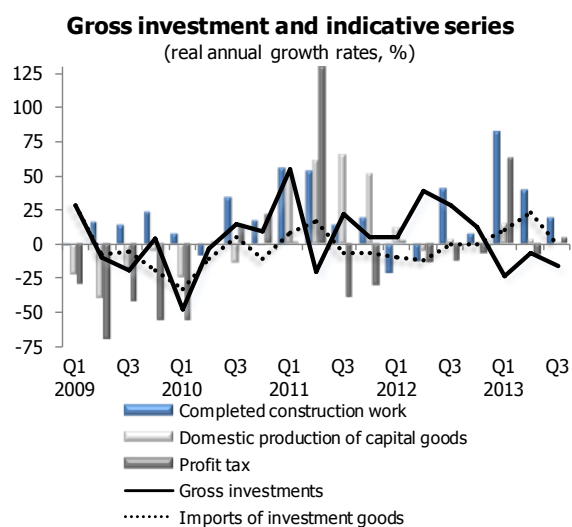
In November 2013, amendments to the 2013 Budget were adopted envisaging higher budget revenues and expenditures as compared to the original plan and a higher budget deficit of 3.9% of GDP (3.5% of GDP in the initial budget). The revision of expenditures requires reallocation of funds within the existing wage bill, providing additional funds to the Pension and Disability Insurance Fund for timely payment of pensions and additional funds for equipping laboratories in higher academic institutions. As a result, Denar 2,888 million higher budget expenditures are anticipated than initially planned. Budget revenues are projected to increase by Denar 1,333 million on the basis of the already generated revenues and those expected by the end of the year, that budget users generate on their own accounts based on donations and self-financing.

1.3.3. Investment consumption

In the third quarter of 2013, gross capital formation shows an annual and



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



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

quarterly decrease. On annual basis, it was down 16.4%, which is a fall for a third consecutive quarter, while the quarterly fall equaled 2.3% (seasonally adjusted). The annual decline of gross capital formation is likely due to the reduced stocks, amid high construction growth, which in the last three years makes up about 50% of the gross capital formation. In the third quarter, the construction again registered a high annual real growth (roughly 30%) and mainly related to investments in road infrastructure related to Corridor 10. These positive trends in the construction sector are consistent with the assessments of managers in this sector¹⁷, which in comparison with the previous quarter estimated that there is a significant improvement in the current economic activity of companies in the third quarter. Analyzing other investment indicators, the domestic production of capital goods registered an annual growth, though slower, while the imports slightly declined. The increased amount of foreign direct investment in the country also indicates growth of fixed capital formation, while the rate of decline of long-term lending to the corporate sector significantly decelerated, which is consistent with the more favorable assessments of banks for the lending in the third quarter¹⁸. For the first time in six quarters, banks referred to a net easing of the terms for approving corporate loans, while in terms of demand for loans, banks continued to indicate a net increase. **The latest available data on investment activity in the last quarter of 2013 indicate positive trends**¹⁹. The construction industry experienced a high growth in terms of further investments in the road infrastructure and in commercial and residential buildings. This trend expects to continue, given that building permits for constructing larger facilities were issued during September and October. The domestic production of capital goods also indicates favorable movements, recording an acceleration of the annual growth, same as the imports of these products that also surged. The fall of government capital expenditures slightly accelerated. The reduction of long-term corporate lending slowed down in the last quarter. The banks' assessments for the fourth quarter of 2013 point to a further net easing of the lending terms and higher demand for loans²⁰.

¹⁷ Business Tendency Survey in the construction conducted by the SSO in the third quarter of 2013.

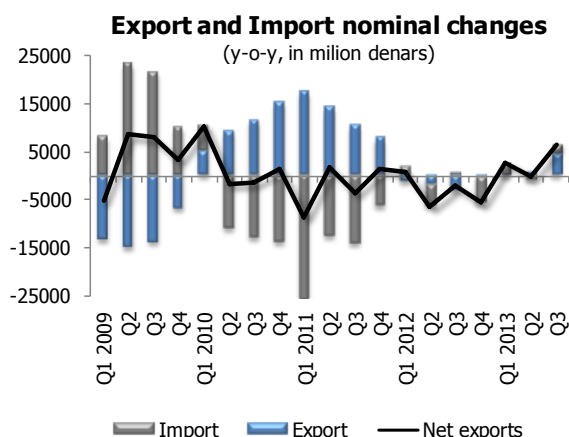
¹⁸ Bank Lending Survey conducted in November 2013.

¹⁹ Data on completed construction works and foreign direct investments are as of October, while other data are as of November.

²⁰ Bank Lending Survey conducted in November 2013.

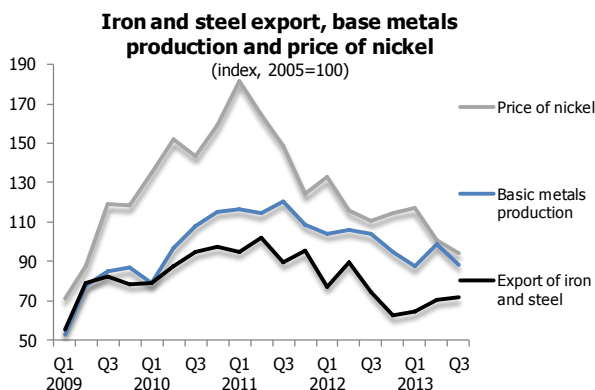


1.3.4. Net export demand



Source: State Statistical Office .

Higher exports of the new export - oriented capacities operating in the technological industrial development zones, as well as the recovery of foreign demand contributed to a significant annual growth of the export sector. However, the further decline of world metal prices and still fragile global demand for metals continues to have a dissuasive effect on the metal industry. This, in turn, led to lower import demand for raw materials, which coupled with the strong reduction of energy imports, are the main factors for the decline of imports. Hence, given the higher exports and lower imports, the net exports made a significant positive contribution to the growth of the overall economic activity.



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

In the third quarter, real export of goods and services recorded a quarterly growth of 3.5% (seasonally adjusted), and solid annual growth of 8.8%, thus being a component of most positive contribution to GDP growth. This increase resulted mainly from the higher export of the capacities operating in the technological industrial development zones. In addition, the foreign demand for Macedonian products increased annually for the first time in six quarters of decline. It contributed to slightly higher utilization of manufacturing facilities²¹ and increase of the domestic industry and export, particularly of machinery and electrical equipment. On the other hand, the further decline in metal prices and the still weak global demand for metals continues to have adverse effect on the domestic metal industry. In import-dependent industry, these trends reduced the need for import of raw materials. Besides, the third quarter witnessed a reduced energy imports, partly because of the lower export demand for oil products from Kosovo. Hence, the reduced imports of energy and raw materials for the metal industry are the primary factors for the decline in imports. Thus, in the third quarter, imports decreased both annually and quarterly by 4.7% and 4.6% (seasonally adjusted).

The latest data on the fourth quarter indicate continuation of trends in exports and imports from the third quarter and continuation of the positive contribution of the net exports to GDP. Given the higher utilization of manufacturing capacities, the

²¹ Business Tendency Survey in the manufacturing industry conducted by the SSO in November 2013.



production of export sector increased, especially machinery and electrical equipment, whose growth was primarily supported by the capacities that operate in the industrial zones. Consequently, the increased export of investment goods is the main driver of growth of the nominal exports in October and November 2013. On the other hand, the nominal import shifted downward again, primarily due to the reduced demand for oil and oil derivatives. Import is a component that has larger effect on the further narrowing of the trade deficit with foreign countries.

Box 2. Revision of GDP quarterly data

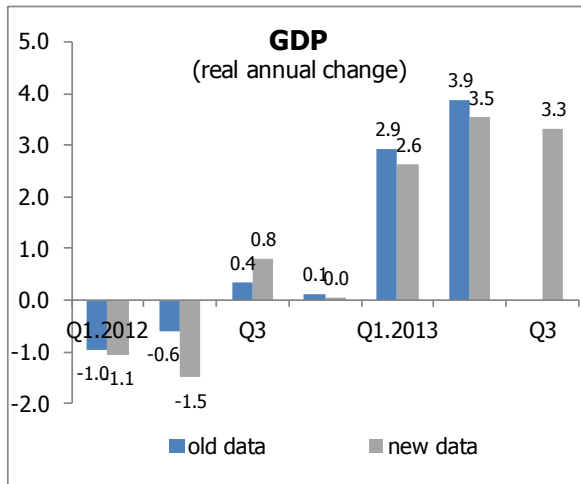
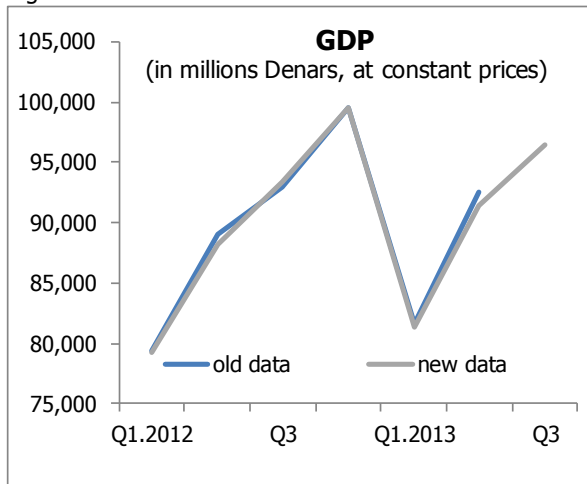
Gross domestic product (GDP) is one of the macroeconomic variables, which is often subject to revisions. All statistical offices, including the State Statistical Office of the Republic of Macedonia, regularly revise GDP data. GDP revisions can occur for several reasons such as inclusion of new information and additional data not previously available, a new assessment of the seasonal trend of certain components or a change in the base years for calculation of the volume amounts, as well as methodological changes in the compilation of GDP data.

This box presents the latest revisions of GDP data and its structure²², particularly focusing on the demand components. The revision includes changes that occurred primarily as a result of new information and data, mainly data obtained by processing the final accounts of the companies. Although the changes in total GDP are not substantial, analyzed from the perspective of individual components, there are significant changes, with the largest being made to the components of domestic demand. These changes alter the macroeconomic picture of the economy and certainly influence the initial assumptions that are an important input to the macroeconomic projections.

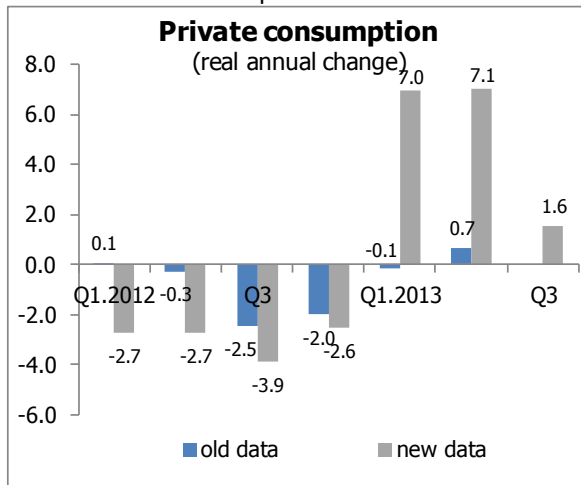
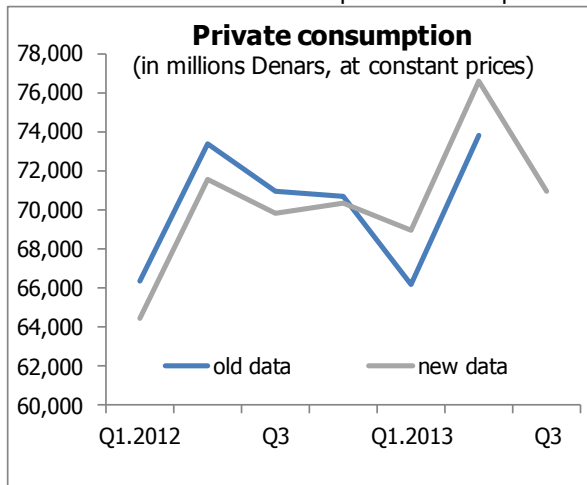
²² On 30 September 2013, the State Statistical Office of the Republic of Macedonia (SSO) disclosed preliminary data for 2012 (annual data at current prices), instead of estimated data (disclosed in the release on quarterly GDP data of 13 September 2013). The release on quarterly GDP data of 13 December, 2013 also disclosed revised data by quarter, i.e. preliminary data for 2012 and revision of the estimates for the first two quarters of 2013 (amounts at current prices and at constant prices and real growth rates). Final annual data for 2012 will be published in the period April-May 2014, and the quarterly data will be disclosed in the release of June 2014. Major revisions of quarterly data are usually made with the June release (for example, Q1 2014), which publishes the final data by quarter for the period that is two years backward from the current year (for 2012) and the revision of the initial estimates for all quarters, for the last year (in 2013), as well as with the December release (for example, for Q3, 2013) which publishes the preliminary data for the last year (for 2012) and the revision of the estimates for the first half of the current year (for 2013).



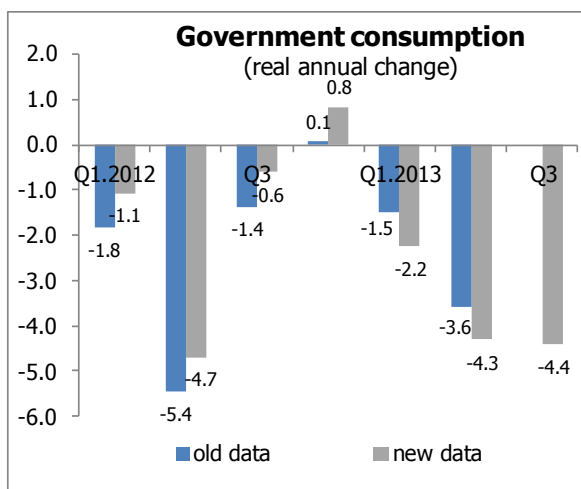
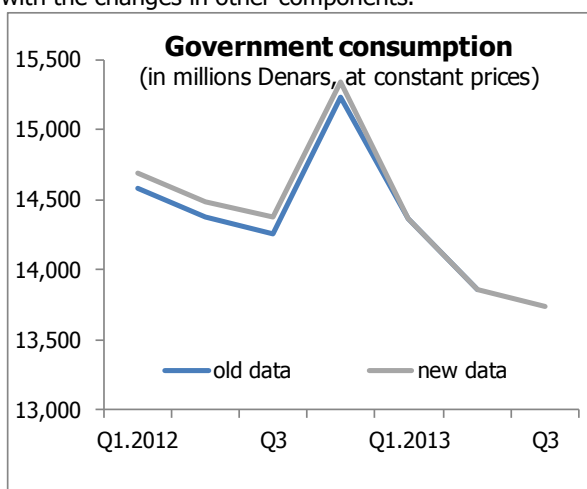
Slight downward revision of GDP in 2012 and in the first half of 2013 ...



...amid downward correction of private consumption in 2012 and its substantial upward correction in 2013...

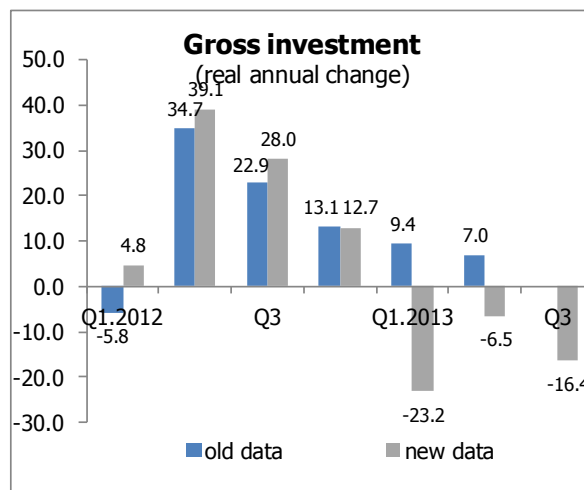
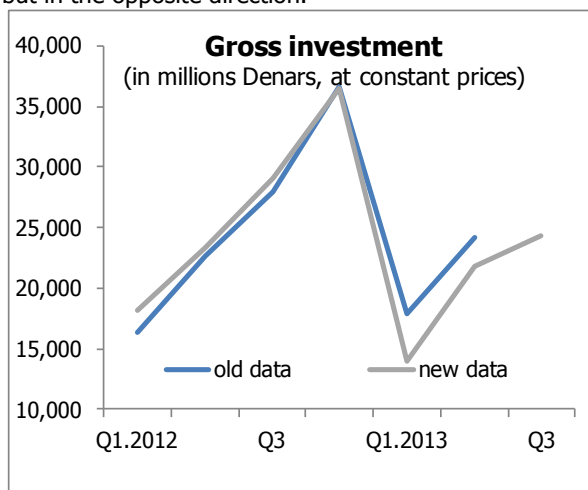


...while the public spending was not subject to major changes, with the directions of annual changes being in line with the changes in other components.

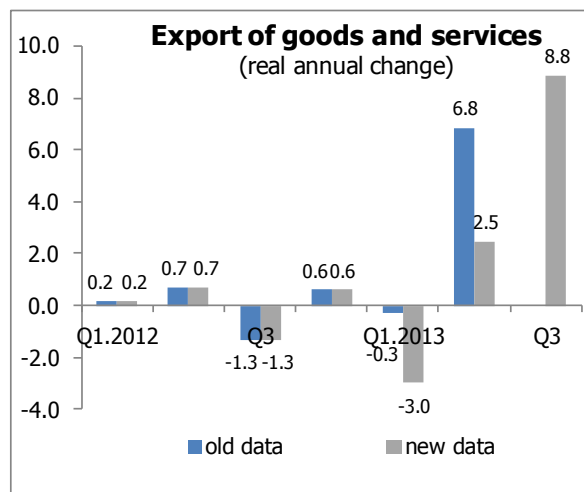
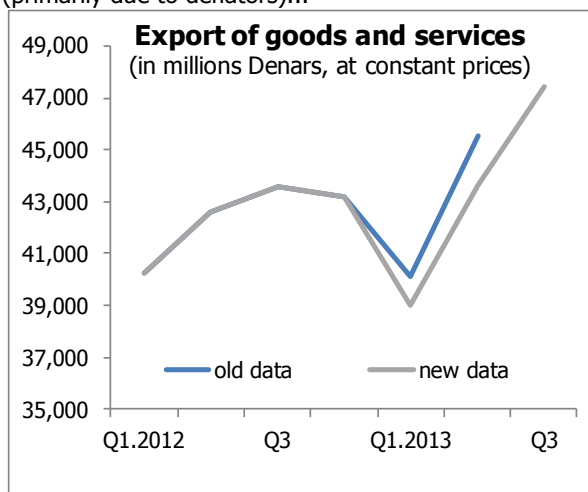




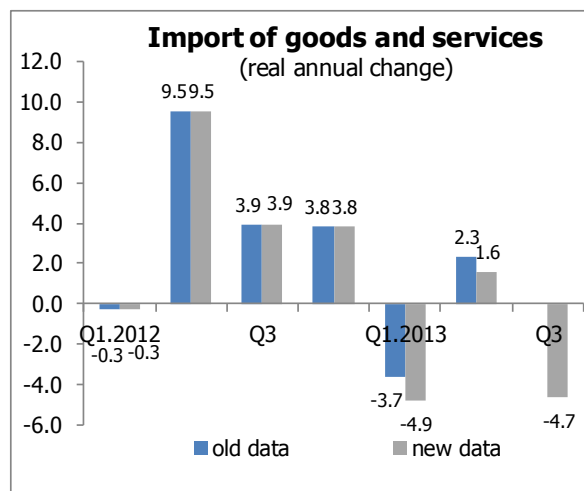
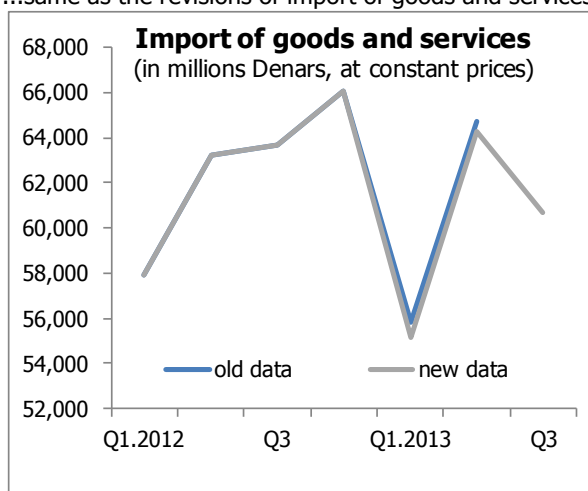
Investment demand was significantly revised upward for 2012, while for 2013, major changes were also made, but in the opposite direction.



Exports were not subject to changes for 2012, while for the first half of 2013, a downward correction was made (primarily due to deflators)...



...same as the revisions of import of goods and services.



Source: SSO.

As mentioned above, the revisions have affected the contributions of individual components to the overall GDP growth, which can change the picture on what component is the main driver of change in GDP. Thus, according to the revisions, the most significant



changes in the contributions to GDP growth occurred in consumer spending and gross capital formation. Particularly significant changes in the contributions of individual components to the GDP growth occurred in the first half of 2013.

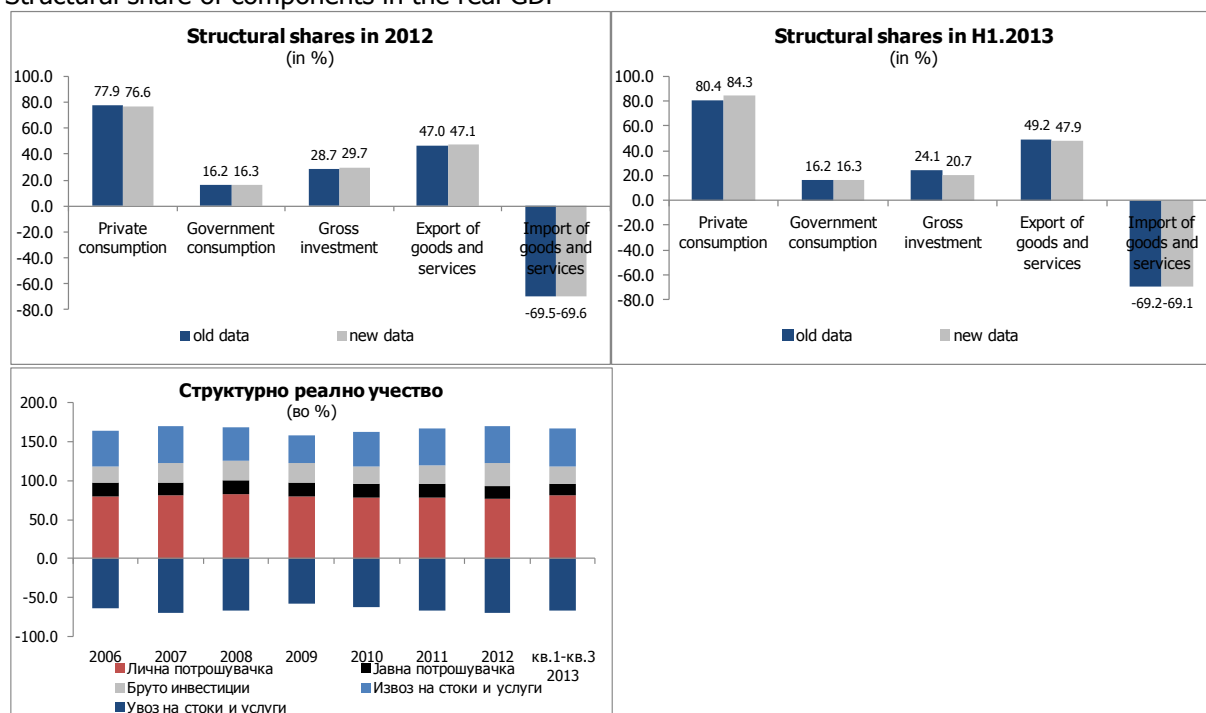
Table 1

2012	contributions in p.p.					
	GDP (%)	Private consumption	Government consumption	Gross investment	Export of goods and services	Import of goods and services
news release 13.09.2013	-0.2	-0.9	-0.4	4.2	0.0	-3.1
news release 13.12.2013	-0.4	-2.2	-0.3	5.3	0.0	-3.1
H1.2013	GDP (%)	Private consumption	Government consumption	Gross investment	Export of goods and services	Import of goods and services
news release 13.09.2013	3.4	0.3	-0.5	2.2	1.8	0.5
news release 13.12.2013	3.1	5.6	-0.6	-3.3	-0.2	1.2

Source: SSO and NBRM calculations.

Revisions to GDP data have an effect on the structural share of each component. Thus, for 2012, according to the revisions, the largest changes occurred in the household consumption, whose share declined (by 1.3 percentage points) at the expense of the share of gross capital formation (up 1 percentage point). Changes in these two components were observed in the first half of 2013, but in the opposite direction. The structural share of private consumption rose to 84.3%, which is one of the highest structural shares so far. On the other hand, the share of gross capital formation and export of goods and services declined, while public consumption and import of goods and services registered no significant changes.

Figure 1
Structural share of components in the real GDP

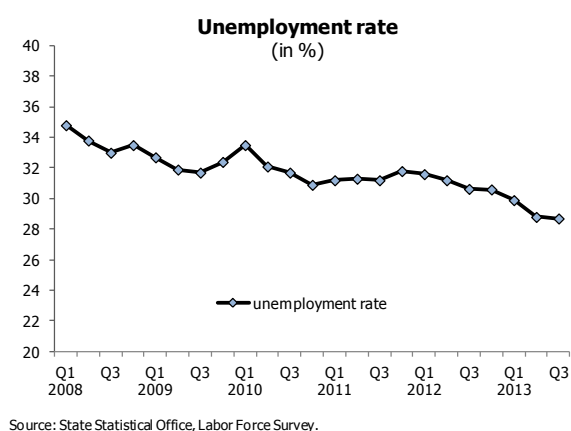
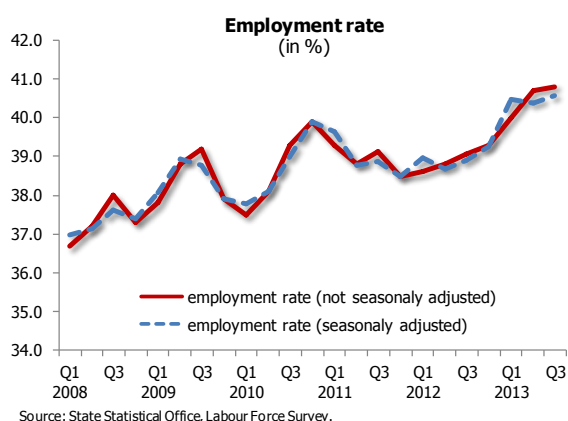


Source: SSO and NBRM calculations.



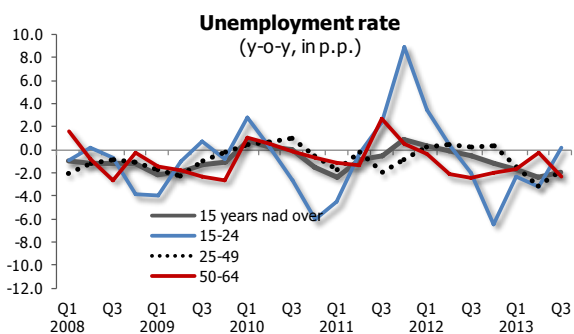
1.4. Employment and wages

In the third quarter of 2013, the number of employees in the Macedonian economy continued to grow on both quarterly and annual basis. Thus, this indicator has been dwelling in the zone of positive changes for six consecutive quarters. These shifts in the labor market correspond with the real sector performance indicators, which are also favorable. The analysis in various industries shows that job creation predominantly relates to the operation of new facilities in the free economic zones, as well as the fiscal incentives in the form of publicly financed construction works, agricultural subsidies, and in the form of employment programs and measures, which have been carried out for several years in succession. In terms of labor cost, there is a slowdown in the annual wage growth in nominal terms, which, despite the weakened inflationary pressures, caused a wage decline in real terms. Analyzing future labor market developments, the aggregated signals from the business tendency surveys show strengthening optimism about the number of employees for the next three-month period. In addition to the positive developments in domestic economy, this trend is also partly due to the gradual recovery of the global economy. In the third quarter, competitiveness indicators registered a quarterly improvement. Thus, labor productivity increased, with the labor costs being downwardly adjusted.

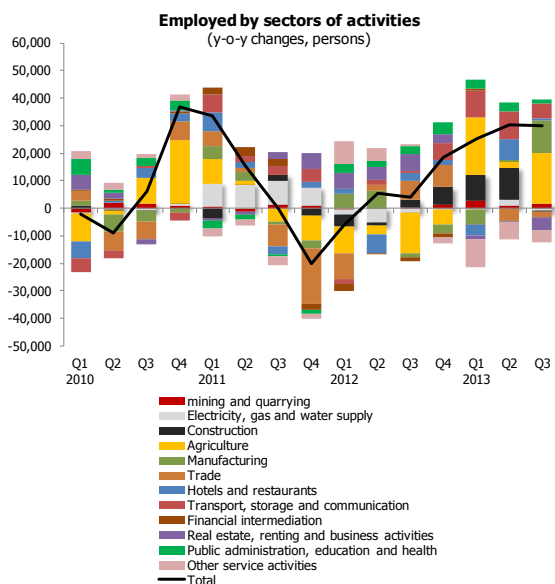
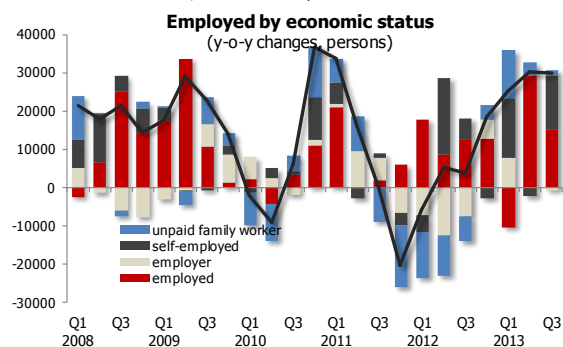


In the third quarter, the number of employees, seasonally adjusted, increased by 0.7%, quarterly²³. Observing by economic status, self-employees and employers reported a quarterly increase of employment. Moreover, given the continuous upward shift since the beginning of the year, in the third quarter, self-employees hit the record high, likely attributable to the growth of employees in agriculture, probably in part as a response to the policies of subsidizing agricultural production and economic policies that are in favor of the rapid development of entrepreneurship, including the simplification of procedures for starting own businesses. Analyzed by sector, the quarterly employment growth, except with the agriculture, is mostly associated with the manufacturing industry. **The employment rate also further improved, i.e. increased by 0.1 percentage points on a quarterly basis. On an annual basis, the number of employees grew by 4.6%, which is only a slight slowdown of the positive dynamics registered in the previous quarter.** This shift resulted in an annual growth of 1.7 percentage points of the employment rate, reaching 40.8%, which is a new historical peak. Analyzed by sector, the drivers of quarterly change mostly explain the annual dynamics of employment, as well. The annual employment growth is largely associated with agriculture and manufacturing industry. Moreover, growth was also observed in the

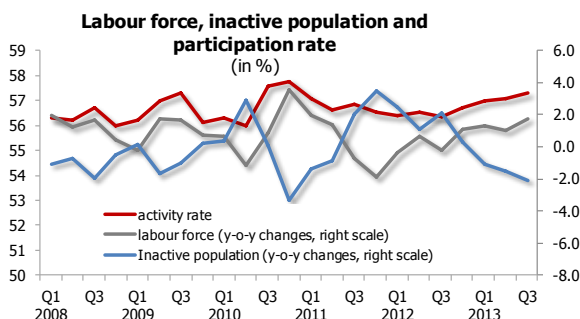
²³ The analysis of quarterly dynamics of employment, unemployment and total active population uses seasonally adjusted data.



Source: State Statistical Office, Labor Force Survey.



Source: State Statistical Office, Labor Force Survey.



Source: State Statistical Office, Labor Force Survey.

transport, storage and communication, which is perceived as a positive externality of the operations of the new facilities with foreign capital and the construction works, since they are complementary. On the other hand, employment in the construction sector has registered a slight downward correction on an annual basis. Employment has reduced in the field of housing construction, but in the field of civil engineering and specialized construction activities it has increased, which is mainly associated with the start of construction of the announced road infrastructure projects. According to the Job Vacancy Survey²⁴, about 39% of new or vacant jobs in the third quarter are in the manufacturing industry.

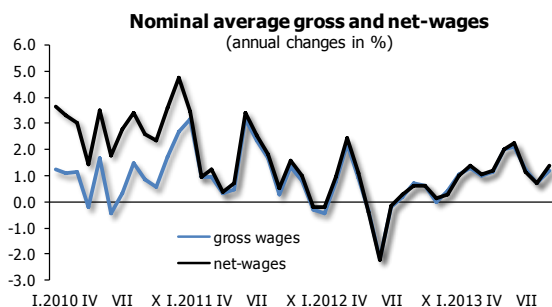
According to the aggregated signals from the business tendency surveys²⁵ there is an increasing optimism for the number of employees for the next three months. This tendency corresponds to the positive developments in the domestic economy and the gradual recovery of the global economy.

The growth of demand led to a quarterly increase of the labor supply. Thus, the labor force grew by 0.6%. The increase of labor and the simultaneous decrease of the number of inactive population resulted in a quarterly upward shift in the activity rate, which reached 57.3%. **At the same time, the total active population registered a further acceleration of the positive annual dynamics (growth of 1.8%).** This shift, along with the simultaneous decrease of inactive population, determined a faster annual growth of the activity rate than recorded in the previous quarter.

The stronger growth of supply compared to the growth of demand for labor led to a quarterly upward shift in the unemployment. The quarterly growth of 0.4% comes after two quarters of significant downward adjustments in the number of unemployed persons. On annual basis, the reduction of the number of unemployed persons of 4.6% is associated with the faster growth of labor demand

²⁴ State Statistical Office for the first time in 2012 began to conduct a Job Vacancy Survey as a part of the labor market research. The purpose of this survey is quarterly information on vacancies in companies in the Republic of Macedonia as an important indicator of the macroeconomic developments and policies in the labor market.

²⁵ Source: State Institute of Statistics, business tendency surveys in the manufacturing industry (November 2013), construction (third quarter of 2013) and trade (third quarter of 2013).



Source: State Statistical Office.

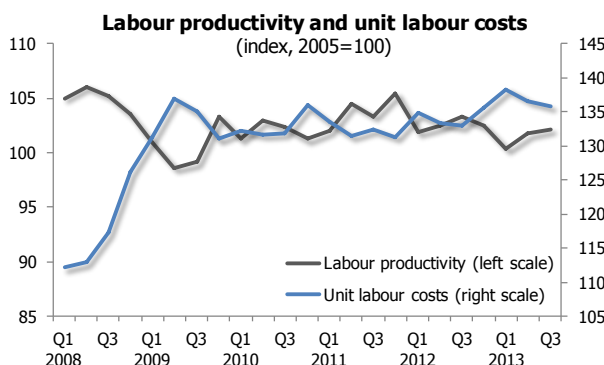
Annual changes in average paid net wage by sectors in Q3.2013 (in %)

	nominal changes	real changes
Total	1.0	-1.7
Agriculture, forestry and fishing	0.5	-2.2
Mining and quarrying	6.2	3.3
Manufacturing	2.2	-0.6
Electricity supply	1.3	-1.4
Water supply	1.0	-1.7
Construction	6.1	3.3
Trade	0.4	-2.3
Transportation and storage	6.4	3.5
Accommodation and food service activities	1.7	-1.0
Information and communication	2.8	0.0
Financial and insurance activities	0.3	-2.4
Real estate activities	0.6	-2.1
Scientific activities	-4.9	-7.5
Administrative activities	2.3	-0.5
Public administration and defence	0.7	-2.0
Education	0.1	-2.6
Health and social work	3.1	0.3
Arts, entertainment and recreation	-1.9	-4.5
Other service activities	2.0	-0.8

Source: State Statistical Office.

compared to the growth of supply. The unemployment rate also recorded an annual decrease (of 1.9 percentage points), hitting the historic low of 28.7%.

The average wage paid in the third quarter continued to grow annually, though slowly. Thus, the nominal net and gross wages registered an annual growth of 1%, with an upward correction being reported in all sectors. The slowdown of nominal wage growth, despite the weakened inflationary pressures, caused a **wage decline in real terms, whose annual dynamics is only slightly weaker than in the previous quarter.** Thus, the average real net wage is lower by 1.7%, on an annual basis. **On a quarterly basis,** net and gross nominal wages are by 0.3% lower, which is the first downward correction in four quarters. Analyzing by sector, this shift reflects a downward adjustment of wages in the service sector. However, due to the decrease in prices during this period, there was a 0.4% quarterly increase of net wages, in real terms. At the same time, the unfavorable movement of nominal wages, amid growth of employment, suggests that employers have still been dealing with the uncertain economic environment through the wage channel, rather than by reducing the number of employees.



Source: State Statistical Office and NBRM calculations.

The negative annual pace of labor productivity has accelerated. The 1.1% decline in productivity in the third quarter indicates that the annual employment growth exceeds the growth of economic activity. On the other hand, productivity recorded a quarterly growth, since the production growth surpassed the growth of employees. **The decline of productivity, with a simultaneous increase of gross wages, determined an annual growth of unit labor costs of 2.2%,** which is a slight slowdown of the growth compared with the previous quarter. However, labor costs were downwardly adjusted by 0.7%, on a quarterly basis.

Box 3. Sector analysis of the labor productivity

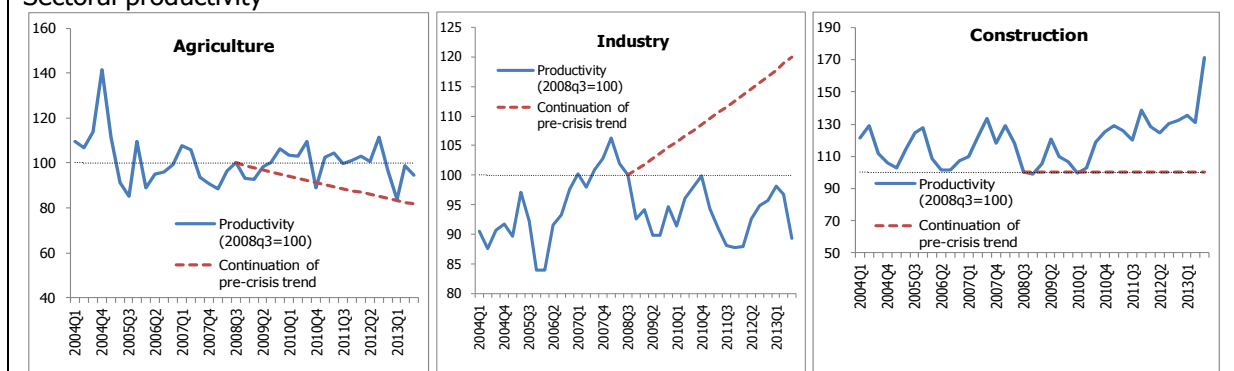
The labor productivity at the level of the total economy, measured as value added per employee, is still below the level registered in the third quarter of 2008, as a reference period, i.e. as a period preceding the very beginning of the crisis. However, the analysis of the developments in whole-economy productivity could mask certain differences in the evolution of productivity between sectors. Such differences may relate to the intensity with which sectors use capital and labor in their activities. There are also differences due to different levels of innovation, as well as the sectors unique ability for absorption of external knowledge and skills. The productivity depends on the degree of process standardization, and on the extent of the potential use of the benefits of the so-called "economy of scale". Furthermore, one of the major drivers of



productivity is also the exposure to international competition. **Within this Box, we give an overview of sectoral productivities, revealing the differences in their dynamics after the acute phase of the crisis and the possible explanations for them.**

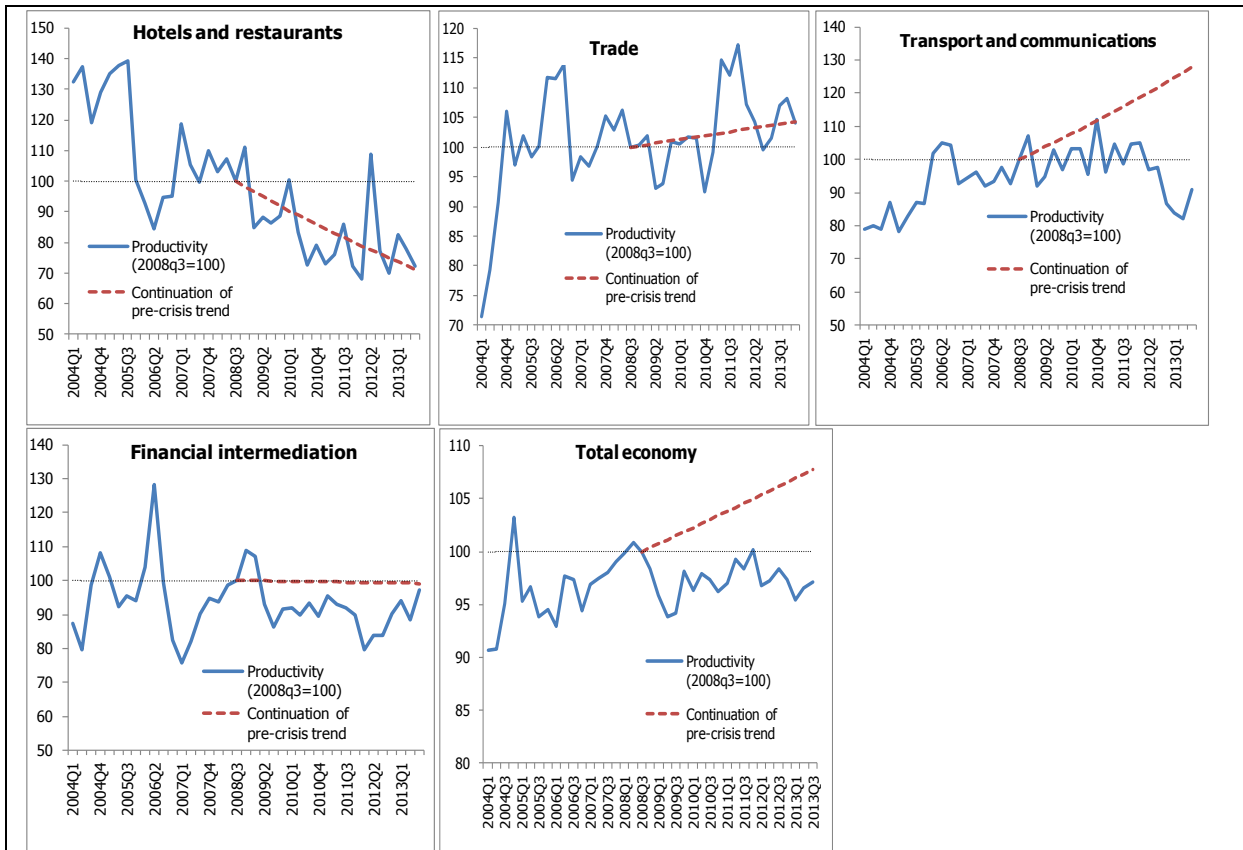
Sectoral productivity data shows that some of the individual sectors display productivity levels which are lower than the ones observed in the third quarter of 2008. The alternative measure of the distance of the productivity from its pre-crisis potential also points out to such a conclusion. The continuations of pre-recession trends are calculated by projecting forward labor productivity using the average quarterly growth rate derived from some longer period before the crisis (due to data limitations, in our case, the 2004-2008 period was taken into consideration²⁶). In such a way, implied productivity levels consistent with a continuation of their pre-crisis trends are obtained. Also these simulations show that the labor productivity in some sectors is still below the continuation of its pre-crisis trend, thus suggesting that a significant degree of spare capacity existed within Macedonian companies. **The deepest negative gap of the current relative to the simulated productivity level is registered with industry**, where the observed increase in the employment in the post crisis period, is not complemented by output growth²⁷. On the other hand, productivity in agriculture and construction has constantly been maintained above the implicit pre-crisis level. From the beginning of 2011, this outlook is complemented by the productivity in trade, which shows signs of more evident recovery thus reaching levels that are exceeding the implicitly set ones.

Chart 1
Sectoral productivity



²⁶ It is a technical concept of IMF originally explained in IMF (2009), 'What's the damage? Medium term output dynamics after financial crises', *World Economic Outlook (WEO)* October, Chapter 4, 121–151. However, because there are no longer time series, to calculate the pre-crisis trend by sectors, the period commencing from 2004, and ending as of the third quarter of 2008, is taken into consideration. As an illustration, in the original source, i.e. in *WEO*, the trends were derived on the basis of seven-year period which ends three years before the crisis. The latest three-year period before the crisis has been excluded in order to avoid the influence of some higher growth rates of the productivity, which commonly precede the recessions. Also, in instances of negative trend, which on one hand means that the value added per employee, i.e. the productivity would fall eternally, even when there is no crisis, this seven-year period was prolonged to 10-20 years, in order to create more reasonable trend path.

²⁷ More details on the movements of the economic activity and employment by sectors of activities are provided in Box 2 Sectoral perspective of employment and economic activity, NBRM, Quarterly Report, October 2013.



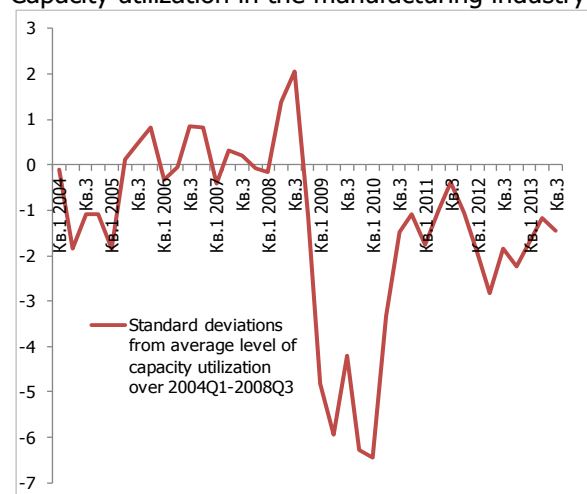
The pre-crisis trend is calculated for the period from the beginning of 2004 until the third quarter of 2008. Trade is an exception, where the trend starts being calculated from the third quarter of 2004 in order to avoid the inexplicably high productivity growth in the first and the second quarter of 2004.

As for the **manufacturing industry**, also the Business Tendency Survey indicates significantly reduced capacity utilization in this sector in 2009, as well as its constant maintenance at the level which is below the pre-crisis period, in the following period. This performance is mostly associated with deteriorated demand, particularly in the traditionally important area, such as the metal industry, which was exposed the most to the negative effects of the global crisis (Chart 2). This may refer to an unfavorable turn in the long-term productivity trend, or, in other words, indicate a weakening of the labor productivity growth rates in manufacturing industry. However, this statement is associated with a certain dose of uncertainty²⁸.

²⁸ Namely, the Business Tendency Surveys might not be entirely reliable indicators of total spare capacity within companies and therefore of developments in long-term trend or productivity potential. The managers of the companies may report immediately available capacity rather than their long-run capacity. Also, there are other reasons why measured productivity may have been weak for a sustained period, without that meaning a persistent impairment of the long-term trend. In fact, some businesses must retain contingent of employees despite reduced activity due to concerns that it would be difficult to recruit suitably skilled staff when demand recovers. That may have been facilitated by forbearance shown by banks. Measured productivity growth could, therefore, recover quite sharply if output growth picks up, although it might also pick up if employers decide to lay off surplus staff.



Chart 2
Capacity utilization in the manufacturing industry



Source: Survey of Business Tendencies of SSO, Capacity utilization manufacturing industry.

However, the increase in the number of employees in the manufacturing industry in the last period, which is mainly associated with the operation of new facilities in the free economic zones, in terms of expectations for reducing the capacity utilization gap according to the initiated economic recovery and full launch of the new capacities, as well as in conditions of the focus of macroeconomic policies that promote stronger connection between the financial sector to the real economy²⁹, creating **expectations for the growth in labor productivity in the manufacturing sector** in the forthcoming period.

Agriculture is one of the sectors where the labor productivity is almost continuously above the level recorded in the third quarter of 2008, and the growth pace is faster than the one consistent with a continuation of its pre-crisis trend. The productivity growth in agriculture in the post-crisis period is primarily related to the several-year agricultural policies of the Government, which contributed towards development and greater competitiveness of Macedonian agriculture through access to favorable loans, subsidizing costs for purchasing of livestock, growing plantation crops and subsidizing agricultural production.

Construction is also a sector the productivity of which in the post-crisis period consistently exceeds the level measured in the third quarter of 2008, while the growth path is faster than the one consistent with a continuation of its pre-crisis trend. The relatively rapid labor productivity growth in the construction sector in the post-crisis period is mainly associated with the several-year fiscal stimulus in form of publicly funded construction work, in the field of both infrastructure construction and building construction. Furthermore, the productivity growth is associated with the construction activities of foreign companies in free economic zones, as well as the enhanced competition in the area of private housing construction, also in form of direct involvement of foreign investors in construction.

Transport, storage and communications sector is one of the sectors where the labor productivity in most of the post-crisis period is below the level registered in the third quarter of 2008, while the dynamics is opposite than the one implicitly expected as continuation of its pre-crisis trend. Namely, the notably strong pre-crisis growth rate in labor productivity in this sector is most likely associated with the telecommunications segment, which is more exposed to larger international

²⁹ Such an example in the Macedonian economy is the subsidizing of the interest rates on the credit lines provided by the European Investment Bank (EIB). The primary objective of credit lines is to provide capital for supporting the small and the medium-size enterprises, which will be directed towards realization of new products, opening new jobs, higher liquidity in the real sector and increased exports.



competition, uses modern technologies, and it is characterized also by fragmentation and international innovation of processes. In addition, although in the post-crisis period this sector shows significant oscillations and even deepening of the gap in comparison with the simulated path, especially in the last period, there are still certain periods in the productivity movement where the level registered in the third quarter of 2008 is exceeded, which is probably positive externality of the construction activity on transport and storage as complementary activities. Also, this positive transmission effect most probably neutralizes most of the negative impact of the slower recovery of the manufacturing industry, which also has activities related to the "Transport, storage and communications" sector.

When it comes to the **trade** sector, according to the Chart 1 it is evident that since the beginning of 2011, the productivity in the trade shows signs of recovery, i.e. reaching levels that exceed, almost constantly, both the level measured in the third quarter of 2008 and the implicitly set level, which indicates continuation of the pre-crisis dynamics. Trade is a sector which is mainly associated with the relatively low levels of capital per employee, then with lower demands in terms of skills (the trade, usually, opens low-paid jobs that do not require high qualifications), with many small firms and limited opportunities for innovation. In Macedonian economy, the enhanced competition and probably the reduced atomization of companies could be indicated as factors that contribute to domestic trade productivity growth in the last period. Namely, it is the construction of several major shopping malls, which triggered the entry of new brands, as well as entry of large foreign retail chains, which are generally known as more effective than the small-size sole proprietors and are prone to greater investment in modern technology.

On the other hand, **hotels and restaurants** are the only sector the productivity of which, with the exception of short periods of growth and stagnation, is characterized by a steady downward trend, in both the pre-crisis and the post-crisis period. Due to the specific nature of the services sector "hotels and restaurants" are consumed at the same location at which they are produced. This specific character, accompanied with wide geographical distribution (which follows that of the total population), especially when it comes to restaurants, limits the possibility of "economy of scale" in this sector. Simultaneously, the restaurant services are traditionally provided at home. Consequently, higher income and greater specialization in this type of services could increase the market interest in them and encourage sustainable positive trend in productivity. Also, a positive impact on productivity in this sector is expected from the Government tourism development strategy³⁰. Namely, apart from the promotion of the tourism potential of the country, significant positive effects on this service segment are expected from investments in road and rail infrastructure, which should increase the number not only of transit tourists, but the tourists staying in country, as well.

The productivity in the **financial intermediation** sector in the post-crisis period is continuously below the level measured in the third quarter of 2008, and follows a downward dynamics path in terms of what would be implicitly expected trend if the global crisis didn't happen. Namely, the slow recovery of the productivity, especially if consider that part of the sector is largely based on information technologies and innovations thereof, and the development of which is globally solid, could be associated with stronger employment growth in the private security activities, specifically in the employment with the security systems protection services, which registers the highest cumulative upward change compared to the third quarter of 2008.

As a conclusion of the analysis, it could be said that the labor productivity at the level of the overall economy, measured as value added per employee, is still lower than the one measured in the third quarter of 2008, registering also a dynamics opposite to the implicitly expected one, consistent with continuation of the pre-crisis trend. However, observed by sectors, significant differences in the dynamics of their individual productivity have been identified, which depend on the specific features of the activities.

³⁰ Namely, the Government's strategy for development of tourism practically consists of two parts. The first part are the central government obligations, and the second part concerns the activities of local authorities. The aim of the strategy is the equal development of summer, winter, ecotourism, alternative, wine and every other kind of tourism that could have a positive impact on the economy.



In any case, this analysis shows that there is still room for boosting the productivity of the economy, and this statement particularly relates to one of the major sectors, i.e. industry. The inflow of foreign capital into the country and greater exposure to international competition can stimulate part of the industrial sector. Of course, such an effect is expected also from the new foreign facilities, which except that as mechanism for larger export activity, are a kind of tool for production diversification and drawing modern technologies in the country. In addition, also the establishment of mechanisms for stimulation of the production relations between these and the local companies can be a factor for boosting the productivity in the domestic economy.

Box 4. Summary of the active labour market programs and measures in the Republic of Macedonia

The decrease in the unemployment, as a serious and long-term problem of the Macedonian economy, is one of the main priorities included in the Government's Annual Operational Program, as well as in variety of established national documents that relate to the employment policies and strategies and unemployment mitigation activities at national level. This Box refers to the active labour market policies and measures encompassed in the annual Operation³¹, aimed for timely and successful implementation of the active labour market programs and measures envisaged in the aforementioned Program, by determining the target groups, the required funds, sources, specific activities and deadlines for implementation of each active measure.

The active labour market programs and policies usually have two main objectives: 1) economic, which is accomplished by increasing the employability of the unemployed, and thus the productivity and income, and 2) social, by improving inclusion and participation as a result of productive employment. Thus the active measures contribute to larger employment opportunities and affect social issues that are often associated with high unemployment. Quite often, the active programs are used to mitigate the negative effects from restructuring of the transition countries. Unlike active, the passive measures, such as the unemployment insurance and social transfers, are designed to alleviate the financial difficulties the unemployed persons are faced with.

The active measures include a wide range of activities to stimulate employment and productivity, which can be grouped into the following three categories:

- measures for increasing the quality of the labour supply (e.g. training);
- measures for increasing labour demand (e.g. organizing public works);
- measures for bringing the workforce closer to the jobs (e.g. job search assistance).

The successfulness of the active measures depends not only on their size and the resources engaged, but primarily on how good they are designed and their effectiveness.

The labor market in the country is characterized by a high unemployment rate of about 32% in the last five years, combined with low activity rate (56.6%) and low employment rate (43.3%). The unemployment is most evident among the younger population, while the long-term unemployed have the largest share in total unemployment. Namely, the persons who have been unemployed for a year or longer comprise 83% of the total number of unemployed persons, 76% of which are individuals who are unemployed for four years or longer.³² The inclusion of these individuals in the labor market is much harder, which indicates substantial loss of human capital. Consequently, most of the active policies and measures that have been implemented in the last five years are directed specifically towards the aforementioned target groups.

³¹ The annual Operation Plan is prepared by the Ministry of Labour and Social Policy (MLSP).

³² Source: Labour Force Survey, SSO.



The active policies and measures that are currently being undertaken in our economy should ensure smart, sustainable and inclusive growth and therefore they are designed as follows:³³

- **Smart growth programs:** Employment Preparation Program;
- **Sustainable growth programs:** Self-Employment Program, Program for Financial Support to Legal Entities (small-size and medium-size enterprises and craftsmen) for creating new jobs;
- **Inclusive growth programs:** Employment Subsidy Program, Subsidies for Users of State-Owned Agricultural Land, Public Works Program.

From the aspect of the target groups, the smart and sustainable growth programs are mainly focused on the long-term unemployed, young people up to 29 years of age, unemployment compensation beneficiaries, former employees whose employment was terminated for business reasons, unemployed aged 30 to 49 years, as well as students and postgraduates. On the other hand, the inclusive growth programs are intended for social welfare recipients and individuals from the so-called vulnerable category (orphans, victims of family violence, homeless people, single parents and parents having larger number of under-aged children (4 and more), convicted persons, Roma, etc..

Among the active employment programs applied, the longest continuous implementation, with relatively wider coverage of unemployed persons and long-term positive effects on employment, register the Self-Employment Program and the Employment Subsidy Program.

The Self-Employment Program refers to the measures that encourage the demand for labor. This measure is used to create new jobs through self-employment (starting own business³⁴). The program is realized by training the unemployed persons in understanding the entrepreneurship, developing a business plan, assistance in registering own business and financial support, which includes non-refundable amount of funds for each self-employment in the amount of Denar 201,897, out of which 90% are in form of direct support for procurement of equipment and/or raw materials. Those who would use the funds through this program cannot be re-registered in the unemployed record in the Employment Agency of the Republic of Macedonia (EARM) within four years from the date of registration of the business. Also, if the employment is terminated without reasonable ground before the expiration of two years from the registration³⁵, the person has an obligation to return most of the used funds. This program is among the more efficient ones, which can have long-term effects on employment, and in the last five years, it has covered a total of 4,346 individuals.

However, it should have in mind that to ensure stable entry of the unemployed persons on the labor market, more extensive consultation and training, in terms of what this measure envisages, and appropriate psychological support, are necessary. Also, the experiences of other countries show that the standard for self-employment programs are not appropriate for young population (15-24 years), and for better efficiency, the target group should be individuals aged from 25 to 29 years, who possess the technical skills previously associated with the business or certain work experience.

Along with this measure, in 2008 the Government of RM initiated a **Project for Self-Employment Supported by Credit**. The goal of this Project is to open new jobs through self-employment by granting a favorable loan³⁶ to unemployed persons who intend to initiate or formalize their informal businesses. The beneficiaries may be individuals registered as unemployed in the EARM, including: young people up to 27 years, unemployment compensation beneficiaries for at least six months and individuals over 55 years. The results of the implementation of this active measure so far

³³ According to the European strategy for smart, sustainable and inclusive growth - Europe 2020. Source: Annual Operation Plan for 2012-2013.

³⁴ By end-2011, programs for formalization of the existing businesses were conducted as separate programs.

³⁵ Provided that it is not due to death or permanent disability.

³⁶ The loans total Euro 3,000 per each newly created job (but five at the most), with an interest rate of 1% on annual basis and repayment period of three years, with a grace period of up to one year.



are estimated as positive, and the measure as highly popular³⁷, because of which its implementation continued in 2013, as well.

The Employment Subsidies Program is another measure that stimulates labor demand and encourages the employment of persons facing harder entry in the labor market (i.e. category of vulnerable persons). Namely, it is a measure which is one of the most expensive and therefore should be focused solely on individuals who face multiple barriers³⁸ on the labour market. Currently, the measure consists of providing financial support in form of gross wage in the amount of Denar 13,000 per month in duration of six months for each employee (for vulnerable persons group, the support equals Denar 17,000 per month, of which Denar 3,000 are for the employer as compensation for the costs of adaptation of the person in the employment process). The employer has an obligation to keep the individuals at work for at least 18 months, or to hire another person from the records of the EARM, otherwise it is required to return the funds. This measure enabled a total of 3902 subsidized employments within 2008-2012 period.

Within the Employment Preparation Program, the training for known employer is the most effective so far, in terms of the number of covered and employed persons. The measure offers the unemployed individuals a certain level of knowledge and skills for an employer, who has a need for certain jobs. The training enables the registered unemployed persons to acquire and improve their knowledge in order to find job more easily, because of which this measure belongs to the group of measures that improve the quality of the labor supply. The measure currently relates to the less educated unemployed persons between 25 and 49 years of age. The training lasts for three months, and the employer has to employ at least 50% of trainees and without reducing the total number of employees within six months. In the last five years, this measure covered a total of 881 unemployed persons.

The **internship program** has similar effect, which has been implemented as a separate program as of 2012, while from 2013, it is included under the Employment Preparation Program. It is a preventive measure, which allows young unemployed persons up to 29 years of age to gain the practical knowledge and skills and prepares them to join the labor market more easily. In 2012, this measure required from the employers to employ 50% of trainees, while in 2013 this requirement was abolished.

The financial support to legal entities (small-size and medium-size enterprises, craftsmen) for creating new jobs is relatively new active measure. The objective of the Program is creation of new jobs and stimulation of the labor force demand on the labor market. It envisages additional irretrievable support in form of materials and/or equipment for creating jobs in the aforementioned legal entities, which operate for at least one year. The employer has an obligation to keep the employees for at least 12 months, with full working time. Within 2010-2012 period, this measure supported a total of 227 persons.

Public Works Program is a measure with the largest scope and largest employment of unemployed persons, but with short-term effect. It was implemented in 2009 and 2012, and its implementation was planned for 2013, as well. It is intended for long-term unemployed individuals, low-skilled and elderly people over 55 years of age, who are hired for a maximum period of six months, during which they receive financial support on a monthly basis. For that period, the engaged unemployed person does not lose benefits based on unemployment. The engagement of persons in

³⁷ Within 2008-2012 period, a total of 8,979 employment applications have been submitted for employment of 10,569 individuals, with 5,514 employment applications for employment of 6,537 individuals being approved. Out of the total approved applications, 4,895 contracts for employment of 5,739 individuals were submitted to the banks.

³⁸ The barriers to labor market may arise from: changes in the labor market (recession, trend of outsourcing instead of regular full-time employees, etc.), discrimination on various grounds (sex, age, nationality or religion, etc.) and systemic barriers related to the availability or quality of certain services (education, training, information, communication, etc.).



the Survey of Job Vacancies of EARM also has short-term effects. Namely, it is a measure where the unemployed persons with high-school and university education are engaged in a telephone survey of employers about their workforce needs, based on previously prepared questionnaire (during a one-month period during the year).

In 2012, **the implementation of a Pilot-Program that subsidizes users of State-Owned Agricultural Land** started. The goal of the Program is to encourage new employment of the unemployed persons who are social welfare beneficiaries and their social inclusion. These measures are aimed at granting state-owned agricultural land to social welfare beneficiaries, who are also paid compensation in the amount of the welfare and the social insurance. The users ought to register themselves as individual farmers with agriculture as their core business. The results of this Program will be evaluated after one to two years, and so far it employed a total of 26 individuals - users of state-owned agricultural land.

In order to make a proper and comprehensive assessment of the effects of the considered active employment measures, they should be followed after certain period of time in order to determine whether these measures contributed to the reduction of unemployment on a longer and steadier basis. According to the available data, within 2008-2012 period, a total of nearly 25,000 unemployed persons have been covered with the active employment programs and measures. Having no complete and comparable data on the number of current employees out of the total covered persons for the entire review period and for all measures, no accurate assessment of the effects on the unemployment can be given. According to the Labour Force Survey (LFS), in the 2008-2012 period, the total number of unemployed persons decreased by around 24,000 persons, almost entirely due to the reduction in the number of persons unemployed for up to four years and longer.

The International Labor Organization (ILO) in 2012 has conducted an analysis and assessment of the effects of the three measures on the labor market in the Republic of Macedonia³⁹: self-employment program, training for known employer and employment subsidy program for the 2007-2010 period. These programs in the aforementioned period did not undergo major changes in its design and they covered most of the unemployed, and also occupy a significant portion of the available funds. The choice of 2010 as the final period for the analysis is made in order to give more realistic assessment of the effects on unemployment, given that all obligations of covered entities/employers in certain programs are expired. The results of the analysis show that 57.8% of all participants covered by the three reviewed programs were employed during 2012, which is considered as relatively high percentage. Moreover, 77.2% of persons who used funds in the 2007-2010 period under the self-employment program, 55.8% of the individuals who used funds for training program and 43.4% of the employment subsidies program, kept their jobs in 2012. As a result of this analysis and the success of these measures, the implementation of these and similar measures will proceed in the following medium-term period, in order to improve the labor market conditions.⁴⁰

³⁹ Performance monitoring of active labour market programs implemented in 2007-2010 - Key findings, ILO, December 2012

⁴⁰ Source: Pre-accession Economic Program 2013-2015, Ministry of Finance of the Republic of Macedonia, January 2013.



Table 1 Summary of the active employment programs in 2008-2012 period

Employees by years	Programs and measures																																		
	Self-employment			Employment Preparation Programme										Employment Subsidy Program		Internship Program		Public works		Survey of Job Vacancies		Roma Employment Program		Financial support to legal entities (small and medium-size enterprises, craftsmen) for creating new jobs		Financial strenght of women, victims of family violence		Labour Force Mobility Program		Program for Subsidies for users of State-Owned Agricultural Land		Total			
	Total	of which: Program for formalization of existing businesses		Total training		Training for known employer		Training for advanced IT skills		Training for demanded professions		Education for starting own business		plan	realization	plan	realization	plan	realization	plan	realization	plan	realization	plan	realization	plan	realization	plan	realization	plan	realization	plan	realization		
				plan	realization	plan	realization	plan	realization	plan	realization	plan	realization																					plan	realization
2008	607	107	642	1528	1218					108	60	1420	1158	600	244	30	124	-	-	-															
2009	850	250	904	1692	1345	512	219			120	66	1060	1060	1430	1384	150	110	5000	4983	90	89	200	16												
2010	950	250	950	2741	1522	1000	188	80	75	161	42	1500	1217	1041	1029	150	142	-	-	60	58	50	7	50	50	125									
2011	950	250	950	2550	1488	156	124	180	179	214	185	2000	1000	655	628	300	282	-	-	40	38	34	23	90	87	70		20							
2012	900	-	900	3380	1871	1000	287	164	176	216	183	2000	1225	600	625	233	103	4000	3064	40	16	-	-	90	90	-		-	-			100	26		
Total	4257	857	4346	11891	7444	2668	818	260	254	819	536	7980	5660	4326	3910	863	761	9000	8047	230	201	284	46	230	227	195	20	7	100	26	31232	24839			
% of total	13.6	2.7	17.5	38.1	30.0	8.5	3.3	0.8	1.0	2.6	2.2	25.6	22.8	13.9	15.7	2.8	3.1	28.8	32.4	0.7	0.8	0.9	0.2	0.7	0.9	0.6	0.0	0.1	0.0	0.3	0.1	100	100		

Source: Ministry of Labor and Social Policy, Employment Agency of the Republic of Macedonia.

Table 2 Selected indicators on the labour market, by country

	Activity rate						Employment rate						Unemployment rate						Youth unemployment rate (15-24)						Long-term unemployment rate (over 1 year)													
	2006	2007	2008	2009	2010	2011	2012	2006	2007	2008	2009	2010	2011	2012	2006	2007	2008	2009	2010	2011	2012	2006	2007	2008	2009	2010	2011	2012	2006	2007	2008	2009	2010	2011	2012			
Albania	60.6	60.5	60.4	60.4	60.4	60.3		0	51.9	52.3	52.6	52.1	52.1		13.5	13	13.8	14.2																				
Bosnia and Herzegovina	43.1	43.9	43.9	43.6	44.6	44	44	29.7	31.2	33.6	33.1	32.5	31.9	31.7	31.8	29.7	23.9	24.1	27.2	27.6	28.1	62.5	58.5	47.7	48.7	57.2	57.1	57.5		25.1	20.2	20.1	22.4	24.8	25.4			
Bulgaria	51.3	52.6	53.8	53	52	52.5	53.1	46.7	49	50.8	49.4	46.7	46.6	46.6	8.9	6.9	5.6	6.8	10.2	11.3	12.3	19.3	15	12.7	16.1	23.1	25.1	28.2	5.0	4.0	2.9	2.9	4.7	6.3	6.8			
Croatia	49.2	48.9	48.5	47.6	46.6	45.6	45.3	43.7	44.2	44.4	43.3	41.1	39.5	38.1	11.1	9.6	8.4	9.1	11.8	13.4	15.8	29	24.2	22.2	25.6	33.5	36.9	44.2	6.7	5.9	5.3	5.1	6.7	8.6	10.2			
Kosovo	52.5	46.5	46	47.7			37.1	28.7	26.2	24.1	26.1		25.6		44.9	46.3	47.5	45.4			30.9	0	0	30.9	75.5													
Macedonia	54	54.5	55.1	55.5	55.7	55.5	55.2	34.6	35.5	36.5	37.6	37.9	38.1	38.1	36	34.9	33.8	32.2	32	31.4	31	59.7	57.8	56.4	55.2	53.7	55.4	53.8	30.2	29.6	28.7	26.2	26.6	25.9	25.4			
Montenegro		51.7	51.9	51.1	50.1	48.7	50		41.7	43.2	41.3	40.3	39.1	40.2		19.4	16.8	19.1	19.7	19.7	19.6	47.9	38.6	30.8	35.8	46	37.2	41.3		14.2	13.3	15.6	15.5	15.7	15.8			
Romania	55.0	54.8	54.5	54.4	54.8	54.3	54.9	51.0	51.3	51.4	50.7	50.8	50.3	51.1	7.3	6.4	5.8	6.9	7.3	7.4	7.0	21.4	20.2	18.7	20.8	22.2	23.9	22.8	4.1	3.2	2.4	2.2	2.5	3.1	3.2			
Serbia	51.0	51.0	51.4	48.9	46.9	46.4	46.7	40.4	41.8	44.4	40.8	37.9	35.8	35.5	20.8	18.1	13.6	16.6	19.2	23.0	23.9	46.8	42.8	34.2	41.7	45.4	45.4	45.9	16.9	14.7	9.9	10.9	13.3	16.9	18.7			
EU	70.5	70.6	71.0	71.1	71.2	71.4	71.9	52.3	53.1	53.4	52.2	51.8	51.8	51.5	8.1	7.1	6.9	8.9	9.5	9.5	10.4	18.5	16.4	16.2	20.8	22.1	22.8	24.9	3.8	3.1	2.6	3.0	3.9	4.2	4.7			

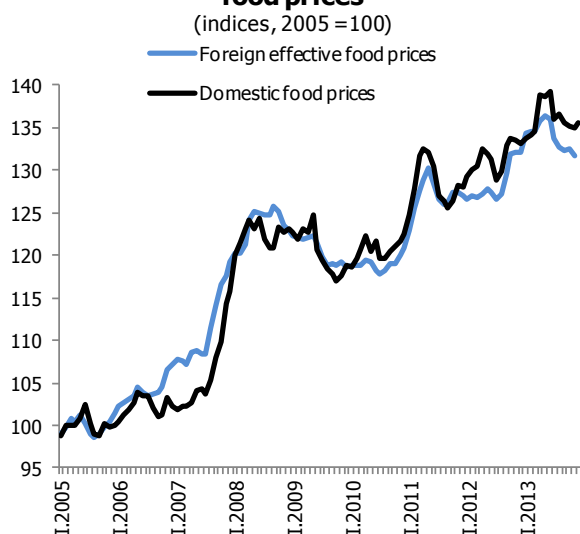
Source: ILO, World Bank, Eurostat.



1.5. Inflation

In the last quarter of 2013, the domestic consumer prices registered minimal increase of 0.1%, after the quarterly decrease of 0.7% in the previous quarter. The minimal increase in the consumer prices is driven mainly from the long-term inflation component, in conditions of downward pressure of world food and oil prices on the corresponding domestic price components. The annual inflation rate continues to slowdown substantially in the last quarter of 2013, reducing to the level of 1.3%, as a reflection of the higher comparison base of food and energy prices. The annual growth is still due to food and long-term inflation component, and the slowdown is largely due to the substantially slower increase in food prices. The long-term inflation component also decelerates on annual basis, although it still remains relatively high. The changes in this component are still explained by the influence of the one-time factors, as well as by certain transmission effects of the earlier rise in food and energy prices. Along with the slowdown in domestic inflation, intensive annual slowdown is registered also in the foreign effective inflation. The prices of the producers of industrial products are getting lower on a quarterly basis, and annually, these prices entered the negative zone of changes for the first times in three years. The unit labor cost is still moving downwards on a quarterly basis, and the annual growth rate decelerated.

Foreign effective food prices* and domestic food prices



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

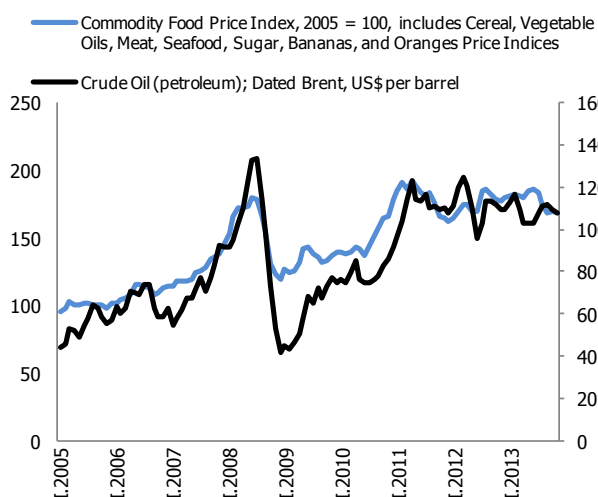
After the significant quarterly decrease of 0.7% in the previous quarter, the domestic consumer prices registered minimal quarterly increase of 0.1% in the last quarter of 2013. In conditions of downward pressures of the import food and oil prices on the domestic food and energy inflation, the minimal increase in the consumer prices arises mainly from the long-term inflation component. Namely, the long-term price component registered a quarterly increase of 0.8% in the last quarter of 2013. After the decrease that lasted for three consecutive quarters, the energy component in the last three-month period registered a minimal increase (0.1%). This increase is mainly due to the transmitted quarterly effect of the increase in electricity price⁴¹, in conditions of decrease in the domestic prices of oil derivatives in line with the reduced price of crude oil on the international stock exchange markets. On the other hand, the food price component of the domestic consumer prices is decreasing in the last quarter (0.6%), as well, given the simultaneously lower prices of raw and unprocessed foods⁴². The downward

⁴¹ On average, the electricity price is higher in the fourth than in the third quarter, because the Energy Regulatory Commission accepted the EVN appeal, according to which from mid-quarter, i.e. from August, the electricity price increases by 1.5%.

⁴² With the sub-components, the most evident contribution to the quarterly decrease in the prices accounts for the price of fresh fruits, which is common for this period of the year and the cooking oil price.

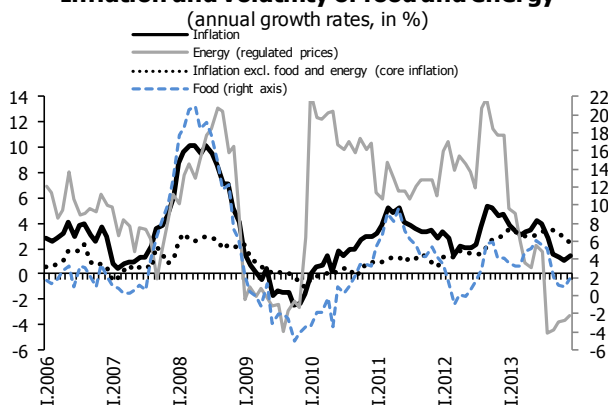


Crude oil and food prices



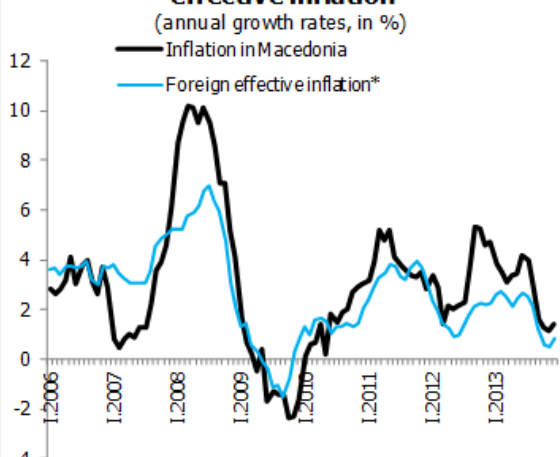
Source: IMF Primary Commodity Prices.

Inflation and volatility of food and energy



Source: State statistical office and NBRM calculations.

Domestic inflation and foreign effective inflation



*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.

adjustment of the domestic food prices corresponds to the fall in the prices of the internationally traded primary products in euro terms, as well as with the foreign effective food prices⁴³, which register quarterly decrease for the second consecutive quarter.

The seasonally adjusted data indicate same course of the movements, showing a minimal quarterly increase in the consumer prices of 0.1%. The minimal quarterly price growth after the extracting the seasonal effects, is conditioned by almost the same price sub-components of the consumer prices with the season included. In this manner, the stagnancy in the price movement by or without elimination of the seasonal effects, proves that neither the seasonal component, nor the trend component register larger movements.

The annual inflation rate continues to register substantial slowdown in the last quarter of 2013, reducing to the level of 1.3% (2.8% in the previous quarter). This inflation rate is the lowest registered rate since mid-2010. Thus the average inflation rate for 2013 reduced to 2.8% (3.3% in the first three quarters) and it is in line with the projected rate in October projection cycle. In conditions of quarterly stagnancy in the movements, the substantial slowdown in the annual inflation rate reflects the higher comparison base, which is related with the higher food and energy prices. Thus the slower annual inflation is due to the growth slowdown or the deeper decrease in all three main price components of the inflation. Namely, the deceleration is largely due to the substantially slower increase in food prices (decelerated growth in the prices of fresh meat and decrease in the prices of vegetable oils), followed by the slower rise in the longer-term component, as well as further decrease in the prices of energy components caused by all sub-categories. Along with the slower domestic inflation, the foreign effective inflation⁴⁴ also decelerated substantially, and it reduced to 0.6% (2% in the preceding

⁴³ The data on the foreign effective food prices refer to the first two months of the quarter.

⁴⁴ The calculation of the foreign effective inflation is derived from the weighted sum of the consumer price indices of the countries that are the most important exporters of the consumer goods in the Republic of Macedonia. The weight structure is based on the normalized shares of the nominal export of each country in the total nominal import in 2010-2012 period. In the calculation of this indicator, the following countries are included: Bulgaria, Germany, Greece, France, Italy, Austria, Slovenia, Croatia and Serbia.



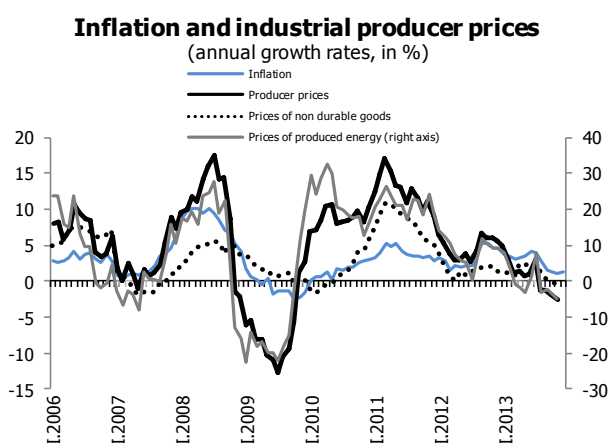
quarter), which is fully a reflection of the base effects.

Individual price categories

	(annual growth rates, in %)										(contributions to annual growth rates, in p.p.)									
	2012				2012	2013				2013	2012				2012	2013				2013
	Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4	
Consumer price index - all items	2.5	2.1	3.8	4.9	3.3	3.5	3.6	2.8	1.3	2.8	2.5	2.1	3.8	4.9	3.3	3.5	3.6	2.8	1.3	2.8
<i>Food</i>	1.4	0.2	3.4	4.7	2.4	3.3	5.4	4.2	1.3	3.6	0.6	0.1	1.3	1.9	1.0	1.3	2.1	1.6	0.5	1.4
Fresh food	0.7	-0.4	6.2	7.4	3.5	4.8	9.4	8.6	4.9	6.9	0.1	-0.1	1.1	1.3	0.6	0.9	1.7	1.5	0.9	1.3
Processed food	2.0	0.6	1.1	2.6	1.6	2.1	1.8	0.5	-1.8	0.6	0.4	0.1	0.2	0.6	0.3	0.4	0.4	0.1	-0.4	0.1
<i>Energy</i>	9.4	8.7	11.2	11.1	10.1	4.2	1.2	-2.5	-3.6	-0.2	1.4	1.2	1.6	1.6	1.5	0.6	0.2	-0.4	-0.6	0.0
Fuels and lubricants	7.9	10.5	8.0	5.1	7.9	0.2	-6.7	-2.2	-4.2	-3.2	0.4	0.5	0.4	0.2	0.4	0.0	-0.3	-0.1	-0.2	-0.2
Electrical power	11.5	7.7	14.9	18.4	13.1	9.9	9.9	-1.0	-3.1	3.9	0.8	0.5	1.0	1.3	0.9	0.7	0.7	-0.1	-0.2	0.3
Heating power	7.6	7.7	7.7	4.0	6.7	-2.8	-6.3	-6.5	-3.8	-4.9	0.2	0.2	0.2	0.1	0.2	-0.1	-0.2	-0.2	-0.1	-0.2
Food and energy (volatile prices)	3.5	2.4	5.5	6.5	4.5	3.6	4.2	2.3	-0.1	2.5	1.9	1.3	3.0	3.5	2.4	2.0	2.3	1.2	0.0	1.4
<i>Core inflation (inflation excl. food and energy)</i>	1.4	1.8	1.8	2.9	2.0	3.3	3.0	3.4	2.9	3.2	0.6	0.8	0.8	1.3	0.9	1.5	1.3	1.5	1.3	1.4

Source: State Statistical Office and NBRM calculations.

After the accelerated annual increase in the long-term inflation component in the third quarter, in the last quarter, its rise retarded. Thus the annual core inflation rate (excluding food and energy price components) decelerated and from 3.4% in the third quarter, it reduced to 2.9% in the previous quarter. The slower core inflation growth can be explained by the changes in the prices of clothing and footwear, the growth of which decelerated on annual basis and therefore contributed less to the core inflation. These developments suggest that the previous acceleration in the core inflation was partly caused by one-time factors, but their effect is gradually exhausting. Also, the growth slowdown was evidenced in the prices of personal care articles and the prices of education and development services. Despite this slowdown, the core inflation remains relatively high, indicating, besides the influence of the single effect, certain transmitted effects of the previous growth in food and energy prices on other prices in the economy.

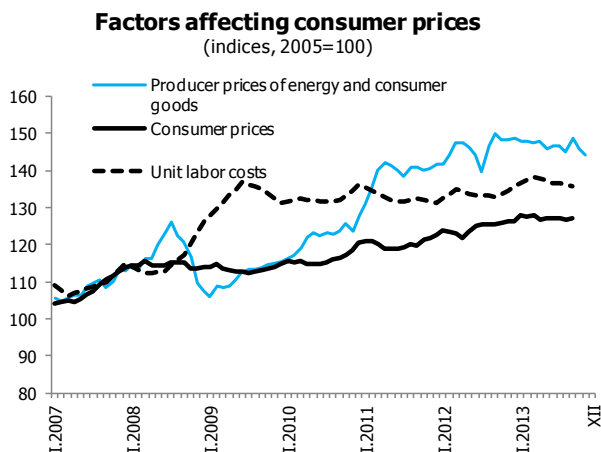


Source: State statistical office and NBRM calculations.

The prices of the producers of industrial products were falling in the last quarter of 2013⁴⁵, as well. The quarterly drop in production prices equaled 0.9% (increase of 0.4% on a seasonally adjusted basis), which is due to the lower production cost of refined oil derivatives, tobacco and food products, given the upward impact of higher production prices of clothing. On annual basis, the prices of the producers of industrial products, for the first time in three years, entered the negative zone of changes, registering a drop of 2.3%. The largest contribution to the annual fall accounted to the prices of the producers of oil derivatives, food products, and the production price of electricity. **The movements in the production prices that influence the domestic component of the inflation⁴⁶ indicate absence of inflationary**

⁴⁵ The data refer to the first two months of the analyzed period.

⁴⁶ Consumer goods (durable and non-durable) and energy.



Source: State statistical office and NBRM calculations.

pressures in the following period. Namely, given the unchanged prices on a quarterly basis (seasonally adjusted data), these prices show an annual decrease of 2.3% in the last quarter (minimal annual growth of 0.8% in the previous quarter).

The unit labour costs are getting lower in the third quarter of 2013 (quarterly decrease of 0.7%), contributing towards further deceleration in the annual growth, which reduced to 2.2%. Having in mind the endurance of the negative output gap⁴⁷, no inflationary pressures through this channel in the forthcoming period are expected.

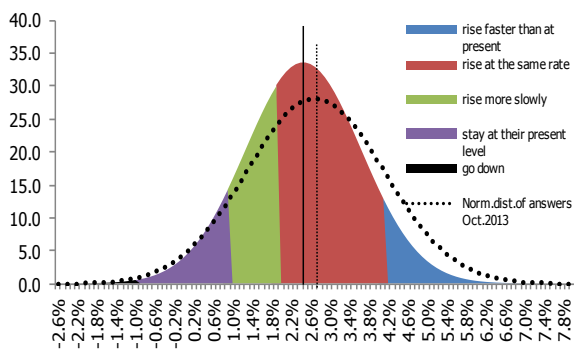
Box 5. Survey on Inflation Expectations

In order to improve the survey-based measuring of the inflation expectations, in 2013 the Monetary Policy and Research Department of the National Bank of the Republic of Macedonia took activities for a more detailed analysis of the experience of other central banks in conducting surveys. Accordingly, the current survey was redesigned, in order to bring it closer to the European practice.

The newly designed questionnaire contains two questions, one is qualitative and the other one, quantitative. The first question about the inflation expectations is designed in a qualitative way, i.e. the respondents do not give a quantitative response, but indicate the direction and the extent of price changes in comparison with the previous 12 months. The procedure for measuring qualitative responses is based on the Carlson and Parkin (1975) probability approach, which assumes that in case of a sufficiently large number of respondents, the expected price change is normally distributed within the population. The quantitative question requires from the respondent to determine accurately the expected average rate of price change in 2014 and 2015.

As previously, the Survey on Inflation Expectations covers three groups of respondents: economic analysts, companies and financial institutions. The qualitative question on the expectations states: Compared with the last twelve months, what are your expectations about the consumer prices in the next twelve months? a) they will increase more rapidly, b) they will increase at the current rate, c) they will increase at a slower rate d) they will stay about the current level e) they will fall f) difficult to determine", while the quantitative question is: What are your expectations/forecasts for the average inflation in 2014 and 2015?"

Chart 1. Normal distribution of answers of the respondents



Source: NBRM, Inflation Expectations Survey.

⁴⁷ The NBRM estimations show that the domestic output is still below the potential (negative production gap).

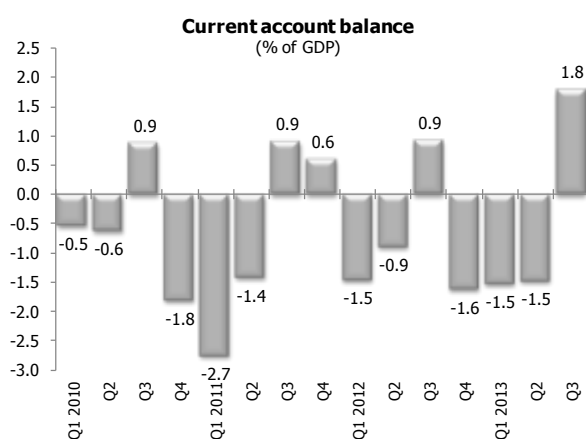


The Survey on Inflation Expectations was conducted in December 2013⁴⁸. The Survey on Inflation Expectations was conducted in December 2013. The results of the Survey show the largest concentration of the respondents' answers in the segment of expectations for unchanged inflation dynamics. Thus, 57.6% of the respondents expect price growth with the current pace in the following 12 months. In addition, 23.9% of the respondents expect inflation growth deceleration, 9.8% expect unchanged prices, while only 7.6% expect faster inflation growth in the following 12 months. In conditions of average inflation in the previous 12 months (of 3.1%), the expectations of the respondents indicate inflation deceleration of 0.6 percentage points, on average, in the following 12 months, **i.e. they expect average inflation of 2.5%**. From the aspect of the individual surveyed groups, the largest deceleration is expected by the surveyed **financial institutions** (expecting an inflation of 2.1%), followed by enterprises (of 2.2%), while the **economic analysts** expect inflation of 2.6%.

The respondents explain these expectations with the assumptions for stabilization of the world oil prices and the domestic food and energy prices, in an absence of significant demand pressures. The respondents expect average inflation rate in 2014 and 2015 of 2.5% and 3.3%, respectively. In comparison with the previous survey, these expectations are lower (3.3% and 3.4%, anticipated inflation in 2014 and 2015, respectively) and they reflect the expected downward trend of the world oil and consumer prices in the Euro area.

1.6. Balance of payments

In line with the usual seasonal dynamics, in the third quarter of 2013 the current account of the balance of payments recorded a surplus. The favorable seasonal dynamics with the current transfers, the improved performance in the foreign trade of goods and the historically highest quarterly surplus in services are the key movers of the quarterly improvement in the current account. The realized current account surplus in the third quarter is higher than the surplus generated in the same quarter of the previous year. These favorable developments in the current transactions are mainly due to lower trade deficit, the higher net inflows in services and the current transfers. Unlike the surplus on the current account, the capital and financial account registered high net outflows, mainly due to repayments of liabilities based on accumulated trade credits and outflows in the "currency and deposits" category. Despite the net capital outflows, the current account surplus was large enough to enable additional increase in foreign reserves in the third quarter.



Source: NBRM.

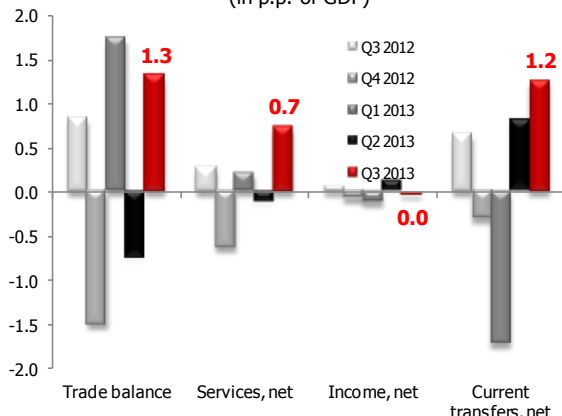
1.6.1. Current account

In the third quarter of 2013, the balance of payments' current account registered a surplus of Euro 133.5 million, or 1.8% of GDP (compared to the deficit of 1.5% of GDP in the second quarter). The quarterly improvement on the current account (by 3.1 p.p. of GDP) is common seasonal dynamics for this period of the year, but much more intensive than in previous years. The reduced

⁴⁸ The percentage of responsiveness of the Survey, conducted in December, equaled 49.2%. By groups of respondents, the financial institutions' responsiveness is 77.8%, followed by the economic analysts with 71.2% and enterprises with 30.1%.

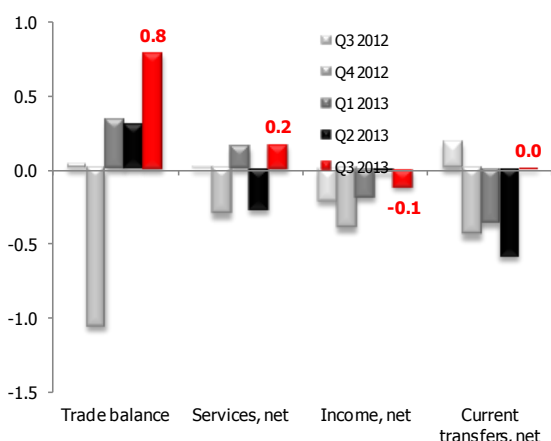


Contribution of current account components in its quarterly change
(in p.p. of GDP)

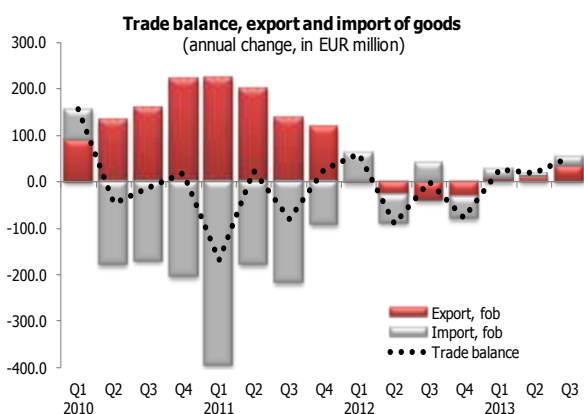


Source: NBRM.

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



Source: NBRM.



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

trade deficit, higher current transfers, as well as the increased surplus in services are the key factors for the positive quarterly change. With the trade balance, the decrease in the deficit (by 1.3 p.p. of GDP) is due to positive developments in both components of the foreign trade of goods, given a small quarterly increase in export of goods, in conditions of quarterly decrease in the import of goods⁴⁹. The quarterly increase in the *current transfers* (of 1.2 p.p. of GDP) mainly stems from higher private transfers in cash, i.e. increase in net inflows of foreign assets purchased on the currency exchange market, in conditions of higher supply of foreign exchange, given almost unchanged demand for foreign currency. The surplus with *services*, which, historically, is the highest quarterly amount since 2003, compared to the previous quarter, went up by 0.7 percentage points, which was higher than the adjustment common for this period. The analysis of individual components of services shows that the change arises from the increased surplus in travelling, then realized surplus in transport services and reduced deficit in other services, specifically improved performances in other business services. On the other hand, the income deficit remained almost unchanged on a quarterly basis.

Favorable developments in the current account are registered on annual basis, as well, i.e. the realized surplus in the third quarter increased by 1.9 times, or 0.8 p.p. of GDP. The biggest driving force of the positive annual change is the trade deficit narrowing (by 0.7 p.p. of the GDP), given the reduction in the energy and non-energy deficit. A significant part for the improved current account was contributed by the movements *with services*, where the surplus registered an increase of 0.2 p.p. of GDP, which mainly stems from the surplus with the transport services (in contrast to the small deficit in the third quarter of 2012), which corresponds to the better realization in the foreign trade. On annual basis, *the current transfers* registered slight increase of 2.1%, or by 0.01 p.p. of GDP. On the other hand, the higher deficit in income by 0.1 p.p. of GDP, due to the higher net outflows based on direct investments income and the reduced net inflow based on compensations for employees, contributed towards deepened current account deficit. **According to the latest available data, the balance of payments' current account, after three-month positive balance, in October 2013 registered a deficit in the amount of Euro 19 million.** On annual basis, the current account deficit reduced by

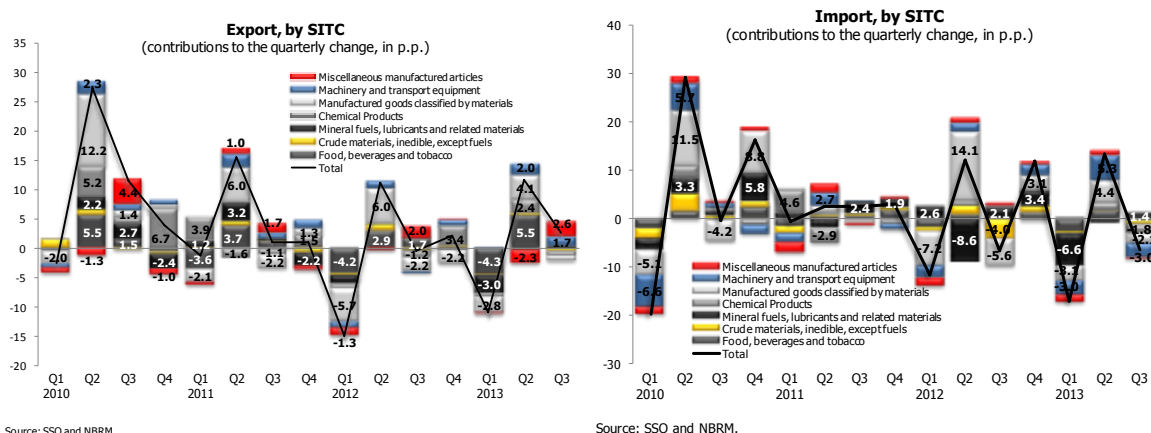
⁴⁹ For more details, please see the part concerning the foreign trade.



about 57%, which arises from the smaller deficit with goods and services, in conditions of reduced net inflows with the current transfers and slightly higher deficit with the income.

Box 6. Foreign trade of goods and movement of the nominal and real effective exchange rate (NEER and REER)

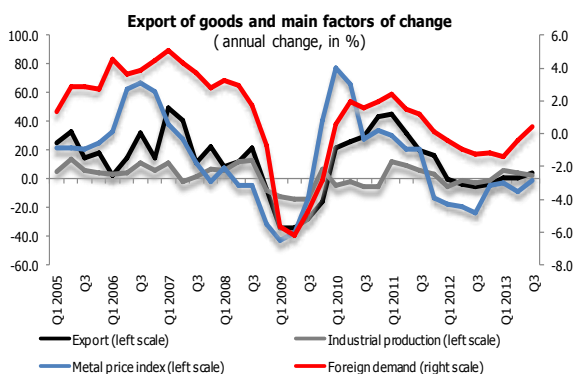
In the third quarter of the year, the foreign trade of goods recorded a quarterly decrease. This fall stems entirely from the decrease in import (6.4%), given the intensified export of goods (2.6%). The divergent movements of the two components of foreign trade caused quarterly **narrowing of the trade deficit by 21.3%**, an effect of substantial quarterly reduction of the non-energy deficit. Namely, after the strong growth in the investment imports in the previous quarter, in the third quarter, the deficit in the trade in investment goods recorded a significant reduction, caused by the simultaneously lower imports of machinery and equipment and the higher exports in this product category. The narrowing of the non-energy deficit was contributed also by the smaller negative balance within industrial raw materials, caused by reduced import of raw materials by the textile industry, following the strong growth in the previous quarter. The smaller export value of the metal manufacturing sector caused by further fall in stock exchange prices of nickel (given simultaneous quantitative growth) on a quarterly basis, reduced the trade surplus in iron and steel within the industrial balance. In the third quarter, smaller deficit in the private consumption goods was registered, given the significant quarterly growth in the export of clothing. The deficit in **energy** registered moderate increase, which in conditions of stagnation of the export component, was fully caused by higher import of oil and oil derivatives. The import structure of this category continued to change through total replacement of the import of crude with oil derivatives. The growth is due to higher import quantities, with minor price changes. The trade in other fuels did not register significant changes compared to the previous quarter.



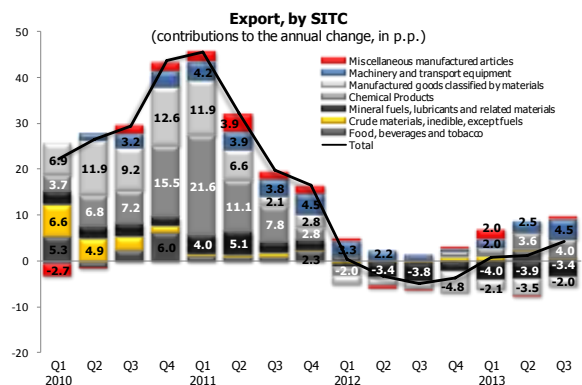
The annual analysis indicates slight increase in the foreign trade, which is solely due to stronger growth in the export component, having in mind the moderate decrease in imports. In conditions of slight recovery of foreign demand and present positive effects of the new capacities in the economy, **the exports continued to recover with faster pace, registering annual growth rate of 4.2%**, the highest in the past seven quarters. The export diversification continued to strengthen the resilience of the export activity, amid a steady fall in metal prices and reduced export market of oil derivatives. The total export of the new capacities in the economy supported the export growth considerably in the third quarter, particularly the investment export categories and the export of chemical materials and products. The positive impulses of the structural changes in the economy on the exports were mainly neutralized by the annual reduction in the export of iron and steel and energy. The unfavorable price changes in metals as a factor for the annual fall, were complemented by the smaller exported quantities. On the other hand, the changes in energy export is due, to a greater extent, to changes in the production process of the domestic refinery, the lower production of which, as expected, resulted in reduced quantity of exported oil derivatives. Regarding other energy, a



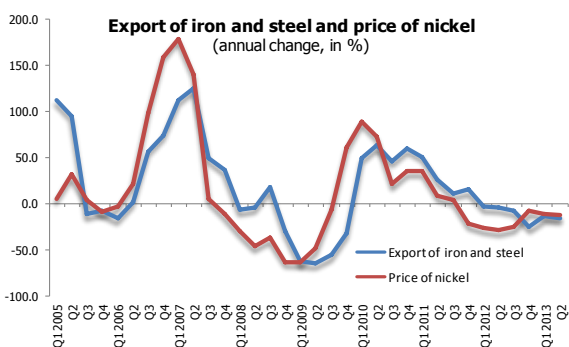
significant change is registered with the export of electricity, where the annual fall is due to the high comparison base in the third quarter of 2012, when the historically highest export of electricity was registered. The analysis of the changes in the export structure indicates further increase in the share of the new export products of the automotive industry in the total exports and increasingly larger share of the products with higher processing level and higher value added.



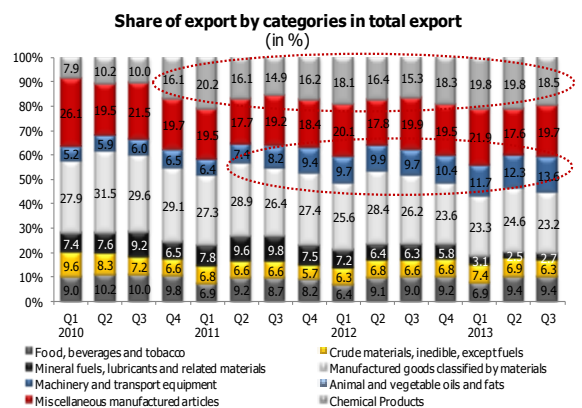
Source: SSO and NBRM.



Source: SSO and NBRM.

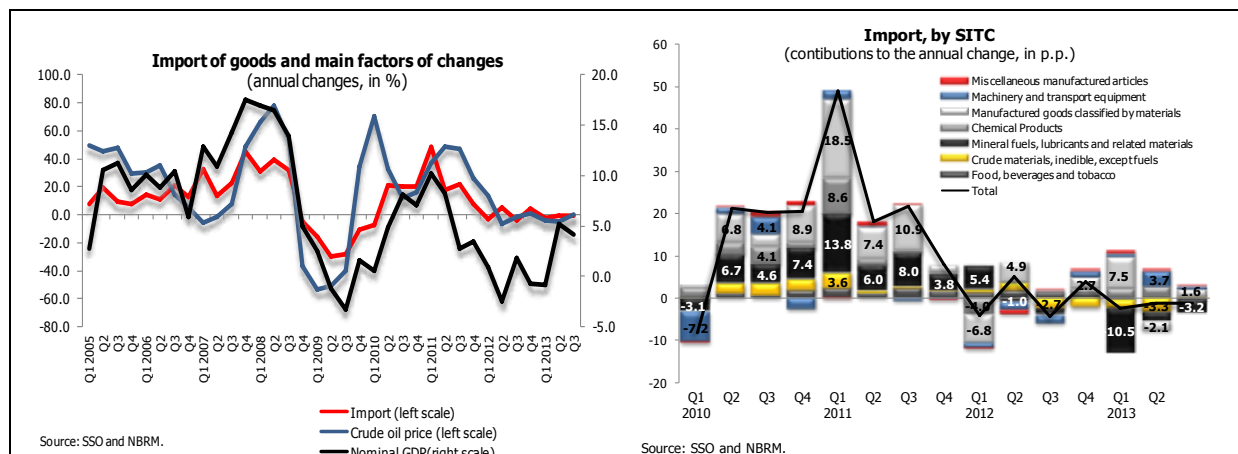


Source: SSO and NBRM.



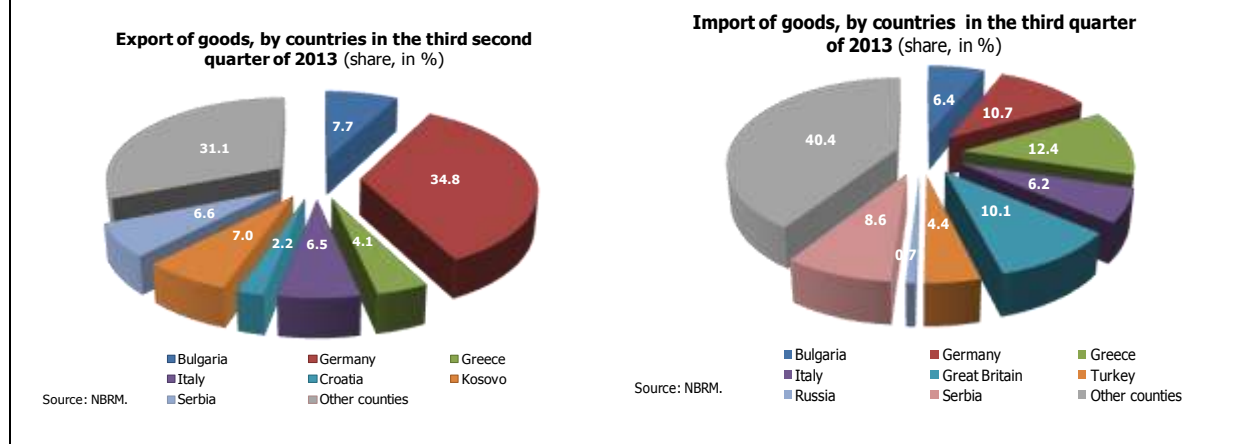
Source: SSO and NBRM.

The import is falling in the third quarter, as well, retaining the rate of annual decrease of 1.2%, as in the previous quarter. The further reduction in imports is due entirely to the reduced import of energy, in conditions of annual growth in imports of industrial raw materials. The investment imports and the imports for private consumption did not register significant changes on annual basis. The analysis of the individual import categories indicates smaller import demand for energy, as a combined effect of price and quantity. The reduced export of derivatives, coupled with lower domestic demand caused a decrease in the imported crude oil and oil derivatives despite the increase in the price of crude oil on the world markets. The favorable price movements in electricity contributed to the smaller import despite the higher import volumes compared to the third quarter of the previous year. The import of iron and steel continued to reduce, which corresponds to the constant fall in the export activity of the metal manufacturing industry and the registered annual fall in metal production. On the other hand, the import of non-ferrous metals, an important raw material component in the manufacturing process of a large export capacity in the economy, and imports of raw materials for the textile industry increased on an annual basis. **The reduced import demand and stronger export growth caused further narrowing of the trade deficit on an annual basis by 11%.** The reviews by balances indicate a significant improvement in investment balance due to the new export industries in the economy, coupled with the positive changes in energy balance and goods for personal consumption. Only trade deficit in manufactured goods and raw materials registered slight annual expansion, influenced by higher imports of platinum and textile yarns.



The latest data on the foreign trade indicate continuing trend of favorable movements in **October and November**, as well. The deficit in foreign trade of goods continues to narrow more intensively on annual basis, registering an annual fall of 15.4%. The favorable changes are caused by export growth, given the simultaneous annual decrease in the annual import component. The higher annual export (3.8%) is due, once again, to higher investments export, as well as the export of industrial products, caused by the export of chemical materials and products and the export of iron and steel. The intensified decrease in the imports (4%) in the October- November period is still caused by reduced energy import, coupled with a slight annual decline in private consumption goods, i.e. reduced import of food.

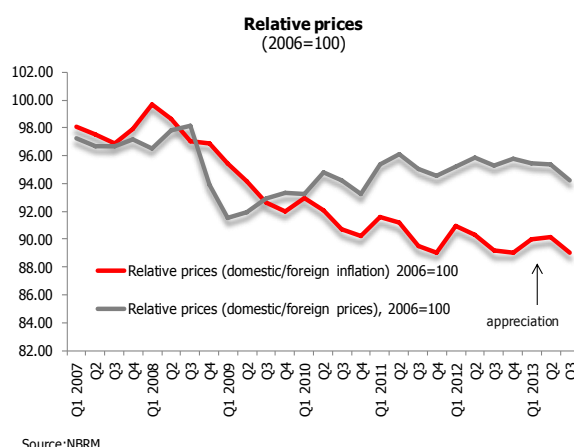
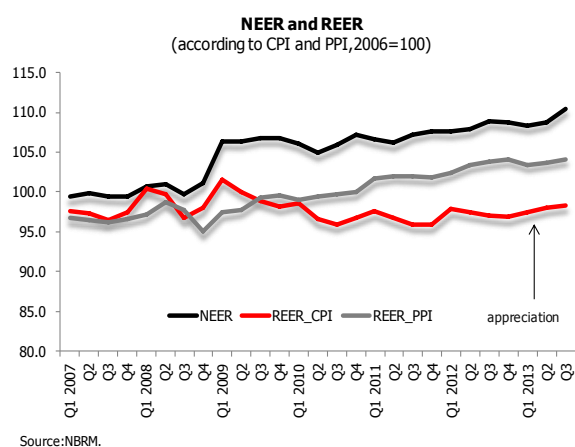
The analysis of foreign trade by trading partners indicates further increase in the share of EU countries in the total foreign trade (of 67.4%). The growth trend in the share of trade with the EU is mainly due to the intensified export to Germany, as well with larger export to Bulgaria and Romania, which together with the reduced energy import from Greece, are the most significant factors for the evident decrease in the foreign trade deficit with the EU member states. The continuous reduction of the import of crude oil from Russia in this quarter, as well, led to a narrowing of the deficit in the trade of goods and further diminishing of the significance of this trading partner. The surplus in the trade with the Western Balkan countries continued to narrow on annual basis, which is a result of the prolonged decrease in the export to Kosovo⁵⁰ as a structural factor of the change and higher import from Serbia (which simultaneously caused widening of the trade deficit with this country). In addition, the reduced export activity of the metal manufacturing industry on the Asian markets, after good export performances in the third quarter of the preceding year (especially in China and South Korea), contributed towards widening of the trade deficit in the trade with this group of countries.



⁵⁰ The reduced export to Kosovo is due to the reduced export of oil derivatives that the domestic refinery is exporting to this market.



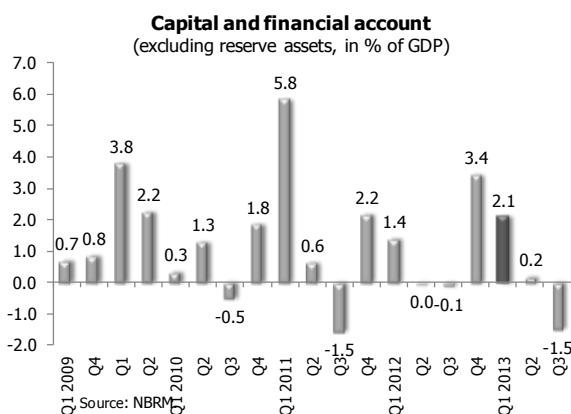
The indicators for the price competitiveness of the domestic economy in the third quarter did not indicate major changes in the price competitiveness of Macedonian products on foreign markets compared to the previous quarter. Compared to the previous quarter, both price indices registered appreciation, i.e. REER index calculated by the consumer prices appreciated by 0.3%, while REER deflated by the prices of the producers of industrial products appreciated by 0.4%. Thus the appreciation in both indices is due to the appreciation of the nominal effective exchange rate, and its increase of 1.5%, compared to the previous quarter, is due to the evident quarterly depreciation of the Russian ruble and Turkish lira relative to the Denar. The changes in relative prices acted in the opposite direction, i.e. the relative prices fell (domestic prices relative to the foreign ones) by 1.2% in both price indices. The latest data on the indicators of price competitiveness for October and November period show further appreciation of REER calculated by the consumer prices (0.2%), due to the appreciation of NEER (0.5%) compared to third quarter of the year, given the moderate decline in relative prices. On the other hand, REER deflated by the prices of the producers of industrial products did not register any change in the third quarter, i.e. the larger decrease in the domestic relative to the foreign prices, neutralizes the appreciation of the NEER.



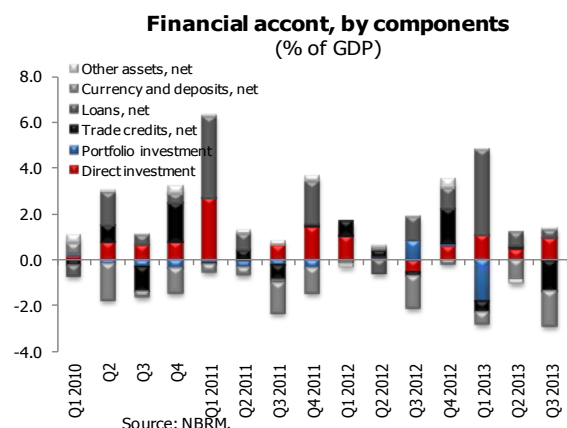
Source: NBRM.

Source: NBRM.

1.6.2. Capital and financial account



Source: NBRM.



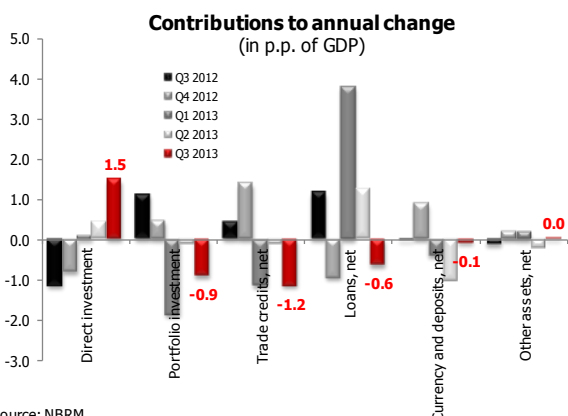
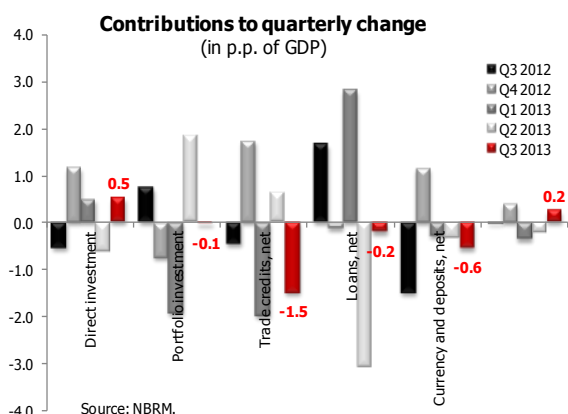
Source: NBRM.

In the third quarter of 2013, net outflows on the balance of payment's capital and financial account in the amount of Euro 111.8 million, or 1.5% of GDP were registered (compared to the net inflows of 0.2% of GDP in the previous quarter). This change is common for this period and it follows after three quarters of constant net inflows. Analyzed by the financial account's components, the sources of the net outflows are segments where such changes are typical for this period. Namely, in this period, higher net outflows based on trade loans accumulated in the previous period, are registered. Also, high net outflows were registered with the "currency and deposits" category. However, in comparison with the previous quarter when the households were the main driving force of the outflows in the "currency and deposits" category, in this quarter, the banks have such a contribution, as well. Namely, after the fall in the foreign currency deposits with the foreign banks in the second quarter (caused mainly by the larger need of foreign assets for



payment of dividend to companies in foreign ownership), the banks in this quarter complemented part of the withdrawn deposits. With the households, the trend of foreign assets withdrawal from the banking system continues, although the withdrawal was smaller in comparison with the preceding quarter⁵¹.

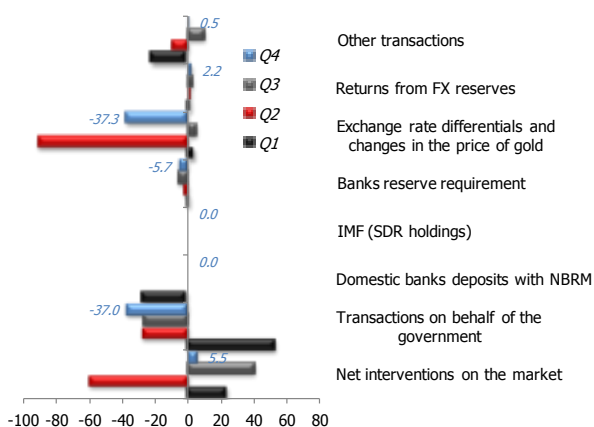
In the third quarter, the net inflows were created through direct investments and net borrowing abroad. Within the direct investments, the debt flows (higher liabilities toward the direct investors, given decrease in the claims) and the non-debt flows (the reinvested earnings and the equity) have contributed to the quarterly inflows almost equally. In the third quarter, the foreign direct investments are twice as high on a quarterly basis due to the reinvested earnings, in absence of payment of larger amount of dividend. In the third quarter, the inflows based on financial borrowings are mainly a result of the long-term borrowing of the non-banking sector. On a quarterly basis the net loans are two times lower, as a result of the repayments with the short-term loans. On the other hand, the net debt based on long-term loans, registers an increase.



The annual analysis of the movements on the capital and financial account indicates significantly higher net outflows by 1.4 p.p. of GDP. However, the most significant contribution in this regard accounts for the net outflows based on trade credits, as well as the lower net borrowing in the third quarter of 2012. Also, the lower portfolio investments, mainly as a result of the high comparison base, are important factor of change in this direction⁵². On the other hand, the net inflows were generated on the basis of the direct investments that mainly reflected the developments in the intercompany debt, which increased by 1,5 times on annual basis.

According to the latest data on the balance of payments, in October 2013, net inflows in the amount of Euro 8.8 million in the capital and financial account were registered. The realized capital net inflows mainly refer to the ones originating from direct investments and trade credits. On the other hand, currencies and deposits, loans and portfolio investments registered net outflows. On annual basis, the net inflow fell by about 84%, as a result of the

Factors of influence on the change of the level of gross reserves in 2013, quarterly
(in EUR million)



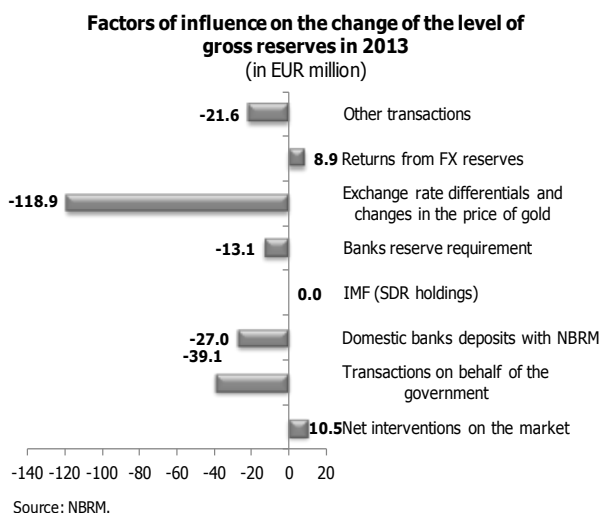
⁵¹ Such developments partially impact the currency exchange market, where further increase in the inflows is registered.

⁵² The high comparison base is a result of the change in the trade in both government Euro bonds. Namely, in the third quarter of 2012, the domestic entities sold part of these government securities, which were in their ownership, which resulted in higher inflows in the balance of payments.



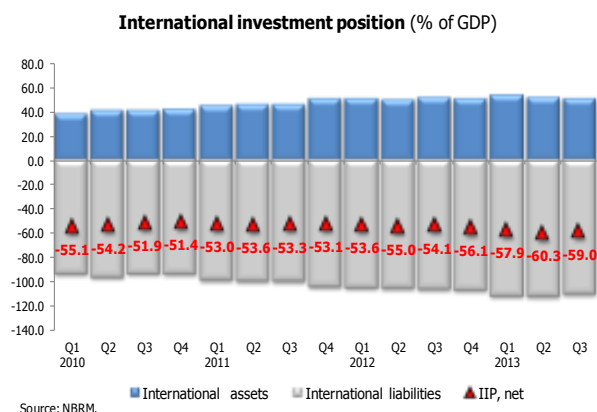
reduced net inflows based on trade loans and realized net payments of loans, contrary to the disbursements in October 2012.

At the end of the third quarter, the gross foreign reserves equal Euro 2,064.8 million, which is a quarterly increase of Euro 25.6 million. The main factors of change are the net purchase on the foreign exchange market by the NBRM, other transactions, as well as the positive price changes and the currency differentials. The transactions on behalf of the Government, on the basis of which there was an outflow of foreign reserves, acted in opposite direction. According to the latest data, at the end of 2013, the gross foreign reserves equal Euro 1,993 million, which is a decrease of Euro 71.8 million compared to September 30, 2013. Most of the quarterly fall in the foreign reserves is a result of the negative price changes and currency differentials and of the outflows due to the transactions on behalf of the Government.

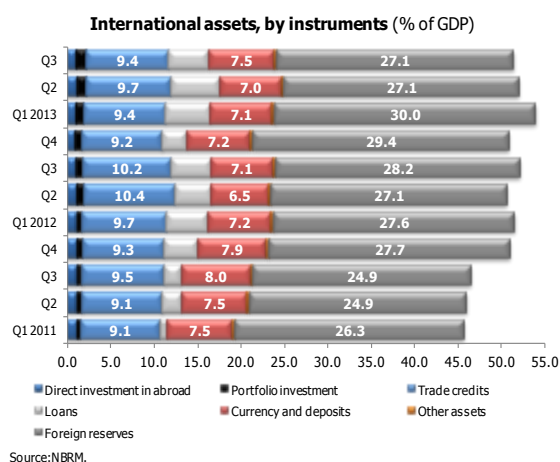


1.6.3. International investment position⁵³ and gross external debt

In the third quarter of 2013, **the negative investment position of the Republic of Macedonia** to the rest of the world narrowed and **on September 30, 2013 it equaled Euro 4,491.3 million, or 59% of GDP⁵⁴**. In comparison with the previous quarter, the net foreign liabilities fell by Euro 50.9 million, or analyzed by the share of GDP⁵⁵, the net liabilities are lower by 1.3 p.p..



The decrease in the negative investment position of the country is due to the **decrease in**



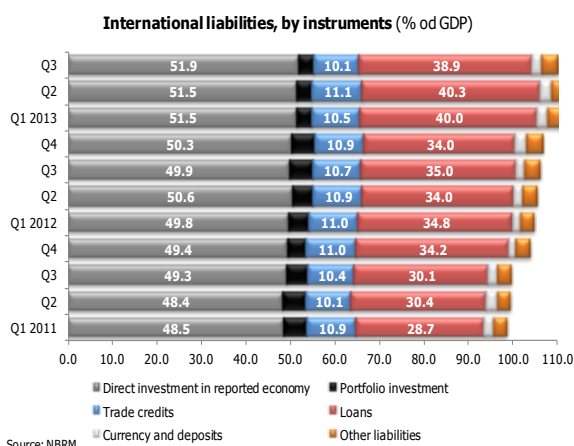
⁵³ In September 2012, the NBRM started disclosing data on the international investment position (IIP) of the Republic of Macedonia, by quarter. IIP data are available at the NBRM website: (www.nbrm.mk/statistika/eksterni_statistiki).

⁵⁴ In the second quarter of 2011, the NBRM started concluding repo and reverse repo transactions. These transactions are investment possibility for using the securities portfolio for generating additional revenues. The conclusion of repo transactions produces liabilities. Simultaneously, the conclusion of reverse repo transactions creates claims that contribute to the increase in gross claims. The NBRM simultaneously conducts matched conclusion of repo and reverse repo agreements, in almost identical amount. Overall, since they are concluded concurrently, these transactions have neutral net-effect, i.e. they appear in almost identical amount on the side of both liabilities and claims, thus having no effect on the total net IIP and the net external debt. The transactions for borrowing securities additionally widened in 2012 and encompassed swap transactions with gold as collateral.

⁵⁵ The calculation uses annualized GDP, which is sum of the registered nominal GDP in the last four quarters.

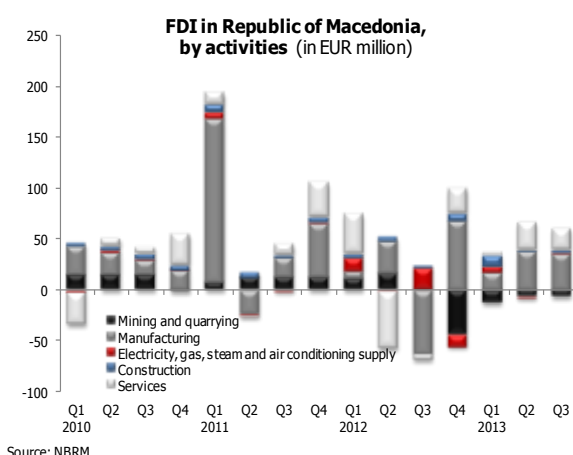


the **international liabilities** of 0.8%, given simultaneous **decrease in the international assets, as well**, of 0.4%. Most of the **quarterly decrease in the assets** arises from the reduced monetary authority's claims based on the short-term loans (repo transactions), as well as on the decrease in the claims based on trade credits. On the other hand, in the third quarter, the banks' claims based on currencies and deposits and the gross foreign reserves, increased. **The quarterly decrease in the liabilities** is mostly due to the lower liabilities based on debt instruments, i.e. loans and trade credits. The change with the loans is a result of the decrease in the loans in form of short-term loans of the monetary authority (repo transactions) and the banks. Only the liabilities to foreign direct investors registered more significant rise relative to the previous quarter.



Analyzed by sectors, the quarterly decrease in the negative net liabilities in the international investment position is due to the banks, Government and the monetary authority, as a result of the decrease in the liabilities, while the "banks" sector simultaneously registers an assets growth. On the other hand, in the other sectors an increase in the net liabilities⁵⁶ to the rest of the world was registered.

	Q3 2012	Q2 2013	Q3 2013	quarterly change			annual change		
				in EUR million	difference	contribution	in %	difference	contribution
IIP, net	-4,038.3	-4,542.2	-4,491.3	50.9	-1.1	-1.1	-453.0	11.2	11.2
Government, net	-1,553.5	-1,637.0	-1,586.4	50.6	-1.1	-3.1	-32.9	0.8	2.1
Monetary authorities, net	2,027.3	1,975.2	1,991.5	16.3	-0.4	0.8	-35.8	0.9	-1.8
Banks, net	-500.6	-610.0	-533.4	76.6	-1.7	-12.6	-32.8	0.8	6.6
Other sectors, net	-4,011.5	-4,270.5	-4,363.1	-92.5	2.0	2.2	-351.5	8.7	8.8

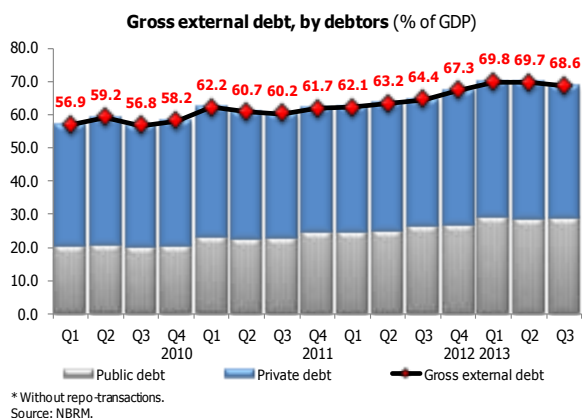


The annual increase in the net liabilities in the third quarter resulted in further widening of the net debt position of the country on annual basis. The increase in the international liabilities was far more evident in comparison with the international assets growth (of 5.8% and 0.2%, respectively), causing **increase in the net IIP of Euro 453 million, or 5 p.p. of GDP in comparison with the third quarter of the previous year.**

⁵⁶ In January 2013, by Government decision, the Agency for state Roads has been restructured into the Public Enterprise for State Roads. By this restructuring, the public enterprise have taken over part of the credit liabilities of the Government, which caused a decrease in the liabilities of the "Government" sector of Euro 47 million in the third quarter, and simultaneous increase in the liabilities with other sectors based on long-term loans by an equal amount. The cumulative effect of this restructuring for the first three quarters of 2013 totals Euro 82 million.

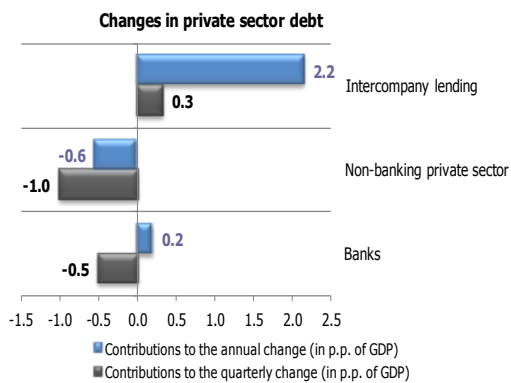


The annual growth of the international assets is mostly due to the higher deposits of the banking sector abroad and to the increased claims based on non-debt portfolio investments of the non-banking private sector. On the other hand, the claims based on trade credits fell, as well the gross foreign reserves, which registered slight decrease. **Regarding the international liabilities**, all individual categories, except the portfolio investments contributed to the annual growth, with the largest contribution being given by the direct investments in the country. In addition, the increase in the international liabilities is mainly due to the larger liabilities of the "Government" sector based on borrowings and the non-bank private sector. *The annual sector analysis indicates that the widening of the negative gap of IIP of the Republic of Macedonia is due to the higher net liabilities in all institutional sectors, especially in "other sectors".*



At the end of the third quarter, the gross external debt amounted to Euro 5,504.5 million or 72.2% of GDP. If the repo transactions of the monetary authority are excluded, the gross external debt amounts to Euro 5,221.2 million or 68.6% of GDP⁵⁷.

The quarterly analysis shows a decline in the gross external debt of the country by Euro 29.8 million, due to the lower external borrowing by the private sector. The quarterly change in the private debt is due to the payments of trade credits, and the lower banks' liabilities based on currency and deposits and short-term financial loans. On the other hand, the slight increase in the public debt is a result of higher long-term borrowing by public enterprises.



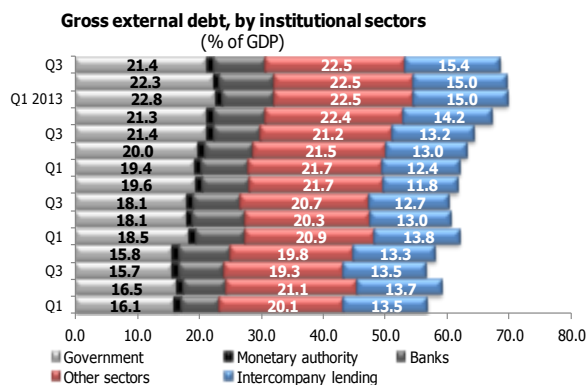
Gross external debt has increased on an annual basis. Compared with the third quarter of the last year, the debt rose by Euro 407 million, or 4.2 percentage points of GDP. The annual change was affected by the concurrent rise of both the public and the private external debt. Factors of the annual change in the public debt are the intensified external government borrowing in the form of long-term loans, and the increased liabilities of public enterprises and public banks based on long-term loans abroad, while the most significant driver of growth of the private debt on an annual basis are the higher liabilities to

⁵⁷ The entire further analysis refers to the gross external debt excluding the liabilities of the monetary authority based on repo transactions.



direct investors and the higher liabilities of the banks in the form of currency and deposits.

The analysis of the dynamics of external indebtedness indicates deterioration in all indicators of solvency on an annual basis, with the exception of the indicator for the share of interest repayment in the exports of goods and services, which has registered an annual improvement of 0.7%. Deterioration in other indicators (ratios of gross debt to exports of goods and services, gross debt to GDP and debt repayment to export of goods and services) has averaged 3.7%, implying a certain slowdown in the deterioration. Despite the deterioration in certain indicators, the Republic of Macedonia remains in the group of low indebted countries according to the indebtedness criteria established by the World Bank. Only because of the indicator for the share of the external debt in GDP the economy continues to be categorized in the group of highly indebted countries. Liquidity indicators point to a favorable external position, with almost complete coverage of short-term debt liabilities with residual maturity with foreign reserve assets. On an annual basis this indicator did not change.



* Without repo-transactions.
Source: NBRM.

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	2.24	120.1	49.3	11.5	1.14	0.89	30.3
31.12.2005	2.33	128.5	56.3	9.66	1.67	1.04	26.7
31.12.2006	2.88	109.8	51.8	18.2	1.95	1.34	29.0
31.12.2007	2.38	102.3	53.2	16.6	1.35	1.08	39.8
31.12.2008	2.30	101.1	55.3	8.8	1.29	0.95	35.2
31.12.2009	2.10	113.3	58.5	10.2	1.29	0.94	32.9
31.12.2010	2.78	121.1	60.1	11.9	1.31	0.90	32.0
31.03.2011	2.70	124.7	63.3	14.5	1.46	1.05	29.1
30.06.2011	2.70	124.3	63.1	14.5	1.40	1.00	29.3
30.09.2011	2.70	124.1	63.0	14.5	1.42	0.99	29.1
31.12.2011	2.70	128.4	65.2	14.5	1.53	1.06	29.4
31.03.2012	2.53	114.3	63.4	11.3	1.49	0.94	29.9
30.06.2012	2.53	115.6	64.2	11.3	1.40	0.92	30.6
30.09.2012	2.53	118.3	65.7	11.3	1.49	0.96	29.4
31.12.2012	2.53	123.2	68.4	11.3	1.39	0.93	31.4
31.03.2013	1.79	119.8	69.6	16.3	1.35	1.02	31.8
30.06.2013	1.79	121.3	70.1	16.3	1.19	0.89	32.6
30.09.2013	1.79	120.6	69.5	16.3	1.30	0.95	30.4
<i>Moderate indebtedness criterion</i>	<i>12 - 20%</i>	<i>165 - 275%</i>	<i>30 - 50%</i>	<i>18 - 30%</i>	<i>1.00</i>		

*The moderate indebtedness criterion is according to the World bank's methodology of calculating indebtedness indicators, which implies 3-year moving averages of GDP and exports of goods and services in the calculation of the indicators. Data for 2013 are according to BoP projection October 2013.
*According to the "Greenspan-Guidotti rule", a country should maintain full coverage of short-term debt at remaining maturity with gross foreign reserves.
*According to the "Greenspan-Guidotti rule", a country should maintain full coverage of short-term debt at remaining maturity with gross foreign reserves.

Source: NBRM.

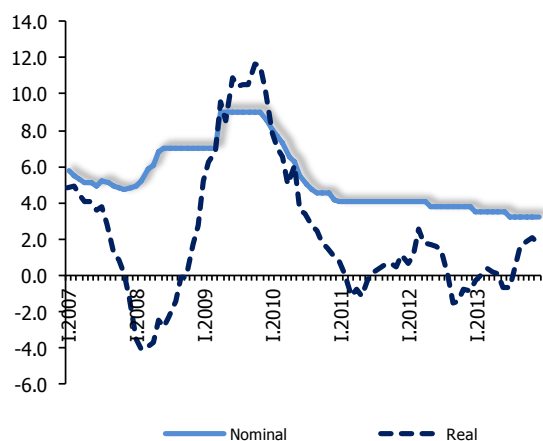
II. Monetary Policy

During the last quarter of 2013, NBRM maintained its key interest rate unchanged at 3.25%. Observed from a monetary point of view, relatively favorable macroeconomic developments were registered in the domestic economy in this period. October projections pointed to a rather favorable environment for the monetary policy in the next period, with estimates for



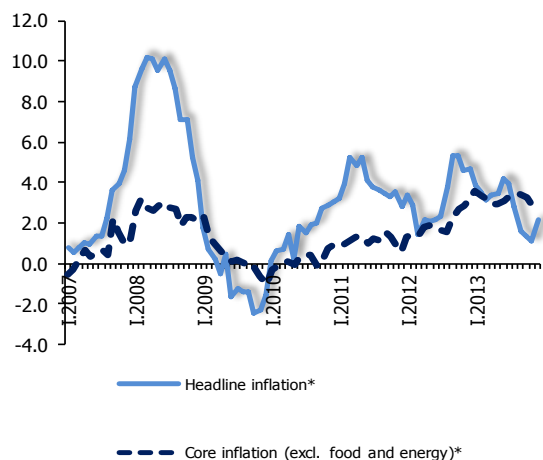
accumulation of foreign reserves and absence of inflationary pressures. Short-term movements during the quarter also were basically favorable and in line with the expectations. Thus, the rise in the general level of prices continued to slow down, amid stabilization of the core inflation. In line with the expectations, foreign reserves decreased in the last quarter, but the indicators of foreign reserves adequacy remained in the safe zone, indicating sufficient capacity to deal with possible unforeseen shocks. The data for the third quarter indicated further continuity of growth of the domestic economic activity, in circumstances of still moderate credit support by the banking sector. However, given the assessments for slow recovery of the economic activity in the Euro area and the still uncertain pace of economic recovery in the USA, external environment remains uncertain, pointing to the still present risks. In such circumstances, and taking into account the previous measures taken by the NBRM which are expected to generate effects in the next period, the NBRM decided to keep the key interest rate unchanged during the last quarter. The NBRM will continue to closely monitor the situation also in the following period, in order to ensure timely and adequate adjustment of the monetary policy.

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



Source: NBRM.

Inflation (in %)



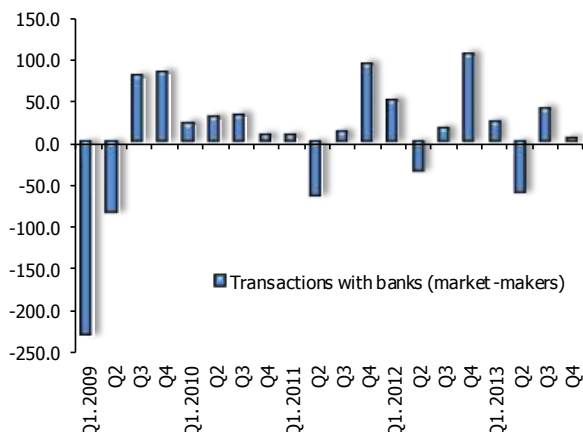
*Current month/same month of the previous year.
Source: SSO

Based on the regular assessment of recent macroeconomic and financial developments, at the sessions of the Operational Monetary Policy Committee of the NBRM held during the last quarter⁵⁸, the interest rate on CB bills was maintained at the level of 3.25%. October projections of the NBRM did not indicate any significant change with respect to the findings about the setting and the risks, compared with previous assessments. During this projection cycle, again, a possibility of accumulation of foreign reserves in the next period, and absence of inflationary pressures were envisaged. Short-term economic movements during the quarter, basically did not deviate much from the expectations. Thus, the growth of domestic prices slowed in the last quarter, whereby the annual inflation rate averaged 1.3%. Such an outturn points to movements in inflation that are slightly more favorable than expected. In the same period there were signs of slowing of core inflation on an annual basis, which in the last quarter averaged 2.9%. During the quarter, foreign reserves declined mostly as a result of the calculated negative price and exchange rate differentials and transactions with the government. NBRM made net purchase of foreign currency on the foreign exchange market in the amount of Euro 5.5 million. In terms of the indicators of foreign reserves adequacy, they remained in the safe zone.

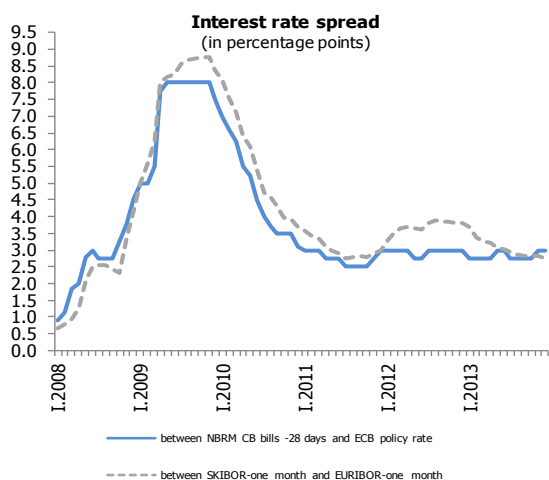
⁵⁸ During the quarter, the Operational Monetary Policy Committee of the NBRM held three sessions (on 9.10.2013, 13.11.2013 and 11.12.2013) focused on the monetary policy setup.



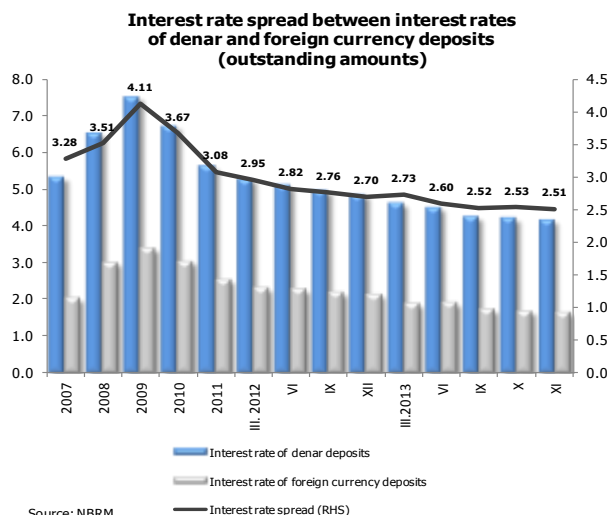
Interventions on the foreign exchange market by NBRM (in EUR million)



Source: NBRM



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



Source: NBRM

Economic activity continued to intensify also during the third quarter, with the construction sector remaining to be the main driver of growth. In the fourth quarter, the movement of the credit market activity accelerated, amid registered growth of the credit support also to the corporate sector. However, the credit projection for the next period is still accompanied by risks associated with banks' perceptions, as well as with the conservative strategies of large banking groups that are present in the domestic market with their subsidiaries. The latest information from the international environment indicated further uncertainty about the global setting, mainly associated with the assessments for slow recovery of the economic activity in the Euro area and the still uncertain pace of economic recovery in the USA. In such circumstances, and amid measures towards monetary policy easing, already taken by the NBRM, which are expected to generate results in the forthcoming period, the policy rate remained unchanged.

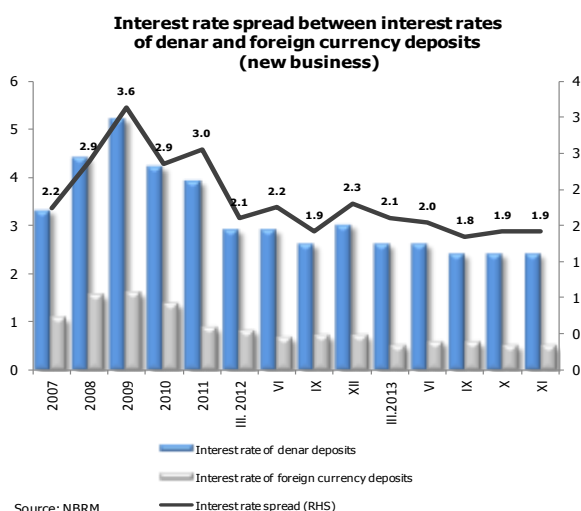
In November 2013, ECB additionally eased the monetary policy, by lowering the policy rate by 0.25 percentage points, which now stands at 0.25%. Such a monetary reaction was explained by the assessments for retention of suppressed inflationary pressures due to the further support of the economic recovery process. The reduction of the key interest rate by the ECB at a time when the NBRM kept the key interest rate unchanged, resulted in a moderate widening of the interest rate spread between the interest rate on CB bills and the key interest rate of the ECB, which in December was 3 percentage points (2.75 percentage points in September 2013). Despite the reduction in the policy rate of the ECB, starting from mid-November and during December 2013, short-term interest rates in the European financial markets tended to increase. These changes are explained by banks' policies for increased accumulation of liquidity (aimed at protection against potential shocks) at the end of the year, and amid reduced levels of excess liquidity in the system⁵⁹. On the domestic financial market, SKIBOR60 registered relatively stable movements. In such conditions, the interest rate spread between the one-month SKIBOR and the one-month EURIBOR slightly narrowed, and in December it equaled 2.7 percentage points (2.8 percentage points in September).

⁵⁹ ECB Monthly Bulletin, December 2013.

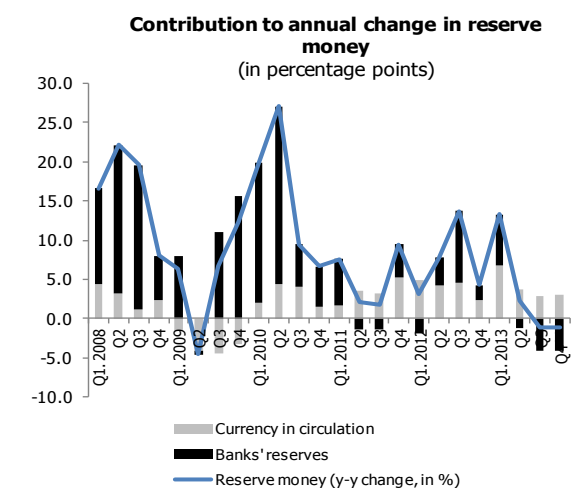
⁶⁰ Interbank interest rate on Denar deposits, calculated by using the quotations of referent banks.



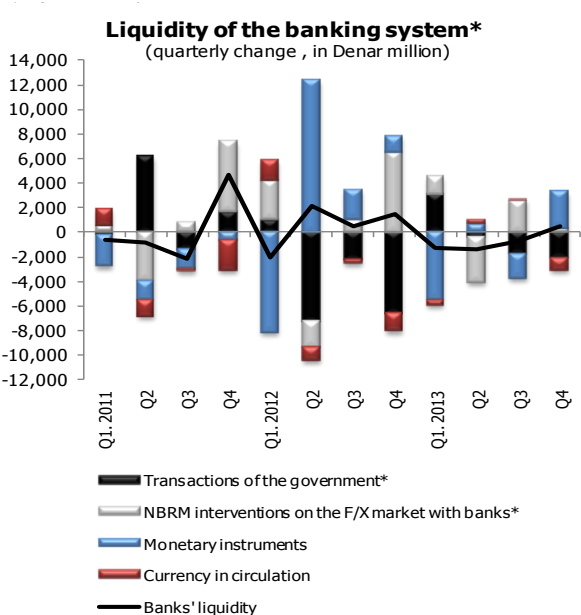
2.1 Bank liquidity and developments on the interbank money market



At the end of December 2013, banks' liquidity rose by Denar 544 million, compared to the end of the third quarter. Thus, banks' accounts with the NBRM⁶¹ at the end of December stood at Denar 15,820 million. In November, reserve money⁶² were lower by 1.2% on an annual basis, as was the annual rate of decrease at the end of the third quarter.



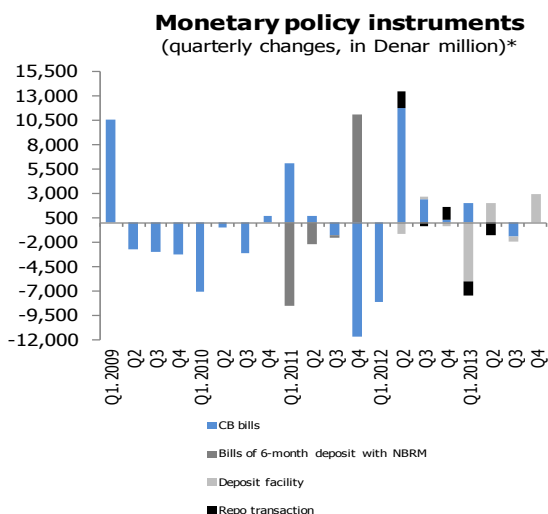
During the fourth quarter of 2013, the autonomous factors, on a net basis, contributed to a liquidity withdrawal totaling Denar 2,447 million. Within that framework, liquidity was withdrawn through government transactions (totaling Denar 2,066 million), which mostly stems from the growth of the deposits on the government Denar account with the NBRM. Currency in circulation totaling Denar 1,010 million contributed to liquidity withdrawal. Through foreign exchange transactions of the NBRM with the market-makers, liquidity in the system was created, in line with the realized net purchase of foreign currency on the foreign exchange market (of Denar 337 million).



In the last quarter, the monetary instruments of the NBRM acted towards creating liquid assets on net basis, totaling Denar 2,991 million. In circumstances of stable CB bills and lack of banks' interest in borrowing liquidity from the NBRM through repo auctions, the change in the total monetary instruments in this period was entirely a result of the withdrawal of banks' funds invested as a deposit facility with the NBRM. Namely, in the fourth quarter, three auctions of CB bills were held, using a volume tender and a fixed interest rate of 3.25%, where the NBRM set the supply of CB bills at the level of the due amount. Thus, the CB bills had a neutral effect on the level of liquidity in the banking system. CB bills have been at the level of Denar 25,500 million for a longer period of time, i.e. since July 2013. At the auctions held in the last quarter, the banks' demand significantly exceeded the amount supplied (the demand was greater than the actual capabilities of banks to invest in CB bills), which is why in November, the NBRM adopted a new Decision on the CB bills that introduced a methodology for determining the

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

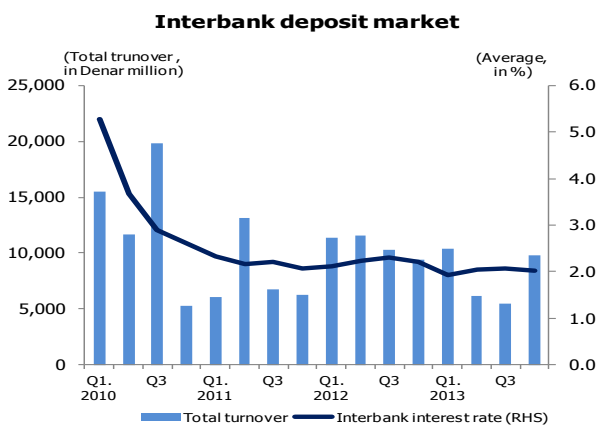
⁶¹ Refers to Denar accounts of banks obliged to allocate reserve requirement.
⁶² Also includes the reserve requirement in foreign currency.



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

potential demand for CB bills⁶³. In the last quarter, banks withdrew part of the funds they held in the form of a deposit facility with the NBRM. Consequently, the total deposit facility in this period registered a decline of Denar 2,991 million on a net basis, which contributed to creating liquidity in the banking sector. For the first time in 16 months, in December, banks used the overnight credit facility totaling Denar 2,500 million. Used assets were returned during the month, so this monetary instrument had a neutral liquidity effect. During the fourth quarter, banks continued to maintain a relatively lower level of excess liquidity over the reserve requirement. Thus, the average excess of liquid assets over the reserve requirement in the October-November 2013 period averaged 0.6% (about 0.4% on average in the third quarter). In November, the NBRM adopted amendments to the Decision on the reserve requirement, according to which the NBRM shall not pay remuneration for the allocated reserve requirement⁶⁴.

In the last quarter of 2013, a total turnover of Denar 9,760 million was registered on the interbank market, which compared to the third quarter, is an increase of 79%. Compared with the fourth quarter of the last year, the activity on the interbank market rose by 3.6%. Analyzed by maturity segments, dominant share in the total turnover realized on the interbank money market in the fourth quarter, was that of the overnight transactions, which explain 63% of the total transactions executed, followed by transactions with maturity up to seven days with a share of 28%. The interbank interest rate (MBKS)⁶⁵ in the last quarter of 2013 averaged 2.02% (2.06% on average in the third quarter). The interbank interest rate for overnight transactions (MKDONIA) averaged 1.82% in the fourth quarter, which is at the level of the previous quarter average. **On the secondary money market**, one transaction with Treasury bills was executed in the last quarter, totaling Denar 15 million.



* Source: NBRM

Box 7. Changes in the monetary instruments of the NBRM in November 2013

On November 28, 2013, the NBRM Council adopted two new decisions: Decision on the CB bills⁶⁶ and Decision amending the Decision on the reserve requirement⁶⁷, which introduced some changes compared to the previous setup of these two instruments.

⁶³ For more details on the new Decision on CB bills see Box 6 of this Report.

⁶⁴ For more details on the amendments in the Decision on the reserve requirement see Box 6 of this Report.

⁶⁵ Average interest rate on the interbank money market.

⁶⁶ "Official Gazette of RM" no. 166/13.

⁶⁷ "Official Gazette of RM" no. 166/13.



Regarding the CB bills, the new Decision introduces a methodology for determining the potential demand for CB bills. Namely, as of July 2013, the NBRM started to carry out auctions of CB bills by applying the volume tender (limited supply and fixed interest rate). At the CB bills auctions held in the period after the change of the tender, in some months the demand was higher than the actual available liquid assets of banks on the day of the auction. When applying this type of tender, this phenomenon is common and reflects the efforts of banks to increase their share in the total amount of CB bills. In this sense, the NBRM developed a methodology for determining the potential demand for CB bills, which takes into account the liquidity needs of banks, on the one hand, and their real potential liquidity, on the other. Thus, the starting point in determining the potential demand are banks' accounts on the last day of the reserve requirement period, increased by the liquidity effect of monetary instruments due on the day of the auction, taking into account the interbank claims and liabilities, and the reserve requirement for the period that begins on the day of the auction. In accordance with the established mechanism, if on the level of the total banking system it is determined that there is a demand higher than the potential one, banks that bid with amounts higher than their own liquidity potential will be obliged to place the difference with respect to the potential, in deposits with a seven-day maturity. The novelties that the new decision brings are expected to lead to matching of the supply of and the demand for CB bills. In accordance with the novelties in the Decision on the CB bills, amendments were made to the Decision on the deposit facility⁶⁸ that allow placing funds in deposits with a seven-day maturity amid higher than potential demand for CB bills.

Regarding the reserve requirement, according to the amendments to the Decision on the reserve requirement, the NBRM shall not pay remuneration for the allocated reserve requirement (previously, the remuneration rate was 1% on the reserve requirement in Denars and 0.1% on the reserve requirement in Euros). These changes may be an incentive for banks to direct a portion of the funds available toward higher-yield investments. The Decision shall apply from January 1, 2014.

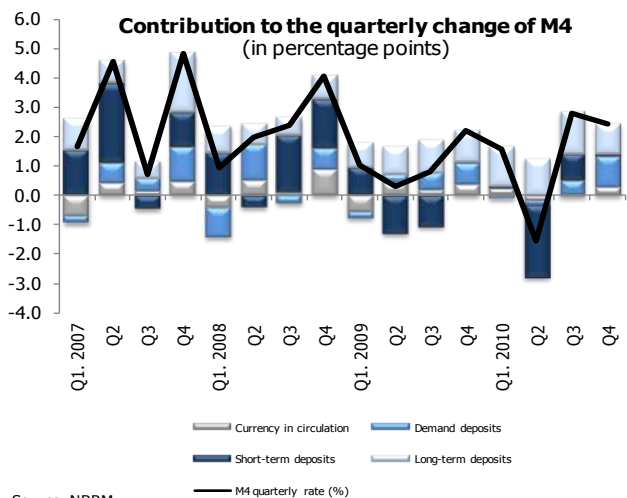
2.2. Monetary and credit aggregates

In the fourth quarter of 2013, M4 money supply continued to grow on a quarterly basis, but with a moderately slower pace compared to the previous quarter. The increase in the money supply resulted from the growth of all its components, with the most intensive growth being registered in demand deposits and long-term deposits. By sectors, household deposits registered the same quarterly growth as in the previous period, while corporate deposits continued to grow, however at a slower pace compared to the third quarter. In the last quarter of 2013, the credit market activity accelerated significantly, whereby the achieved quarterly growth of credits in the domestic economy is the highest since the beginning of the crisis. These developments have contributed to the improved utilization of the deposit potential of banks for lending to the private sector and point to more stable perceptions of banks regarding the presence of risks in the private sector. In fact, after five quarters of higher credit exposure to the household sector, in the fourth quarter, most of the banks' loans were directed towards the corporate sector. The intensified activity of the corporate segment corresponds with the better outturn in the real sector in the first three quarters of 2013. These developments are partly reflected in the dynamics of non-performing loans, given the slower growth of non-performing claims in this quarter. However, in a relatively short period of intensified lending to the corporate sector, it is still early to draw conclusions about a more significant change in the behavior of domestic banks.

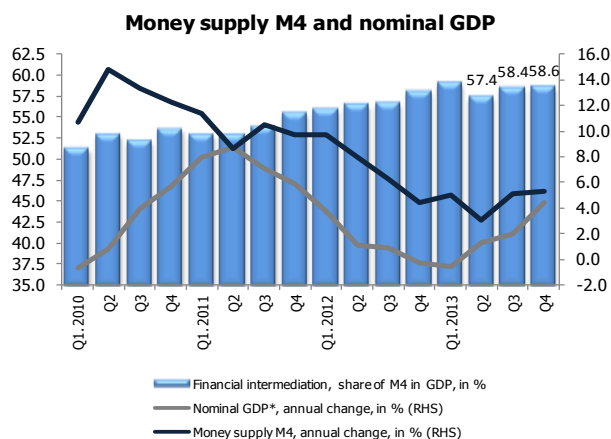
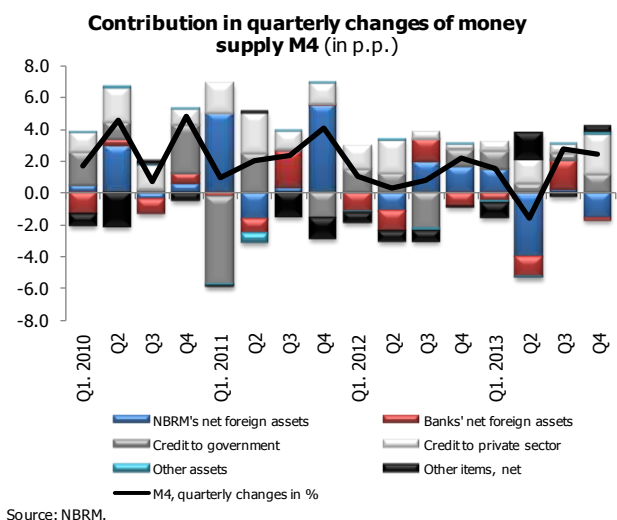
⁶⁸ "Official Gazette of RM" no. 166/13.



2.2.1. Monetary aggregates



In the fourth quarter of 2013, broad money M4 registered a quarterly growth of 2.4%, versus 2.8% in the previous quarter. Such positive movements in the money supply in the last quarter were a result of seasonal, but also fundamental factors, given the favorable economic outturn in the domestic economy since the beginning of the year. Regarding the *structure*, the quarterly analysis shows that the growth of the broad money supply was due to the growth of all its components. The most liquid assets (currency in circulation and demand deposits) in this quarter acted toward an increase in the money supply with a total contribution of about 53% to the growth in the money supply M4, unlike the previous quarter when their contribution was about 16%. These changes are explained by the common seasonal increase in the demand for liquid assets at the end of the year in anticipation of the New Year and Christmas holidays. In the last quarter, the growth of total deposits slowed down, resulting in a slower growth in the money supply M4 on a quarterly basis. Long-term deposits gave a more significant contribution to the growth of total deposits also in the last quarter, which is has been a continuous feature of deposit movements since the beginning of 2012. Regarding the *balance sheet*, the quarterly growth of M4, was predominantly caused by the loans to the private sector in line with the extensive lending activity by banks in the last quarter. **The annual analysis of the broad money supply, also shows growth, but with a little less intensity compared to the previous period (5.3% in December, versus 5.1% in September).** All its components gave a positive contribution to the annual growth of broad money M4, with the exception of short-term deposits, which still register an annual decline. In such conditions, the rate of monetization⁶⁹ was 58.6% in the last quarter, which is close to the level of the third quarter.



In the fourth quarter of 2013, banks' total deposit potential (excluding demand deposits)⁷⁰, recorded quarterly growth of 1.5%, versus 3.1% in the previous quarter. Regarding the currency, the increase in total deposits in this quarter was driven by higher Denar deposits, amid significantly slowing quarterly growth of foreign currency deposits (from 3% to

⁶⁹ Measured by the share of the money supply in GDP (annualized nominal GDP, calculated as the moving sum of the past four quarters).

⁷⁰ Quarterly growth in total deposits including demand deposits was 2.3%, versus 3.2% in the previous quarter.



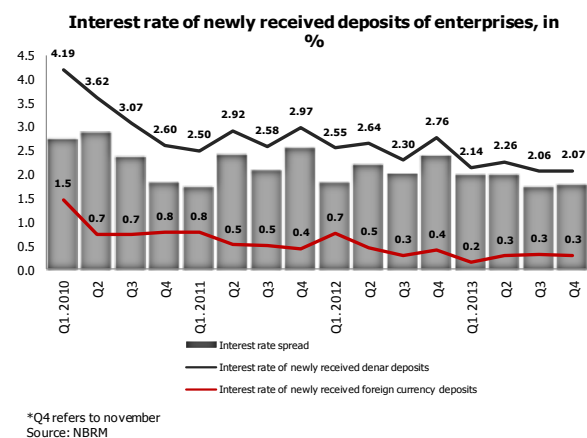
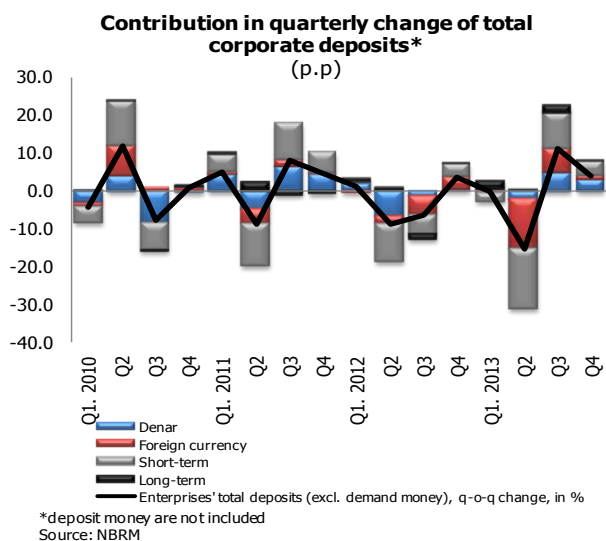
0.6%). These developments in part reflect the base effect (taking into account the registered decline of foreign currency deposits amid payment of dividend in the second quarter). The slower growth in foreign currency deposits in the last quarter contributed to a reduction in the rate of Euroization⁷¹ of the economy on a quarterly basis. Regarding the maturity, the positive dynamics in total deposits, remains primarily driven by the growth in long-term saving (with a share of about 94%), with simultaneous growth also in the short-term saving. Compared with the previous quarter, there is a significantly reduced contribution of short-term deposits in the total deposits growth (from 40% to 6%) due to their significantly slower quarterly growth in this period. **On an annual basis**, in December, total deposits (excluding demand deposits)⁷² grew by 5%, while retaining the same quarterly growth rate registered in September.

The analysis by individual sectors shows an increase in the total household deposits (excluding demand deposits)⁷³ of 1.5% in the fourth quarter, with the same intensity as in the previous quarter. Analyzed **by currency of denomination**, in the fourth quarter, an increase of Denar deposits was registered, with their contribution to the household deposits on a quarterly basis being increased from 55% to 82%. Foreign currency deposits registered a small growth on a quarterly basis, which is different from the movements in the previous quarter, when amid seasonally higher inflows of private transfers, a significant accumulation of foreign currency household deposits was also registered. Regarding the **maturity structure**, short-term deposits recorded quarterly fall for the third consecutive quarter, amid continuous increase in long-term deposits. **The analysis of interest rates on new Denar and foreign currency deposits of the household sector** indicates generally stable movements in the yields on savings instruments. Thus, interest rates on both Denar and foreign currency deposits in November compared to September were lower by 0.1 percentage points, respectively. Such a quarterly dynamics resulted in an unchanged interest rate spread between the Denar and foreign currency deposit interest rate. As for the

⁷¹ Presented through the share of foreign currency deposits in broad money M4.

⁷² With demand deposits included, the annual growth rate of total deposits in the last quarter was 6,1%, versus 6,4% in the third quarter.

⁷³ With demand deposits included, the quarterly growth rate was 2,4% in December, versus 1,3% in September.



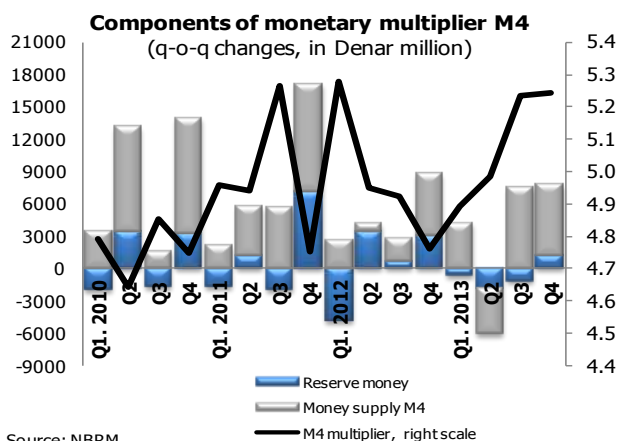
maturity structure⁷⁴, significant downward shift was observed in both the short-term and long-term foreign currency deposits by 0.2 and 0.1 percentage points, respectively. **On annual basis**, in December, total household deposits (excluding demand deposits)⁷⁵ grew by 6.2%, versus 6.1% in September.

In the fourth quarter, corporate deposits (excluding demand deposits)⁷⁶ continued to increase on a quarterly basis, but at a slower pace compared to the previous period (4.1% versus 11.3%). Despite the slowdown in the growth of corporate deposits, this type of deposits registered favorable movements in the second half of 2013, especially if taking into account the rate of quarterly decline in the first half of the year (in part driven by the payment of a large amount of dividend in the second quarter). Such developments indicate positive pass-through effects from the intensified economic activity since the beginning of the year on the ability of the corporate sector to generate revenue, and consequently accumulation of deposits in the banking sector. An additional factor for the accelerated corporate deposit growth was the increased lending activity by banks toward this sector in the last quarter, contributing to an increased multiplication effect of lending on the deposits to the corporate sector. Analyzed by **currency**, the quarterly growth in corporate deposits in the last quarter was largely due to the growth in the Denar deposits (with a share of about 70%), with simultaneous growth in foreign currency deposits. Due to these developments, the contribution of foreign currency deposits in the total quarterly growth of corporate deposits dropped from 58% in the third quarter down to 31% in the fourth quarter. Analyzed by **maturity**, short-term deposits remain the dominant category in the deposit potential of enterprises, amid almost negligible growth in long-term deposits. **Interest rates on newly accepted Denar and foreign currency corporate deposits did not register any significant changes in the fourth quarter (October and November).** Following the quarterly decline of 0.2 percentage points in the third quarter, interest yields on Denar deposits remained unchanged in the period October-November. The interest rate on new foreign currency deposits remained at the level reached in

⁷⁴ The analysis of the interest rates for households and companies by maturity structure, does not take into consideration the interest rates on the sight deposits.

⁷⁵ With demand deposits included, the annual growth in the fourth quarter was 6,7% (versus 6,6% in September).

⁷⁶ With demand deposits included, the quarterly growth in the fourth quarter was 4,1%, versus 9,1% in the previous period.



Source: NBRM.

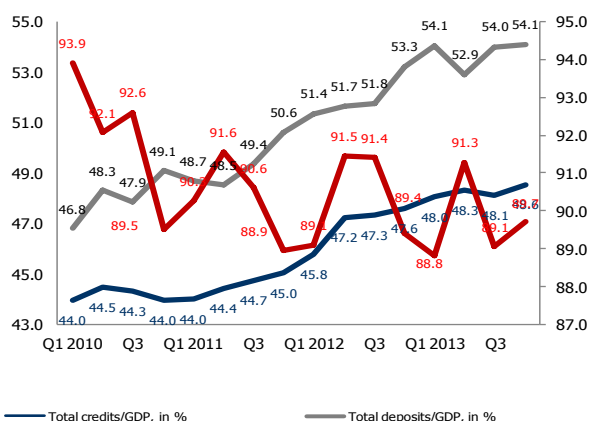
June 2013. In such conditions, the interest rate spread between the Denar and foreign currency interest rate remained stable at around 2 percentage points. In the fourth quarter, the decline of corporate deposits (excluding demand deposits)⁷⁷ slowed down on an annual basis, with a decline of 2.1% being registered in December, versus 2.5% registered in September.

In the fourth quarter of 2013, the M4 money multiplier averaged 5.3, which is an acceleration for the third consecutive quarter (in the previous quarter it was 5.1). The acceleration of the multiplication process took place amid continuous monthly growth of the money supply in the last quarter, and oscillations in the monthly pace of reserve money.

2.2.2. Lending activity

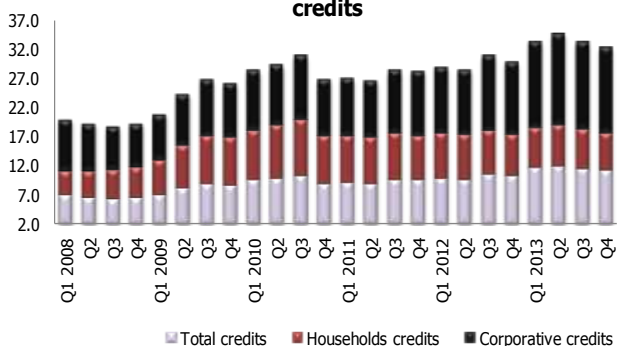
After the slowdown registered in the third quarter of 2013, the quarterly growth rate of total bank loans in the last quarter accelerated from 0.6% to 3.0%, which is the fastest quarterly growth since the beginning of the crisis. Credit flows recorded in this quarter were higher by 4.8 times compared with the previous quarter and more than half of them were realized in December. Thus the annual growth rate of total bank loans at the end of the year reached 6.4%. **Besides the intensified credit growth, in the last quarter significant changes in the structure of growth were registered.** Thus, after a continuous lending directed mainly to the household sector in the past five quarters, in the last quarter of 2013 banks directed a significant portion of the approved credit support towards the corporate sector. Corporate loans explain 62% of the total credit growth in the last quarter. These developments in the credit market may indicate a gradual improvement of the banks' perceptions of the companies' risk profile, influenced by positive economic developments in the domestic economy in the previous period and the improvement of economic activity indicators in the Euro area as our largest trading partner. Apart from the supply side, positive effects of the favorable economic performance can be expected also on the part of the demand for loans, resulting in an improved financial health of the corporate sector and improvement in its creditworthiness. Given such developments, in the fourth quarter, improved quality of the loan portfolio of both the companies and the households was registered,

Total credit and deposit potential of the private sector and the economic activities



Source: NBRM.

Share of doubtful and contested claims in total credits



Source: NBRM.

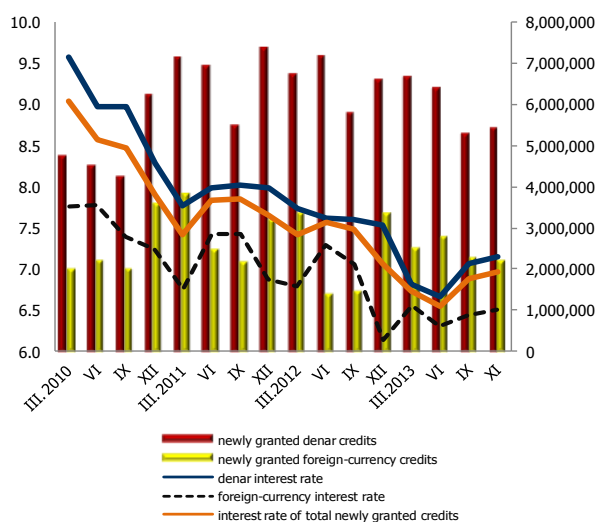
⁷⁷ With demand deposits included, the annual growth of corporate deposits in December was 3,1%, versus 4.3% in September.



with the share of non-performing loans in the total loans recording a slower growth rate of 11.3% (11.5% in September). However, one should keep in mind that this is a relatively short period of acceleration of lending to the corporate sector, which may be driven also by some temporary factors. Given that, drawing firm conclusions about possible changes in the behavior of domestic banks will take a longer period of time.

The credit growth, which is faster than the growth of the deposit base, led to another **increase in the use of deposits as the main source of funding**, for the second consecutive quarter, whereby the loans/deposits ratio stood at 89.7% versus 89.1% in the previous quarter.

Newly granted credits of enterprises and their interest rates (in thousand of denars and in %)



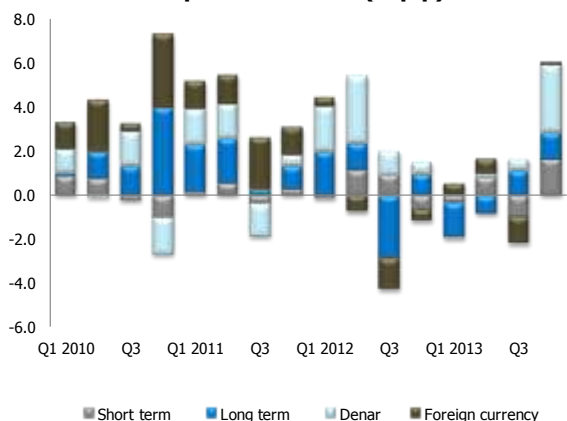
Source: NBRM.

Analyzing the maturity structure of total loans, in the fourth quarter of 2013 all types of term loans gave positive contribution to the total quarterly growth, contrary to the decline in short-term loans in the previous quarter. However, the credit flows of the long-term loans are 3.4 times higher than the flows of short-term loans in this period. **In terms of the currency structure**, along with the significant increase in Denar deposits, in the fourth quarter, 97% of the total growth in lending were due to the growth of Denar loans. After declining in the third quarter, foreign currency loans had a small positive contribution to the total credit growth in this quarter.

After the fall of 0.7% registered in the previous quarter, the credit activity of banks aimed at the corporate sector in the fourth quarter of 2013, registered a growth rate of 3.2% on a quarterly basis. Thus, after a long period of restrained credit support (for five consecutive quarters), corporate loans re-emerged as the main generator of the total lending activity. These achievements are in part related to the use of funds from the EIB 3 credit line, given that in the period from November to December two tranches were withdrawn (totaling Euro 11.2 million). The monetary measures taken so far, aimed at easing the monetary conditions, probably had an additional effect. Thus, since the beginning of the application of the non-standard measure in the reserve requirement, until November, net exporters and manufacturers of electricity were granted new loans totaling Denar 6,390 million. Also, there is a possibility for improvement of the banks' perceptions of the assessed level of risk in the corporate sector, which is confirmed by the

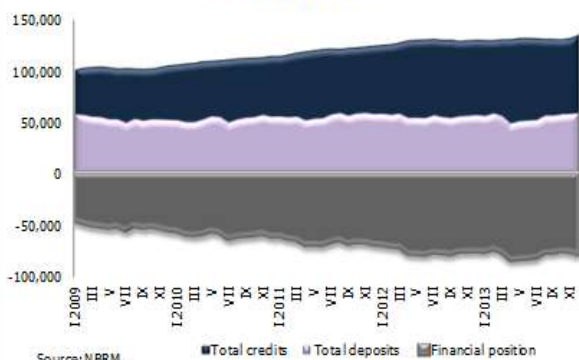


Contribution in quarterly change of corporative credits (in p.p)



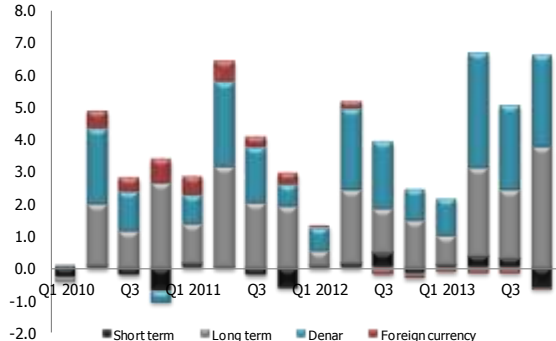
Source: NBRM.

Financial position of enterprises (in million denars)



Source: NBRM.

Contribution in quarterly change of household credits (in p.p)



Source: NBRM.

analysis of the cost of newly granted loans to the corporate sector, which shows retention of the interest rates on Denar and foreign currency loans at a relatively stable level in the October-November period (in the third quarter an increase in the interest rates was registered). The interest rate on the total newly approved loans to companies in November amounted to 7.0%. **In circumstances of faster growth in lending to companies and moderate growth in their deposits, an increase of the negative financial position⁷⁸ of the corporate sector in this quarter is registered.**

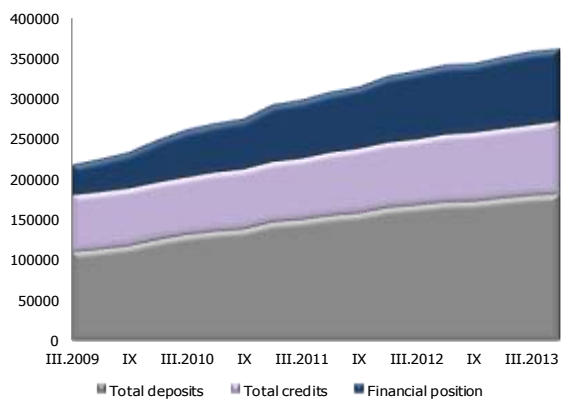
The enhanced lending to the corporate sector corresponds with the banks' expectations for the last quarter, given in the Lending Survey for the third quarter of 2013. Thus, the Survey points to an announcement of net-easing of the lending conditions to the corporate sector and increased credit demand by the companies in the fourth quarter. **Banks reported easing of the lending conditions on net basis also for the third quarter, which is the first such change since the beginning of 2012.** The factors from the risk perception group associated with the expectations for the overall economic activity, the prospects of the particular economic branch, and the risk of default of the collateral, are considered the main reason for this policy. In terms of **demand**, the Survey points to growth in the demand for corporate loans on a net basis in the third quarter, mainly driven by the need for investments in inventories and working capital and debt restructuring. On the other hand, for the third consecutive quarter, banks assess investments in fixed assets to be a factor with a neutral impact on the demand for loans.

In the fourth quarter, the quarterly growth rate of lending to the households segment accelerated to 2.8%, after the moderate slowdown registered in the previous quarter. Banks' perceptions for lower risk of this segment, accompanied with various offers of promotional loans and interest rates, contribute to the continued growth of the loans approved to this sector. Thus, within the Lending Survey for the third quarter, there is an increased number of banks that announced a net easing of

⁷⁸ It is defined only with respect to the deposit and the credit position of the companies, without taking into account the other components of their portfolios. The financial position is the difference between the total corporate deposits and the total corporate loans. If the difference is negative, the corporate sector is debtor to the system, while if positive, it is a creditor in the system.

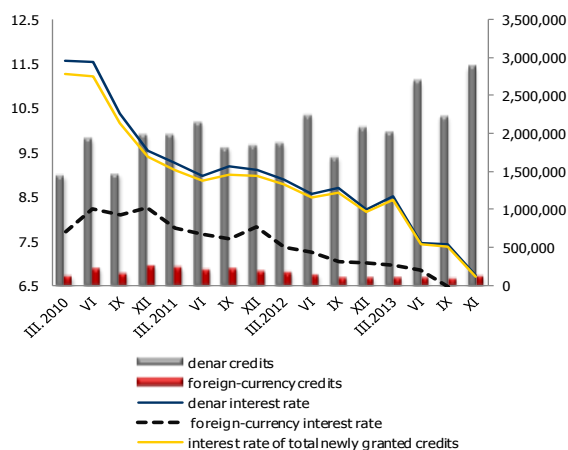


**Financial position of the households
(in million denars)**



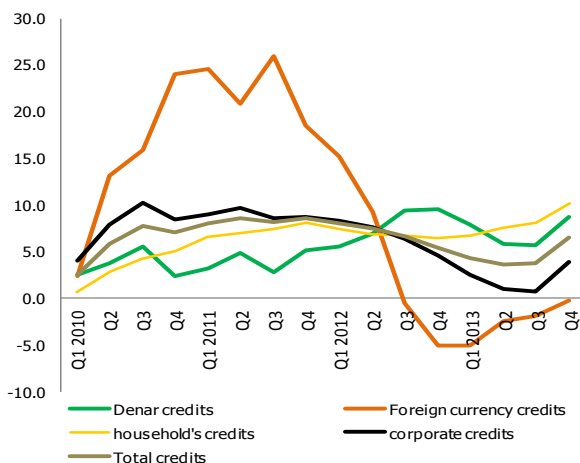
Source: NBRM.

**Newly granted household credits and their interest rate
(in thousand of denars and in %)**



Source: NBRM.

Total credits of the private sector, annual change, in %



Source: NBRM.

the lending conditions for the households in the next quarter, with expectations for growth in the credit demand. Analyzed by categories of loans, in the last quarter, the highest growth was recorded in the consumer loans. These changes correspond to the results of the Survey, which shows a net easing of the conditions for approval of consumer loans in the third quarter, with stable banks' perceptions of risk. On the other hand, the number of banks which assessed increased demand for consumer loans is significantly reduced. Car loans registered a further decline. In addition, housing loans registered a moderate rise also in the fourth quarter. According to the Survey data, about one-third of banks point to growth in the demand for housing loans in the third quarter, amid simultaneous net easing of the conditions for approval of these loans. In the last quarter, **the quarterly growth of loans to the household sector was slower than the accelerated growth of their deposits, which acted toward improvement of the financial position of households⁷⁹.**

The analysis of interest rates on newly granted Denar and foreign currency loans to the household sector points to a decrease in the prices in both categories (of 0.7 and 0.4 percentage points, respectively, in November compared to September), at a time when the interest rates on newly accepted household deposits remained relatively stable. With the latest reduction, the interest rate on the total newly approved household loans in November was 6.7%.

Analyzed on an annual basis, the growth of total loans at the end of 2013 accelerated, reaching 6.4%. Higher growth rates were registered in Denar loans amid simultaneous slowing of the decline of foreign currency loans. Analyzed by sectors, on an annual basis, there is a continuous improvement in lending to households, amid more significant acceleration in the annual growth rate of total corporate loans in the fourth quarter. Under these conditions, in December 2013, total corporate and household loans increased by 10.2% and 3.8%, respectively, on an annual basis. The combined effect of the positive trends in both segments of the economy contributed to the growth in the

⁷⁹ Difference between the total household deposits and the total household loans. If the difference is negative, the households are debtor to the system, while if positive, they are a creditor in the system.



share of total loans in GDP⁸⁰ to 48.6% in the last quarter (48.1% in the previous quarter).

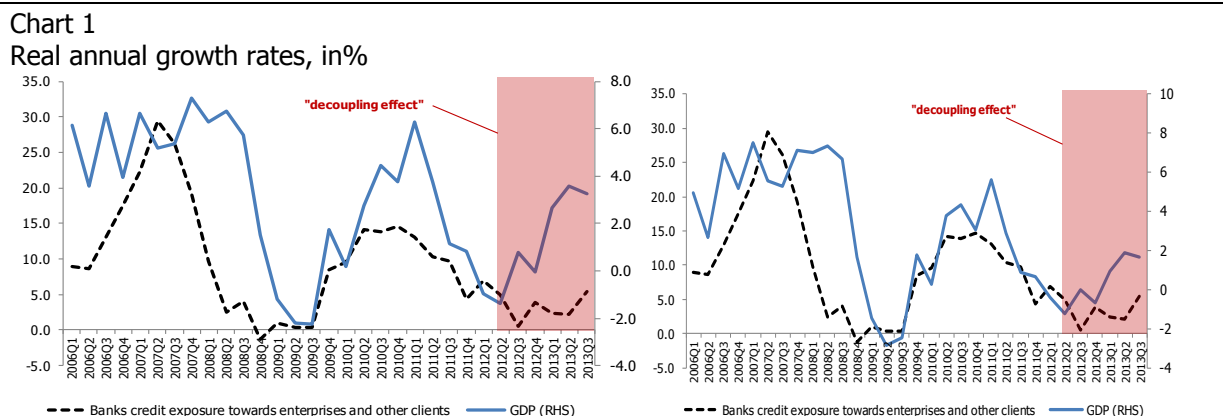
Box 8. Sector perspective of economic activity and credit growth

Starting from the second half of 2012 and especially since the beginning of 2013, the Macedonian economy has been characterized by a significant slowdown of banks' credit activity, particularly lending to the corporate sector. Thus, for the first ten months of 2013, about 91% of the growth in total loans is explained by the increased lending to households, as opposed to the performance in the period 2010-2011, when the average contribution of corporate loans to the annual credit growth was about 70%. In the years immediately before the global crisis, the contribution of corporate loans to total credit growth averaged around 50%. **On the other hand, in the first three quarters of 2013, when a slowdown in the rate of credit growth was registered, economic activity recovered, amid an annual real GDP growth of 3.1%.**

Such dynamics may seem to suggest the beginning of a so-called "decoupling" of the economic from the credit growth, which in the literature is linked with the phenomenon of the so-called "creditless recovery" (Calvo et al., 2006; Claessens et al., 2008). Drawing experiences from the previous conditions of major economic and/or financial crises, these studies show that in the first years after the crisis, the economic recovery usually takes place without adequate credit support from the banking sector. The reasons for the "creditless recovery" can be located in both the supply and the demand for loans. On the supply side, given the high uncertainty that usually follows the post-crisis periods, banks may limit the volume of newly granted loans, irrespective of their capacity for lending to the private sector. On the demand side however, in the initial phase of post-crisis recovery, companies may prefer engaging their own funds or alternative financing through intercompany or capital market borrowing for financing investment needs, in order to improve the conditions of funding.

In the case of the Macedonian economy, this seemingly disrupted relationship between credit and economic growth can be explained by the occurrence of factors specific to the Macedonian economy in this period. Thus, the inflow of foreign direct investment in development zones significantly contributed to mitigating the effects of the global crisis on the domestic economic activity. Increased activity of these new facilities has been one of the key drivers of economic recovery since the beginning of 2013. Those are facilities that are not financed through domestic banks, and therefore their performance is not directly related to the performances of the domestic credit market. The second factor is the **fiscal stimulus**, which has provided continuous support to economic activity since the beginning of the crisis, particularly to the construction and its related activities. This is also a factor that is not directly connected with the domestic credit market. Considering these particularities of the domestic economy, it is likely that if the impact of these factors is isolated, the disruption of the relationship between credit and economic growth will not be as pronounced.

⁸⁰ Annualized nominal GDP, calculated as a moving sum of the respective four quarters.



Source: NBRM and the SSO.

In an attempt to answer some of these questions, and to draw some indication of the relationship between credit and economic growth in the Macedonian economy, in this Box we present the sector analysis of the degree of synchronization of the movements of value added and credit exposure by economic activities. The analysis covers the period from the first quarter of 2005 to the third quarter of 2013, with a focus on two sub-periods. The first sub-period extends from the first quarter of 2005 until the third quarter of 2008, while the second covers the period from the last quarter of 2008 until the third quarter of 2013. This will cover two different stages of the functioning of the domestic economy, a stage of expansive and a stage of restrained economic growth. As an indicator of credit support to banks, data on the total credit exposure⁸¹ to the respective sector were used, which for the purpose of comparability with the real GDP statistics⁸² were appropriately deflated by the consumer price index.

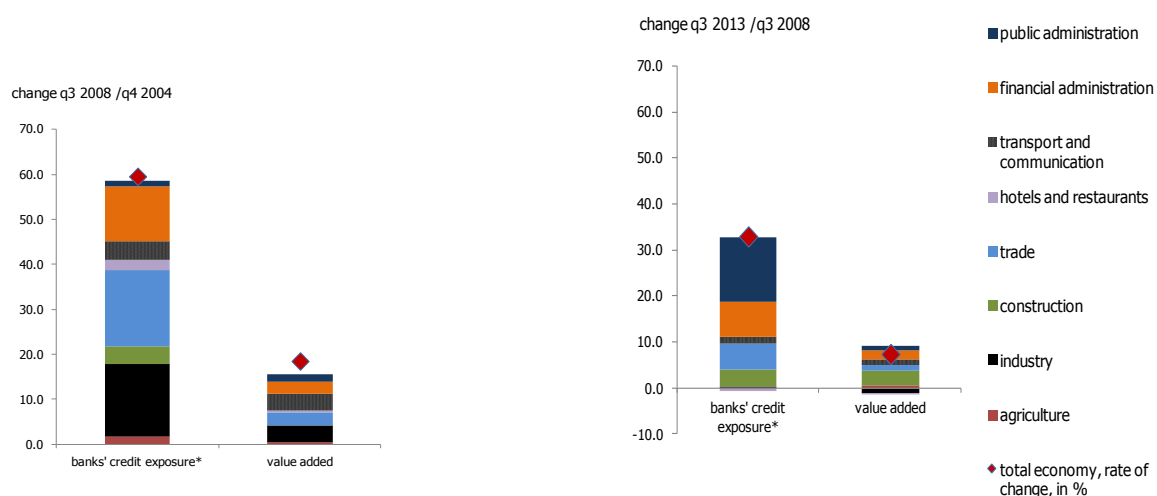
⁸¹ The total credit exposure includes balance sheet claims (loans, interest, commissions, financial leasing, investments in securities that are available for sale or held to maturity, etc.) and off-balance sheet claims (unused lines of credit, unused credits on the basis of overdrafts on current accounts and on credit cards, letters of credit, guarantees and other contingent liabilities for the bank).

⁸² For the purposes of cross-analysis of the economic activity with the credit exposure of banks an approximate synthesizing of the data on the credit exposure by economic activities was made, i.e. their classification according to NKD Rev.1 (NACE Rev.1). This allows comparability of statistics on credit exposure with the national accounts statistics by quarter.



Chart 2

Contributions of individual sectors of activities to the change in the value added and the credit exposure in percentage points
(real, seasonally adjusted data)



* Refers to the credit exposure to companies and other customers.

Source: NBRM and the SSO.

In the years immediately before the global crisis, the Macedonian economy was in a stage of expansion with an average real GDP growth of about 5% for the period 2005-2008. These developments contributed to a significant increase in the GDP level, which in the third quarter of 2008, as a turning point before the global crisis, was by 18.5% higher, compared with the last quarter of 2004. Industrial sector and the sector "transport and telecommunication" gave the largest contribution to the growth of economic activity in this period, followed by trade and the financial sector, while construction⁸³ and agriculture were sectors with the smallest contribution to GDP growth. **The growth of the economic activity in this period was adequately supported by the banking sector,** given that the total credit exposure to companies and other customers at the end of the third quarter of 2008 registered high real growth of nearly 60% compared to the end of 2004. **The structural analysis of the credit exposure shows that the fastest-growing sectors simultaneously received the greatest credit support from the banking sector, which was primarily focused on lending to trade and the industrial sector (contributing with 17.1 percentage points and 16.1 percentage points, respectively).** The analysis of the period after the start of the global crisis shows that in the third quarter of 2013, the total economic activity surpassed the pre-crisis level by 7.5%, but the growth structure changed considerably in comparison with the pre-crisis period. So, now the main generator of growth is construction, amid increased government support of this sector through public projects, followed by the financial sector. Trade and "transport and telecommunication" also give a significant positive contribution. On the other hand, industry, which was one of the key driving forces of growth in the pre-crisis period, has a negative share in the second period. **Changes in the economic activity were accompanied by an appropriate adjustment of the activity in the banking sector, which also continued to grow in the period after the start of the crisis, but at a**

⁸³ Regarding construction, it should be borne in mind that there is a risk that according to NACE Rev.1 classification of economic activities there is not a full coverage of activities in the construction sector, which primarily applies to smaller firms that have registered under another primary activity, and perform additional work in the construction industry. It would mean that the total activities of these legal entities, including construction, are statistically recorded within the primary activity sector, which can be considered a potential limiting factor in the analysis, containing to some degree the obtained results and conclusions.



slower pace. Thus, at the end of the third quarter of 2013, the total credit exposure of banks to companies and other customers rose by 33.1% in real terms, compared to the same period of 2008, which is half of the growth in the pre-crisis period. Besides the intensity of growth, the crisis affected the investment preferences of banks, which have restructured their loan portfolio towards higher share of risk free and highly liquid instruments. Namely, given the uncertain environment, increasingly non-performing portfolio and increased risk aversion, the largest contribution to the growth of the credit exposure was that of the investments in government securities, liquid foreign currency assets and monetary instruments of the NBRM, which observed by sector, covers the sectors "public administration"⁸⁴ and "financial intermediation"⁸⁵. In terms of the credit support to the non-financial sector, both the pre-crisis and the second period are indicative of a relatively high degree of synchronization of the credit growth with that of the economic growth structure. Thus, now, trade stands as the sector with the highest credit support from banks, followed by construction, while the credit exposure to the industry is with slightly positive, almost insignificant contribution. Regarding construction, the intense growth in the period after the start of the crisis can be in large part explained by the fiscal stimulus in the form of public infrastructural projects, and the increased credit support from the banking sector also gave its contribution. Also, one should keep in mind that the intense credit support to the construction sector in the pre-crisis period was predominantly given in the period immediately before the crisis (2007-2008), indicating certain repercussions on the performances of this sector also in the period after the outbreak of the crisis. The period after the start of the crisis is characterized by an increased fiscal support to the agricultural sector in the form of government subsidies, which probably in part explains the more intensive growth of agriculture in the period after 2008, compared to the pre-crisis period, given the weaker credit support to this sector in the period after the third quarter of 2008, compared with the period before the crisis. In the sector "hotels and restaurants" movements in credit and economic activity in the two sub-periods were synchronized⁸⁶.

⁸⁴ The "public administration" sector includes the activities of public administration normally carried out by the public administration authority. This includes the adoption and the legal interpretation of the relevant laws and regulations, and the administration of programs that are based on them, legislative activities, taxation policy, defense, public order and safety, immigration services, foreign affairs and the administration of government programs. This sector also includes the activities of compulsory social insurance. Consequently, credit exposure to this sector includes all banks' balance sheet and off-balance sheet claims on the public administration institutions.

⁸⁵ The "financial intermediation" sector includes activities related to monetary intermediation (central bank and other monetary intermediation), activities of holding companies, trusts, other funds and similar financial entities, financial and service activities other than insurance and pension funds (financial leasing and other credit and financial- service brokerage), insurance, reinsurance and pension funds, except compulsory social insurance and ancillary activities in the financial services and insurance activities. Consequently, credit exposure to this sector covers banks' claims on the NBRM (primarily monetary instruments, with the exception of the reserve requirement), and the remaining deposit and non-deposit financial institutions.

⁸⁶ However, when interpreting the results for this sector, one should bear in mind that within the banks' credit exposure to the sector "hotels and restaurants" a small number of agents are included, because this sector relies very little on bank loans in its work. Hence, these conditions may affect the results of the analysis.

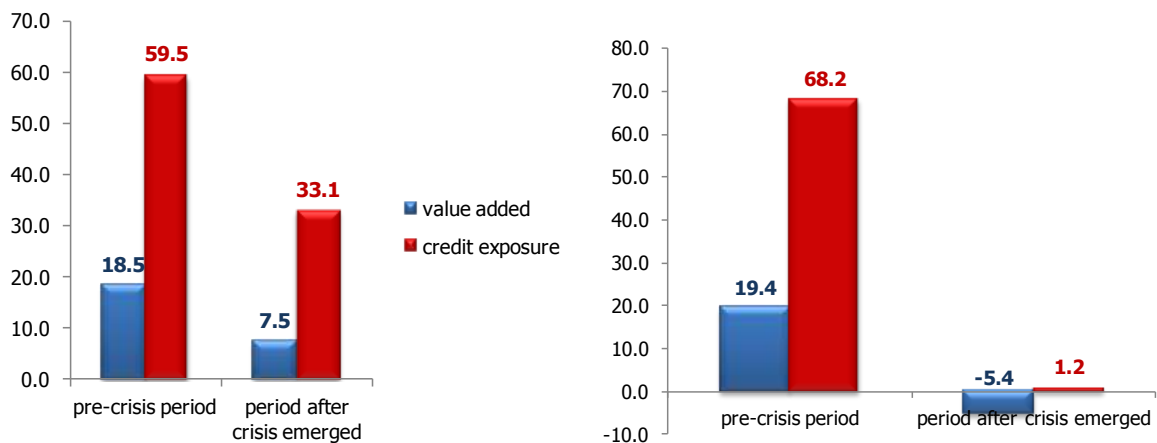


Chart 3

Value added and credit exposure by activity
(real growth rates by period, in %, seasonally adjusted data)

Total: The intensive growth of overall economic activity in the pre-crisis period was appropriately supported by the banking sector....

Industry: From being one of the key drivers of growth in the pre-crisis period and one of the sectors with the highest credit support from the banking sector....

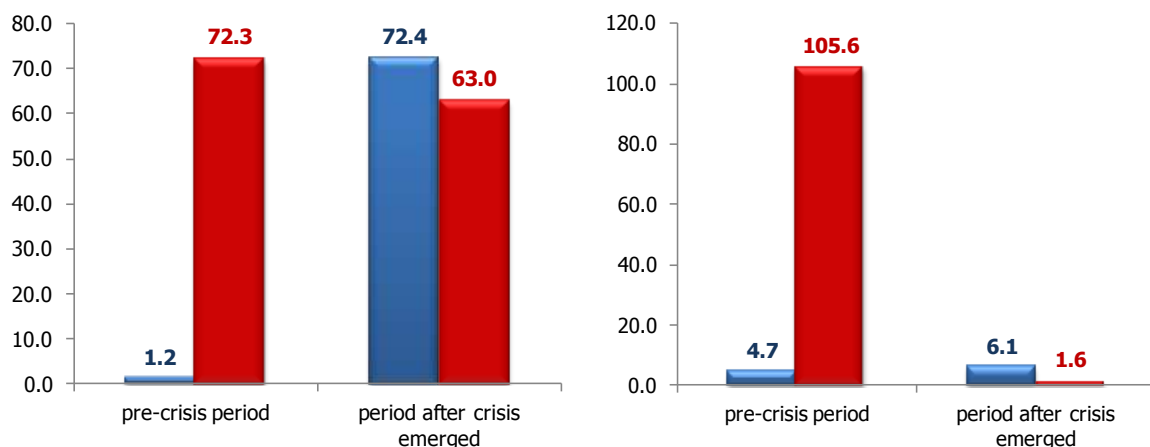


... and the slowdown in the economic growth in the second sub-period was accompanied by an appropriate adjustment of the overall lending activity.

... in the second sub-period, industry gave a negative contribution to growth, amid simultaneous significant adjustment of the credit activity.

Construction: Sector with marginal contribution to growth, but solid support from the banking sector in the pre-crisis period...

Agriculture: Growth in the pre-crisis period was followed by an appropriate growth in lending...

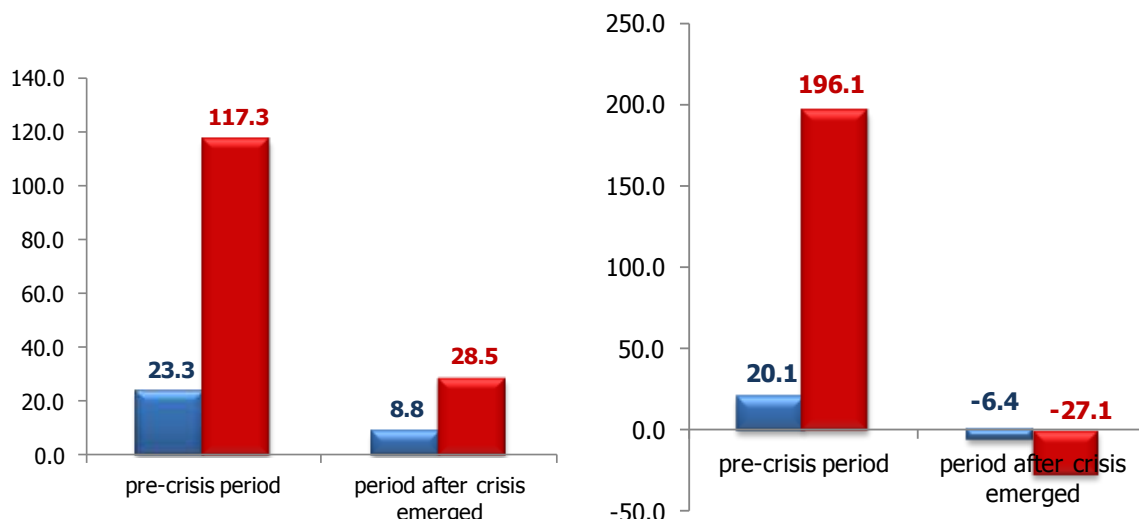


... while in the second sub-period construction becomes a central branch of growth, supported by the fiscal stimulus and foreign investment, amid simultaneous retaining of the pace of credit growth in this sector...

... which intensifies in the post-acute phase of the crisis, in circumstances of weaker credit support from the banking sector, but increased government subsidies to agriculture.

Trade: Amid intense lending by the banking sector, trade is among the sectors with the highest contribution to GDP growth in the pre-crisis period...

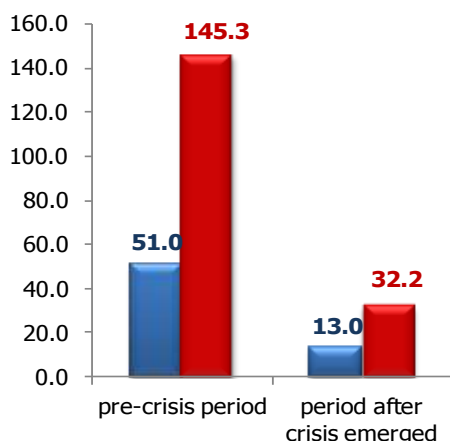
Hotels and restaurants: The high level of synchronization between the movements of the value added and lending in the pre-crisis period towards growth ...



... and the effects of the crisis are almost equally seen in the dynamics of value added and lending activity.

...was maintained also in the second sub-period.

Transport and Telecommunications: The dynamic growth of value added in the pre-crisis period was appropriately followed by the banking sector...



... and the parallel movements continued in the post-acute phase of the crisis by a significant deceleration of the growth of both the value added and the credit activity.

Pre-crisis period refers to the rate of change in the third quarter of 2008 compared to the last quarter of 2004.

The period after the start of the crisis refers to the rate of change in the third quarter of 2013 compared to the third quarter of 2008.

Source: NBRM and the SSO.

A general conclusion from the analysis of the dynamics of change in the two sub-periods is that with the exception of agriculture, economic performances in all other sectors are accompanied by corresponding changes in lending activity, which applies to both the period before and the period after the acute phase of the global crisis. Based on the dynamics of credit and economic activity, data on the second sub-period indicate relatively weaker credit support, which is likely to be insufficient to support a more significant recovery of the economic activity. In such circumstances, a possible explanation for the occurrence of the effect of "decoupling" of economic and credit growth, especially evident since the beginning of 2013, could be that a significant contribution to the growth of economic activity in the first three quarters of the year was derived from the increased activity of the new export facilities in the development zones, which do not

rely much on loans from domestic banks as a source of funding, as well as the introduced fiscal stimulus that provided direct support to the growth of construction..

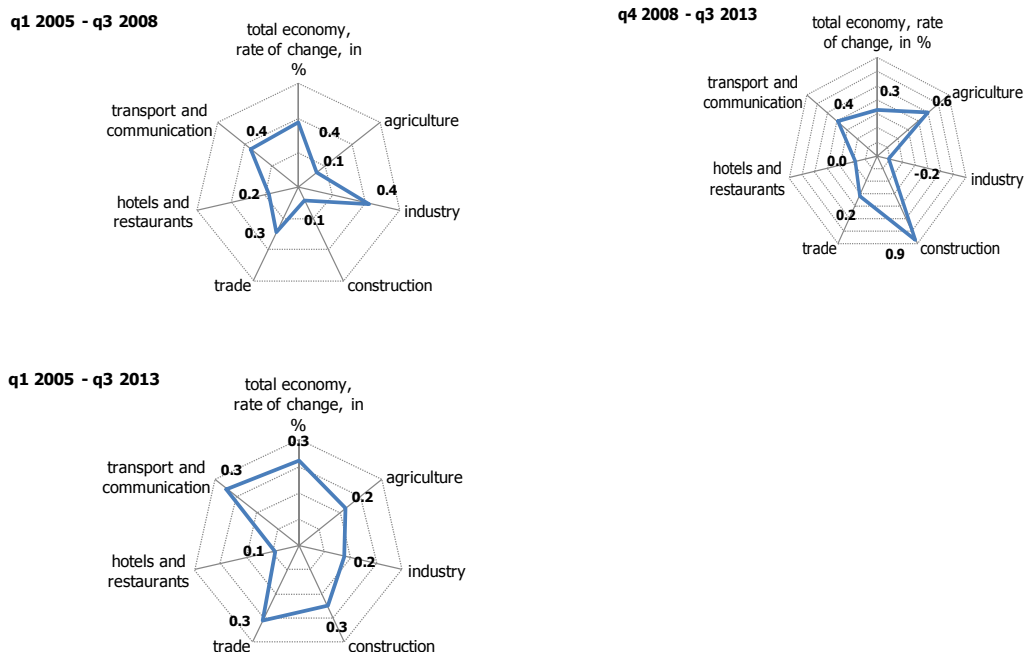
We will try to formally assess the elasticity of economic activity on the growth of banks' credit activity, on the basis of a simple monitoring of the dynamics of change, by calculating the elasticity coefficient. For calculating the elasticity, the Kapsos (2005) approach is applied. A log-linear model specification, where economic and lending activities enter in levels⁸⁷, is used as well.

The elasticity of GDP is calculated by:

$$\ln Y_t = \alpha + \beta \ln X_t + u_t \quad (1)$$

where Y_t is the real level of GDP (specifically, value added), X_t is the credit exposure, while β is the elasticity coefficient of economic versus the credit activity. Higher positive elasticity coefficient implies credit growth which contributes to higher economic growth, and vice versa. One of the model's drawbacks is the non-inclusion of other variables that also affect economic activity. Additionally, it does not take into account the potential feedback loop from economic to credit activity, given that the phase of the business cycle may affect the willingness of banks to lend to the private sector. Despite the shortcomings, elasticities presented in this study provide a useful indication of how credit and economic activity mutually vary during the analyzed historical period. Consequently, the results should be interpreted only as an indication of the existence of correlation, or in other words they should not be interpreted as causality. For all input variables seasonally adjusted quarterly data are used, in real amounts, for the period from the first quarter of 2005 to the third quarter of 2013. In addition to the entire period, an assessment of elasticities for both sub-periods is made, in order to obtain indications of possible changes in the relationship between economic and credit growth under the influence of the global crisis.

Chart 4
Elasticity of GDP to lending



Source: Own calculations based on data from the NBRM and the SSO.

⁸⁷ Namely, according to Islam and Nazara (2000) and Islam (2004) (quotation from Kapsos (2005)), elasticities calculated by rates of change show greater volatility.



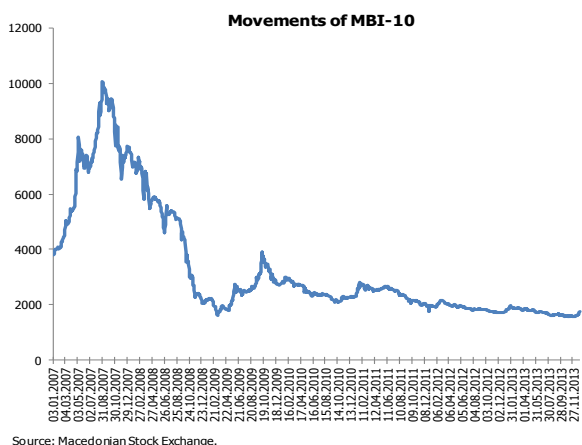
Chart 4 shows the estimated elasticity coefficients. **As shown in the chart, for the entire period of analysis, all the elasticity coefficients of economic activity in terms of lending are positive, moving in an interval of 0.1 to 0.3.** The analysis by sub-periods shows no significant change in terms of the overall economic activity. However, after analyzing the various sectors, there are some noticeable changes, towards increasing the elasticities in the agricultural and especially in the construction sector, for which a high coefficient of 0.9 is obtained for the second sub-period (compared to 0.1 in the pre-crisis period). The results for the industry show negative correlation in the second period (compared with the positive coefficient of 0.4 in the period before the crisis), which is explained by the decline in the industrial activity in this period, when the credit support from banks keeps the upward trend. However, although positive, the credit exposure of banks to the industry in the second period, registered very slow growth (only 3% of the amount of credit support provided in the pre-crisis period), which could hardly support a more significant investment activity in the sector. Hence, it can be concluded that also in the period after the start of the crisis, changes in the credit exposure to the industrial sector largely correspond to the actual economic performance of the sector.

In summary, the analysis of the actual movements in credit and economic activity by sector in the pre-crisis period and in the period during and after the global crisis indicates general synchronization of credit and economic growth, which is confirmed by the positive sector elasticity coefficients. Of course, the intensity of change is not the same, which is probably explained by factors specific to individual sectors. Thus, the character (in terms of labor or capital-intensive) and the dynamics of the activity and the need to introduce new technologies associated with it, the size of the company, its ownership structure, profitability, stage of its development, the accepted model of financing and access to alternative sources beside the credit market, are some of the factors which may influence the importance of lending activity for the growth of a certain economic branch. **In any case, this simple analysis provides an indication of the correlation between credit and economic growth, which means that for a sustainable economic recovery of the domestic economy, among other factors, the pace of credit market recovery will also be important.**

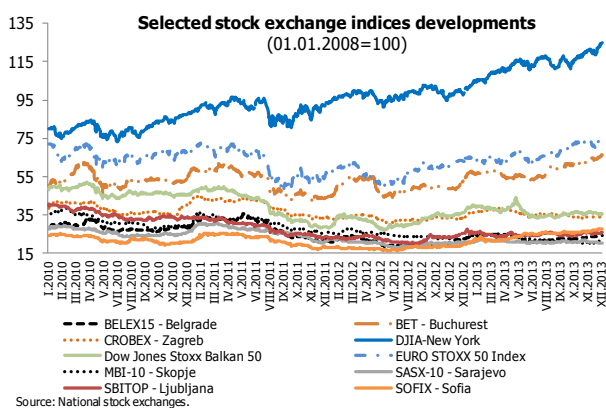
III. Stock exchange indices and prices of real estate

The Macedonian stock exchange index MBI-10 increased in the last quarter of 2013, after the negative changes registered in the previous two quarters. The favorable trend of the MBI-10 index is associated with the expected further positive developments in the domestic economy and external positive signals associated with the economic growth in the Euro area. Also, the bond index (OMB) continues to move in an upward path. Similar to the domestic capital market, the regional stock exchange indices rose. These changes are associated with the positive signals of the leading markets and the favorable relevant economic data of developed economies. Real estate prices in the last quarter of 2013 again follow a downward trajectory, after the interruption of the nearly two-year downward trend that occurred in the third quarter.

After the reduction registered in the previous two quarters, the value of MBI-10 increased in the fourth quarter of 2013. At the end of December 2013, the MBI-10 index was by 6.4% higher compared with the end of September 2013. Analyzing the dynamics of movement of the index over the last quarter, it may be noted that the stock market index followed an almost stagnant path until early December, and from this period until the end of



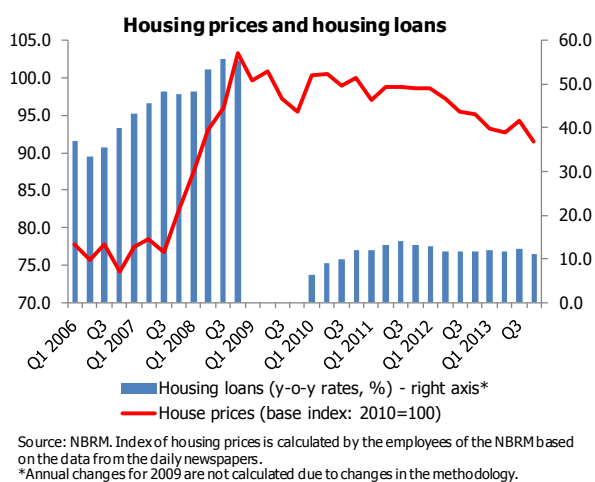
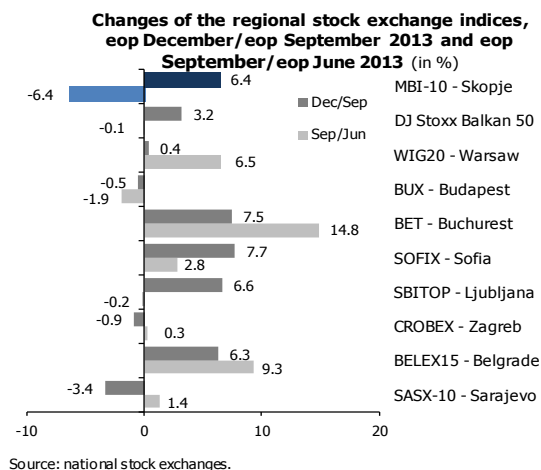
the year it registered an upward trend. The expectations for continuing positive developments in the domestic economy and further positive signals from the external economic environment, associated with the quarterly economic growth in the Euro area, are considered to be the factors that influenced the favorable trend of the index. However, despite these positive periodic oscillations, the long-term trend of MBI-10 is still in a downward direction and primarily reflects the absence of foreign institutional investors from the stock market and slow recovery in the global economic environment. The total stock exchange turnover⁸⁸ went up by 34.3% compared to the previous quarter, while the turnover based on traditional trading grew by 8.8% on a quarterly basis, as a result of the increased sales of shares. Along with the growth of MBI-10⁸⁹, the bond index (OMB) also continued to move in an upward direction, with its value registering an increase of 0.3% at the end of December 2013, compared with the end of September 2013.



Positive signals coming from the leading markets and the favorable relevant economic data on the developed economies determined the upward trend of the regional stock indices during the last quarter of 2013. Thus, growth in the value of the stock indices was registered in almost all countries of the region, with the exception of the Sarajevo stock exchange index, and the small negative changes in the Budapest and Zagreb stock exchange indices. The Bucharest, Ljubljana, Belgrade and Sofia stock exchange indices registered the fastest growth. Positive shifts in most regional indices reflect the announced data on further solid GDP growth in the Euro area. The positive sentiment in regional stock markets was supported by the further growth of the USA economy, and the growth of the leading world's stock exchange indexes associated with the positive reports published by large multinational companies for the third quarter of 2013. Also, the

⁸⁸ Starting from 16.12.2013, the amendments to the Rules for trading on the Macedonian Stock Exchange began to apply. These amendments changed the way of concluding cross transactions for the purpose of their liberalization, imposing certain changes in the criteria and the procedure for concluding the administrator and systemic block transactions, and brought a number of changes of technical nature.

⁸⁹ Given the large price fluctuations and specifics in trading, on 27.12.2013, the Stock Index Commission of the Macedonian Stock Exchange performed an extraordinary audit of the MBI-10 index and decided not to include the shares issued by "Fershped" AD Skopje in the calculation of the MBI-10 index. The date of the extraordinary audit, i.e. the date on which the MBI-10 index began to be calculated with the new composition is 30.12.2013.



most important event in the world markets in the second half of December was the Fed's decision to start tapering⁹⁰. Its effect on the markets indicates that investors perceive this decision as a signal of a relatively good economic situation in the United States.

After the termination of the nearly two-year downward trend that occurred in the third quarter, real estate prices in the last quarter of 2013 declined again. The index of housing prices⁹¹ dropped by 3% on a quarterly basis. Such quarterly movements contributed to the acceleration of the annual decline (of 3.8%, after falling by 1.3% in the third quarter of 2013). Reduced cost of housing can be explained by the continually high supply on the real estate market in the past few years, which is evident from the high cumulative growth (80%) of the construction of residential buildings in the first three quarters of 2013. The lower number of residential construction permits issued in the third quarter of 2013, also indicates an already relatively high supply. The lower construction costs, i.e. the cost of materials (according to the of construction costs index⁹²) have an additional impact on the decline in the price of the apartments. On the other hand, observed from a viewpoint of the ratios on the demand side, in the last quarter of the year, housing loans accelerated their pace of quarterly growth, which is in part associated with the promotional offers of some of the banks at the end of the year⁹³.

⁹⁰ Weekly reports of Raiffeisen Research (Raiffeisenbank Austria dd Zagreb).

⁹¹ Hedonic Apartment Price Index prepared by the NBRM on the basis of notices of sales in the capital city, published by real estate agencies. The price of the apartment is a function of its size, neighborhood, floor, whether the apartment has central heating and year of its construction.

⁹² Source: Construction cost index for new residential buildings, SSO.

⁹³ Banks' promotional offers mainly related to the elimination of one-off administrative costs and estimation costs when approving a home loan.