

National Bank of the Republic of Macedonia



Quarterly Report May 2015



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Introduction

During the first quarter of 2015, the NBRM kept its policy rate unchanged at the level of 3.25%. This decision was based on the latest performance of key macroeconomic and financial indicators, which did not indicate significant changes in the environment for conducting monetary policy compared with the last macroeconomic projections of the NBRM from October 2014. Changes in **inflation** (both headline and core) in the first quarter were aimed towards its reducing on an annual basis, stronger than projected though, which is still mainly driven by factors on the supply side. Hence, it was assessed that the adjustment of the general price level is temporary and creates no risks of prolonged deflation. The growth of **economic activity** in 2014 was within expectations, and the latest short-term indicators pointed to further retention of positive trends since the beginning of 2015. Banks continued to support economic growth through further growth of **credit activity**, which at the end of March was above expectations of the October projection. The survey findings indicate positive developments on both supply and demand side of credit, whereby both factors that drive the credit market tend to stimulate credit growth. Foreign exchange market developments were stable in the first quarter, and the NBRM purchased foreign currency. However, foreign reserves declined on a quarterly basis, mainly due to the early repayment of the IMF's Precautionary Credit Line. If we exclude this effect, the decline in foreign reserves is moderate and as projected in October. The reserve adequacy ratio still indicates an adequate level of foreign reserves for dealing with any shocks. **Global environment** has not undergone significant changes compared to last estimate. Thus, assessments show that **risks about future developments in the domestic economy** in this period were mainly exogenous, associated with uncertainty about the pace of global growth and changes in the prices of primary products, although risks to the euro area mitigated with the latest support from the ECB monetary policy. **Amid continuing solid economic and credit growth that does not create imbalances through inflationary pressures or pressures on foreign reserves, and still present external risks, the current monetary easing was assessed to be sufficient. Also, it was assessed that the exit of the NBRM from the zone of accommodative monetary policy will be determined by the external sector developments.**

Between the two projections, besides **changes in the initial conditions for some indicators of the domestic economy**, there were certain changes in the expected trends of the **main indicators of external environment**. This statement is especially true of **foreign effective inflation**, indicating favorable terms of trade and significantly lower pressures from import prices on inflation in 2015 and 2016. **Changes also occurred in the assumptions for foreign effective demand** which is expected to further recover throughout this and next year, although in 2015, it will be at moderately slower pace than previously expected, mainly due to the weaker expectations for some countries in region, whilst for some countries in the euro area, expectations have been adjusted upwards. Changes in estimates for growth in the euro area are broadly based on the quantitative easing by the ECB, which tends to create additional liquidity as an additional incentive for the growth of economies. As in previous assessments, dynamically speaking, it is expected that the external environment will be more stimulating in the medium term.

Despite the **moderate external demand recovery**, estimates for growth of the domestic economy continue to point to **solid performance and expectations about the future. Data indicate GDP growth of 3.8% in 2014**, in line with the expectations in the October cycle projections, while high-frequency indicators point to a permanent solid growth in the first quarter of 2015. These developments, combined with the expected path of key external and domestic factors, point out that economic growth will boost in the future. Namely, **the domestic economy is expected to increase by 4.1% in 2015 and additional 4.5% in 2016, which means that the growth assumptions from the October projection remain.** Such assessments are based on the indications of further "decoupling" of the rate and intensity of growth of the Macedonian economy from the moderate recovery of the foreign effective demand, triggered by specific structural factors that reduce the vulnerability of the domestic economy. Specifically, exports are still expected to give strongest impetus for the economic growth, amid increased activity of the existing and the new export-oriented facilities with foreign capital and the gradual recovery of external demand. Almost equally high positive contribution to growth in the next two years is expected from investment



activity, which will be supported by public investments in road infrastructure, inflow of foreign capital in export-oriented facilities, as well as investments in domestic businesses. These movements will prompt the further growth of private consumption by increasing wages and employment in the private sector. Besides, the growth of private consumption will further affect the growth of wages in the public sector and the growth of pensions. Under such assumptions, as in the previous projections, domestic demand is expected to continue being major generator of economic growth, whilst net exports would make minimal negative contribution.

Solid growth of private consumption and investments was supported by the banking sector, and this trend is expected to continue in the next two years. Improved credit market performances, as of March, and assumptions about the movement of the sources of funding for banks indicate a solid credit growth of 9% and 10% in 2015 and 2016, respectively (same as in the previous projection). These expectations are conditional on the further positive private sector developments as a major factor on the side of credit demand, as well as the growth of deposit base and the maintenance of stable risk perceptions of banks as a major factor on the supply side.

Lower growth rates are expected for 2015 compared to the October projection (0.5% instead of 1%). These estimates reflect price movements in the first quarter of the year, and the expected containment of the negative contribution of energy prices on headline inflation by the end of the year. Moreover, downward revisions of foreign effective inflation indicate lower pressures through the import channel. On the other hand, positive inflationary pressures are expected from food prices, as well as from assumptions about the effect of domestic demand on prices, expecting that the negative output gap will close in the second quarter of 2015 (fourth quarter of 2014 in the October projection). The gradual opening of the positive output gap, given the continued growth of the domestic economy, and the expected increase of food and oil prices will increase inflation to about 2% in 2016 (same as in the October projections). Inflation projection is accompanied by risks, mainly associated with the movements in world oil prices, as well as the potential effects of adverse weather conditions in the country early this year.

Recent assessments about the balance of payments position point to lower current account deficit than previously expected for 2015, i.e. deficit of 1.6% of GDP, compared to 3.9% of GDP in the October projection. Changes between the two projections result from improved initial conditions, i.e. lower current account deficit in 2014 of 1.3% of GDP versus the expected 2.7% of GDP in the October projection. Another factor are the changes in the trade balance where the deficit is expected to narrow on an annual basis primarily due to the significantly improved energy deficit amid low price of crude oil on world markets, and as an effect of the improved performance of new export-oriented companies. Considering the dynamics, projections for 2015 still imply increase in current account deficit compared to 2014, but at a more moderate pace relative to the October expectations, and reduced relative share of secondary income in GDP (mainly private transfers). **The current account deficit is expected to further expand in 2016 and to reach 3.1% of GDP (4.6% of GDP in the October projections).** This projection reflects expectations for further active use of existing facilities and entry of new foreign investments in export-oriented sector that would increase investment imports. Also, amid expectations for higher oil prices, energy imports is also expected to rise, which all together would result in widening of the trade deficit annually. A significant part of the deficit will continue to be funded with secondary income, with expectations for a moderate reduction of its relative share in GDP, which would mean continuity of relatively high inflows of private transfers. The present path of the current account deficit and its structure do not suggest major imbalances in the economy. As in the previous projection, current assessments suggest that the structure of capital inflows will be a combination of debt and non-debt flows. Dynamically speaking, in 2015, transactions in the balance of payments are expected to reduce the foreign reserves, in part determined by the government or the high amount of repayments of the government external debt that falls due in 2015¹, since assets for servicing these liabilities were provided by government borrowing on the international capital market in 2014². Estimates for 2016

¹ In 2015, early repayment was made of a portion of liabilities based on the arrangement with the IMF, which initially was to fall due in 2016.

² In 2014, the government issued the third Eurobond worth Euro 500 million, with maturity of 7 years and rate of return of 4.25%, i.e. an interest rate of 3.975% per year.



indicate space for additional accumulation of foreign reserves based on the assumptions for a gradual increase in foreign investments and borrowings of the private sector, and based on further debt inflows for the government (according to the structure of budget funding, provided in the last fiscal year strategy for 2015-2017). Cumulatively for both years, the current projection foresees a slight decline in foreign reserves. However, despite the expected slight decline, foreign reserves adequacy indicators remain in the secure zone, suggesting a sufficient level of foreign reserves to deal with any unforeseen shocks.

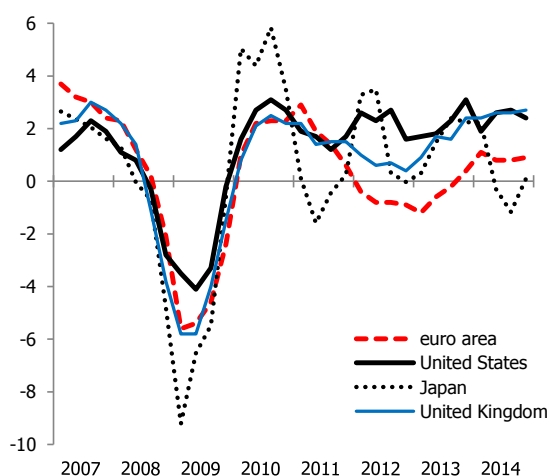
Overall, recent developments suggest similar macroeconomic landscape as projected in October, with assessments for solid economic and credit growth, absence of price pressures and balance of payment position that ensures maintenance of foreign reserves at an adequate level. Risks surrounding this macroeconomic scenario are still mainly exogenous, and associated with the possible shifts in the pace of recovery of the global economic growth (particularly in the EU) and the movements in the prices of primary products in world markets. Nevertheless, the external risks are more balanced relative to the October projection. On the other hand, the baseline April macroeconomic projection is accompanied by risks associated with domestic non-economic factors (uncertainty about political upheavals), which may adversely affect the domestic economy. The NBRM will continue to closely monitor the developments in the period ahead, and if appropriate, will accommodate monetary policy for successful achievement of the monetary policy objectives.

I. Macroeconomic developments

1.1. International economic surrounding³

Indicators for global economic activity for 2014 point to continuation of the trend of gradual recovery, at a pace similar to that in the previous year. Yet, the global growth remains modest, at uneven pace among economies, influenced by short-term and long-term factors. Economic activity in developed countries has strengthened, and the solid growth of the US and the UK economies remains the major engine of positive changes. Also, the euro area reported slightly better performance, and the Japan's economy overcame the recession. On the other hand, economic activity of some emerging and developing countries registered sudden slowdown in the last period of the year. Such performances to some extent reflect the redistribution effect of the sharp drop of oil price in the world markets on the income from oil exporting countries to oil importing countries. Recent estimates predict that the global economy will grow moderately, with further prevalence of downward risks. Inflation further decelerated and is expected to remain low in the coming period, mainly due to the decline in stock prices of oil. The improved global economic conditions are expected to prompt the acceleration of global inflation.

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

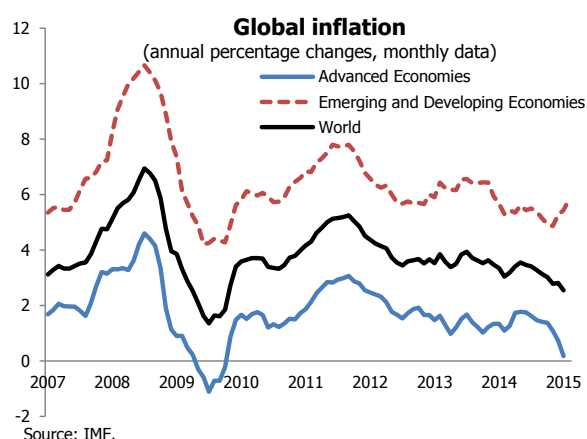
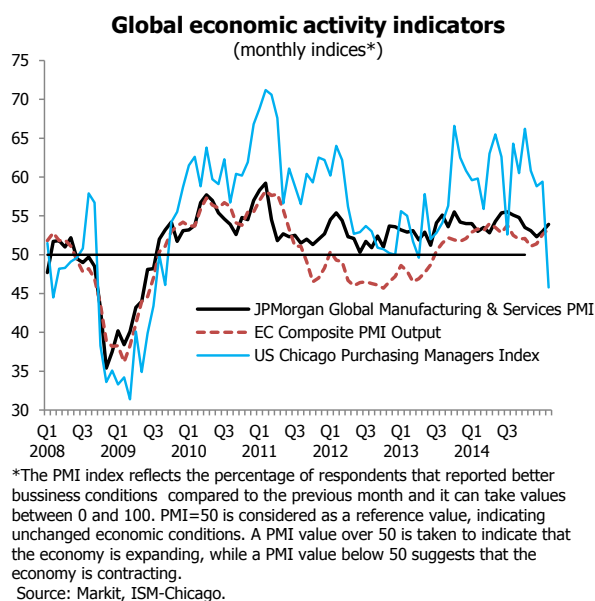


Source: Eurostat.

According to the latest indicators, in the fourth quarter of 2014, the global economic activity continued to recover gradually, at a similar pace as in the previous quarter. Observing the developed countries, the US economy continued to yield good results and increased by 0.5% on a quarterly basis, reaching a GDP annual growth of 2.4%⁴. Such performance primarily results from the recovery of private consumption and investments, despite the negative contribution of net exports and public spending. The US labor market continues to improve, reflecting significant increase in employment. Accordingly, in February, unemployment was down to 5.5%, which is a level close to the long-term rate. The process of recovery continued in the British economy, which despite the quarterly slowdown in the last quarter, the British GDP registered a solid annual growth of 2.6% in 2014. Economic activity in Japan is back in the zone of quarterly growth after the fall in the previous two quarters. On the other hand, the major emerging economies continued showing divergent trends towards the end of the year. While economic growth in China and India was relatively strong, in Russia and Brazil it continued to be weak due to the deteriorating conditions in the markets of primary products and the political

³ The analysis is based on the ECB's economic bulletin; press releases of "Markit Economics"; the monthly reports of the Deutsche Bundesbank and the reports of "Capital Economics."

⁴ However, the quarterly growth in the US economy in the last quarter of 2014 is by 0.7 percentage points lower than the growth in the third quarter, which explains the stimulating effect of one-off factors in the period.



uncertainty. High-frequency survey indicators of economic activity - PMI suggest acceleration of the world economic growth at the beginning of 2015. Thus, in the first quarter of this year, the global composite PMI reached an average value of 53.5 index points, due to the improved performance of the services sector. Analyzing expectations, stronger economic growth in the developed economies is forecast for the coming period, while some developing countries will report stabilization or deceleration. In the short and medium term, such assessments are attributed to the developments in the primary commodity markets, which predict that the fall in market prices of oil will cause significant redistribution effects on the income from the oil exporting countries to the oil importing countries. However, the net effect on the prospects of the global demand is expected to be positive. Observing the expectations for the United States, while the appreciation of the US dollar will limit export growth, domestic demand is expected to remain stable, supported by improved financial conditions and reduced effect of fiscal consolidation. Favorable developments are expected for the euro area, whose economic activity is expected to strengthen during 2015, driven by domestic and external demand, despite the weakness in the labor market.

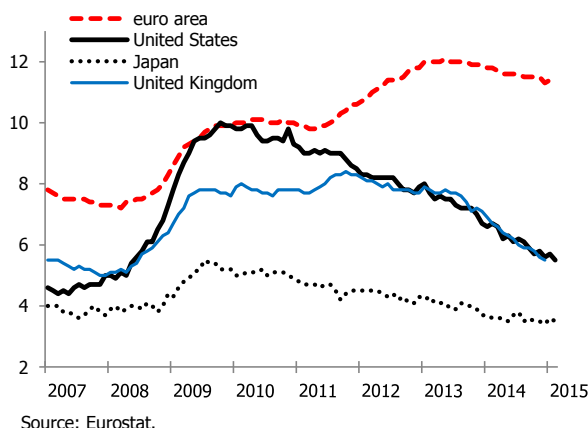
Available data on global inflation point to its further slowdown at the beginning of 2015, mainly caused by the decrease of energy prices. The annual inflation rate⁵ in January 2015 was 2.5%, which is 0.4 percentage points less than in the previous quarter. In addition, this performance is considered the lowest in the last five years. Analyzing developed countries, in the period January-February, inflation rate in the United States and the United Kingdom dropped to -0.1% and 0.2%, respectively. On the other hand, inflation in the developing countries accelerated (5.6%), given the upward pressures from higher import prices or from inflation expectations caused by the depreciation of some of their currencies.

In the fourth quarter of 2014, the economy of the euro area continued yielding modest yet positive results under the influence of several factors that had a positive impact on the economic recovery. Compared to the previous quarter, real GDP growth marginally accelerated at a rate of 0.3%, and the annual growth rate reached 0.9%. The analysis of individual GDP components shows that private consumption

⁵ Source of data is the IMF's International Financial Statistics database.

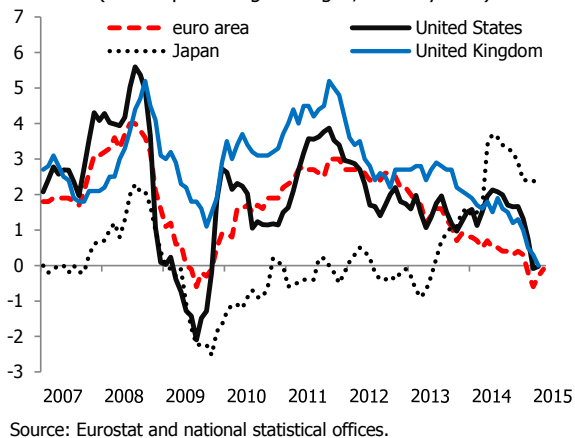


Unemployment in advanced economies (in percent; seasonally adjusted monthly data)



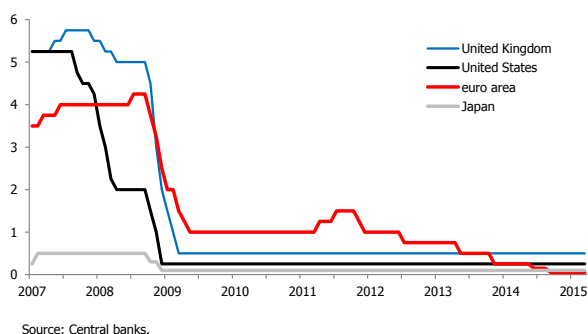
makes the most significant contribution to these rates. Moreover, it was supported by rising real disposable income, reflecting higher wage income, reduced fiscal consolidation and favorable conjuncture of energy prices. Another factor that had a positive impact on consumption and investments is the accommodative monetary policy that improved the financing conditions. Furthermore, the depreciation of the euro and the expectations for further recovery of external demand contribute to the positive results in net exports. Among the largest economies in the euro area, Germany and Spain are the main drivers of the positive economic results, achieving a quarterly growth rate of 0.7%. On the other hand, the French economy grew by merely 0.1%, while the Italian economy stagnated after a long period of negative quarterly growth rates. Observing the labor market, in the first two months of 2015, the unemployment rate remained at the level of the previous quarter and averaged 11.4%, which is lower than the record high of 12.1% in 2012, but indicates continuous high underutilization of the existing facilities.

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



In the first quarter of 2015, the average annual inflation rate in the euro area equaled -0.3%. While the consumer price index ranged in the zone of negative annual changes for the fourth consecutive month, this trend gradually slowed down, and in March decreased by 0.1% annually. Moreover, this performance largely reflects the decline in energy component, which is in line with the fall in market oil prices. Downward movements are seen in food prices, while core inflation recorded a slower growth compared to the previous quarter, which may suggest continuous disinflation trends in the long term. However, it is expected that after the exhaustion of the effect of the fall in oil prices, in the coming period, the upward pressures will be more pronounced due to changes in labor cost and depreciation of the euro against the more relevant currencies.

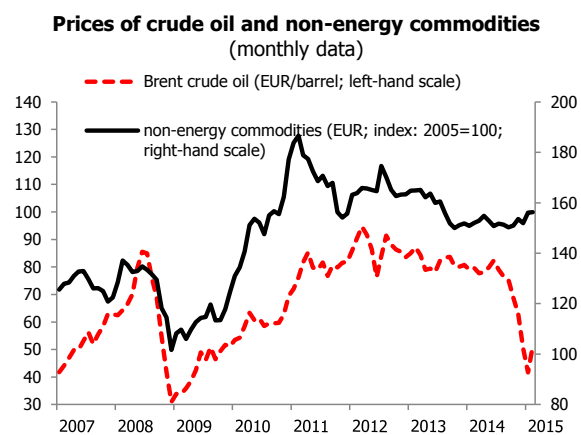
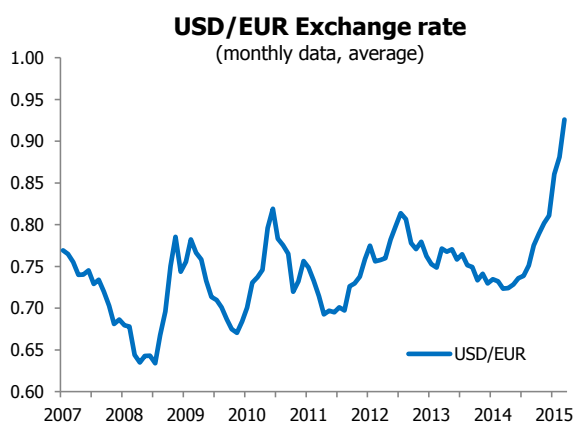
Policy rates in advanced economies (in %)



During the first quarter of 2015, the policy rates of the Fed, the ECB and the Bank of England remained unchanged at levels near zero (0 - 0.25%, 0.05% and 0.5%, respectively), meaning that developed countries continued implementing accommodative monetary policy. At the March meeting, the Fed's Federal Open Market Committee (FOMC) confirmed that the policy rate is appropriate for the present conditions, representing support for the current progress toward successful achieving of the Fed's

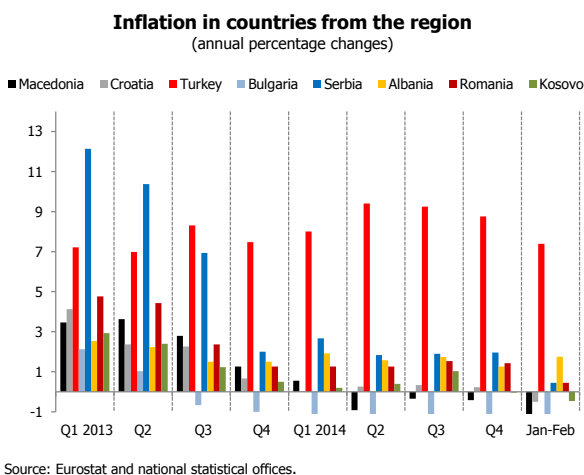
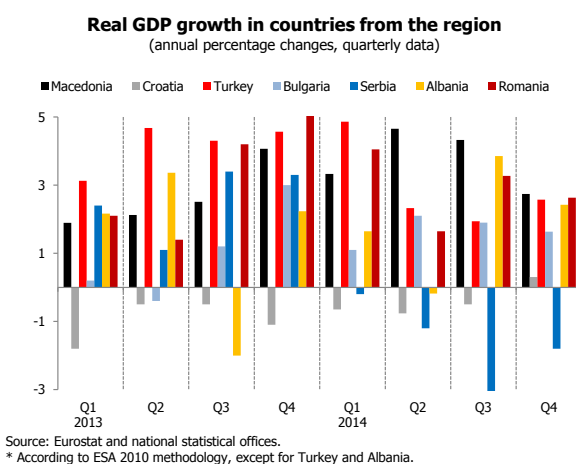
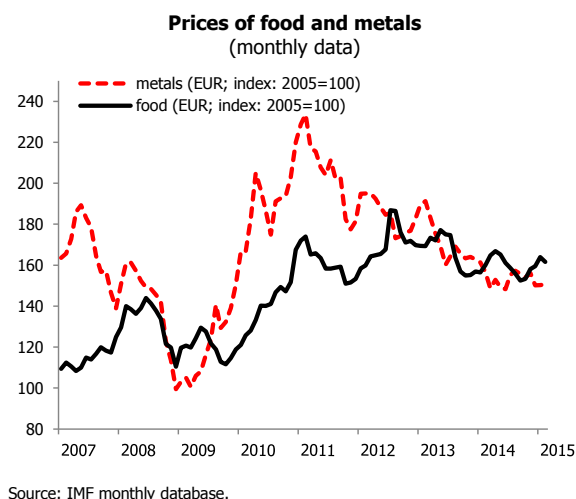


objectives, i.e. achieving maximum employment and price stability. The Committee found that at the next session of the FOMC in April, the increase in policy rate is unlikely. The decision to increase policy rate and the gradual normalization of monetary policy will take into account several labor market indicators, inflationary pressures and financial market expectations and developments. The current practice for reinvestment of matured debt in new assets continues in order to maintain favorable conditions of financing through solid balance sheet of the Fed. Considering the non-standard monetary measures taken by the ECB, in the first quarter of 2015, the focus was put on the implementation of the new extended program for purchase of financial assets in the euro area, announced in January 2015. Thus, in March 2015, the central bank began with the direct purchase of securities issued by private and public sectors of the euro area member states and some European institutions, thus providing further support for the economic recovery and reversal of the inflation rate in the euro area to the target level of about 2% in the medium run. This measure is expected to be implemented by September 2016, with the possibility to continue depending on the inflation growth. Also, the central bank continues delivering two programs for purchase of asset-backed securities and covered bond issued by financial institutions in the euro area denominated in euros, where the total monthly purchase of financial assets including the new program is expected to amount to Euro 60 billion. Contrary to the expectations for tightening of its monetary policy, the Bank of England kept its policy rate at the level of the previous quarter, with further redemption of funds amounting to GBP 375 billion.



Source: IMF monthly database.

The nominal exchange rate of the US Dollar against the Euro continued appreciating during the first quarter of 2015, at a significantly faster rate. Thus, in January and March, the US Dollar recorded a high monthly appreciation of 6.1% and 5.1%, respectively, while in February, the monthly appreciation rate equaled 2.4%. Quarterly, the US Dollar significantly appreciated by 11.1% relative to the previous quarter (appreciation of 6.1% in the fourth quarter of 2014). These movements are mainly attributable to the further monetary easing of the ECB through the new extended program for purchase of financial assets in the euro area. As of March, the US Dollar appreciated by 28%, on an annual basis, when one US Dollar was exchanged for Euro 0.93, which is the highest value of the US Dollar against the Euro since March 2003.



During the first two months of 2015, there was a further significant reduction in the average oil price, expressed in euros. In this period, crude oil "Brent" was sold at an average price of 46.4 euros per barrel, which is a quarterly decline of 23.7%. An analysis on a monthly basis shows divergent trends in oil prices in January and February. Thus, in the first month of the year, as a result of the higher supply and reserves, and supported by the OPEC's decision to maintain the same market share, there was a drastic cut of oil prices (41.7 euros per barrel). Further downward impact on oil prices resulted from the appreciation of the US Dollar in this period. On the other hand, after eight months of continuous decline, in February, oil prices registered a monthly increase of 22.5%, mainly due to lower supply from Libya, Iraq and Russia, amid strong demand from Asia. **Prices of non-energy primary commodities⁶ denominated in euros went up by 2.7% in the first two months of the first quarter compared to the previous quarter** as a result of the increased food prices (quarterly growth of 3.7%), amid quarterly decrease in metal price (a decline of 2%). The rise in food prices solely reflects the appreciation of the US Dollar against the Euro in this period⁷ while the drop in metal prices is associated with the slower growth in demand for metals in China.

In the last quarter of 2014, the countries of the region recorded divergent trends in economic activity, with the majority of them remaining in the positive zone of economic growth. Thus, amid weaker net exports, but improved domestic consumption, Romania and Bulgaria reported a moderate slowdown in the GDP growth rate, while in the same period, Serbia and Croatia reported some improvement in economic activity. As a result of gradual exhaustion of negative effects of the floods that hit the region, Serbia reported a slowdown in the negative GDP growth rate. In Croatia, after three years of continuous decline, the last quarter of 2014 was marked by a moderate positive rate of economic growth.

During the first two months of 2015, most countries in the region reported slower rate of inflation, and some countries experience deflationary trends. Thus, Turkey, Serbia and Romania reported a moderate

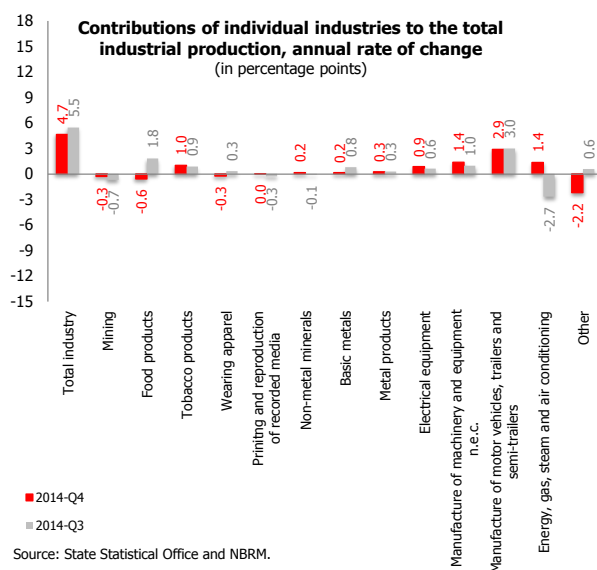
⁶ Price index of non-energy primary products includes: prices of food, beverages, agricultural raw materials and metals.

⁷ Expressed in US dollars, food prices registered a quarterly decline.

slowdown in the general price level, while in Croatia, Kosovo and Bulgaria, the general price level decreased. On the other hand, amid increased prices of unprocessed food, caused by the great flood that hit the country in January and February, Albania reported moderate acceleration in the rate of inflation.

1.2. Domestic supply

Favorable developments in the economy continued in the last quarter of the year that registered an annual GDP growth of 2.7%, which, amid small quarterly decline, is a moderate slowdown in the pace of growth. Thus, for the entire 2014, GDP growth equaled 3.8%. Solid economic performance in the fourth quarter of 2014 were distributed among different sectors, with the highest contribution to the annual growth making the increased activity in the manufacturing industry, mostly due to the activity of the new export-oriented facilities. In the fourth quarter, performance in the construction sector improved, which confirms previous assessments that the unfavorable developments registered in the second and third quarter of the year are temporary.

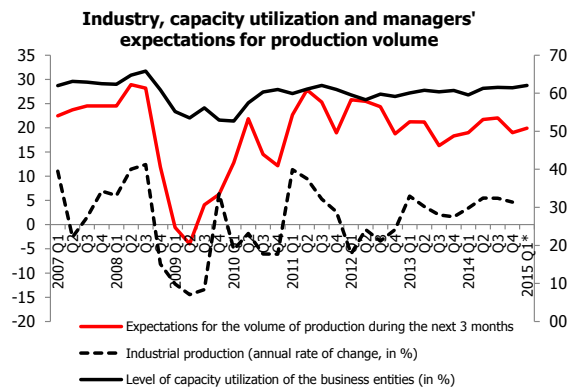


The last quarter of 2014 registered a small quarterly GDP decline of 0.2% (seasonally adjusted). However, on an annual basis, economic activity continued to grow, and the real GDP increased by 2.7%. Moderate quarterly downward adjustment of GDP mostly reflects the decline in the value added in agriculture, manufacturing industry, and in the trade, transport and communications sector. Analyzing annual dynamics, industry and construction are major drivers of the growth in the fourth quarter. Higher added value than that in the same period last year was registered in almost all services sectors with the exception of trade, transport and communications sector⁸. In agriculture, after the growth registered at the beginning of the year, in the fourth quarter, the value added declined.

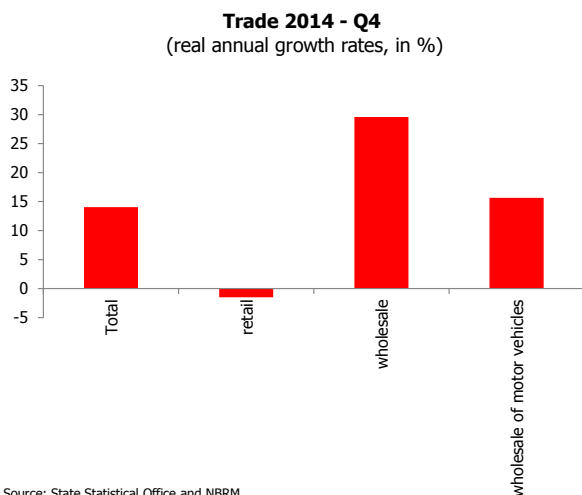
	annual growth rates, in %										contributions to GDP growth (in p.p.)									
	Q1 2013	Q2 2013	Q3 2013	Q4 2013	2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014	2014	Q1 2013	Q2 2013	Q3 2013	Q4 2013	2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014	2014
Agriculture	16.0	7.3	1.7	14.3	9.0	3.8	8.7	0.9	-3.1	2.0	0.9	0.5	0.2	1.2	0.7	0.2	0.6	0.1	-0.3	0.2
Industry	6.7	5.8	4.5	6.2	5.8	2.6	5.7	5.9	2.8	4.3	0.8	0.7	0.5	0.8	0.7	0.3	0.7	0.7	0.4	0.5
Manufacturing	10.8	7.8	7.8	10.4	9.2	8.2	11.3	16.6	4.5	10.0	0.8	0.7	0.7	1.0	0.8	0.7	1.0	1.5	0.5	0.9
Construction	5.8	4.0	8.9	5.7	6.0	9.5	0.3	3.2	11.1	6.1	0.7	0.4	0.8	0.5	0.6	1.1	0.0	0.3	0.9	0.6
Trade and transport	10.6	5.7	3.4	-0.2	4.5	3.5	5.8	3.9	-0.9	3.1	1.5	0.9	0.6	0.0	0.7	0.5	1.0	0.6	-0.1	0.5
Information and communication	10.4	10.7	9.2	10.0	10.1	2.3	4.7	4.0	2.0	3.3	0.5	0.5	0.5	0.5	0.5	0.1	0.3	0.2	0.1	0.2
Financial and insurance activities	2.6	1.1	0.5	3.6	1.9	4.2	3.5	7.5	3.8	4.7	0.1	0.0	0.0	0.1	0.1	0.2	0.1	0.3	0.1	0.2
Real estate activities	-10.4	-2.5	3.5	5.8	-1.3	4.8	4.1	2.8	0.9	3.2	-1.4	-0.3	0.4	0.6	-0.2	0.6	0.5	0.3	0.1	0.4
Professional, scientific and technical	-3.0	7.8	11.7	17.4	7.6	2.0	6.9	8.2	12.4	7.2	-0.1	0.3	0.4	0.5	0.3	0.1	0.2	0.3	0.4	0.2
Public administration	2.0	1.5	1.0	0.4	1.2	0.6	0.6	0.8	0.0	0.5	0.3	0.2	0.1	0.0	0.2	0.1	0.1	0.1	0.0	0.1
Other service activities	-19.6	-7.5	10.5	22.0	-1.0	12.2	11.3	11.6	11.7	11.7	-0.6	-0.2	0.2	0.4	0.0	0.3	0.3	0.3	0.3	0.3
Gross Domestic Product	1.9	2.1	2.5	4.1	2.7	3.3	4.7	4.3	2.7	3.8	1.9	2.1	2.5	4.1	3.4	3.3	4.7	4.3	2.7	2.9

Source: State Statistical Office and NBRM calculations.

⁸ Since the third quarter of 2014, the three activities: trade, transport and communications, and hotels and restaurants have been published aggregately, i.e. it is impossible to present their growth individually.



Source: State Statistical Office.
 * average of expectations for 1 and 2 month of 2015



Source: State Statistical Office and NBRM.



Source: State Statistical Office and NBRM.

During the fourth quarter of 2014, industrial sector developments remained favorable. Yet, there was a slowdown in the annual growth rate, reflecting the quarterly decline in the value added of this sector.

Manufacturing industry is generator of the annual growth, where the improved performances are largely attributable to the activity of new export-oriented facilities, and growth has also been observed in some other facilities. Analyzed by sector, the annual industry growth is mostly explained by the growth of manufacturing of electrical equipment, machinery and its equipment and motor vehicles and equipment, as well as the higher production of tobacco products. Besides the manufacturing industry, the fourth quarter also registered a growth in the sector of supply of electricity, gas, steam and air conditioning despite the negative developments in this sector over the last three quarters of the year. On the other hand, mining sector again made negative contribution to the growth. Improved performance in manufacturing industry was also confirmed in the **Business Tendency Survey in manufacturing industry⁹**. Namely, according to the survey, the fourth quarter recorded an increased average capacity utilization compared to the same period last year, and there are favorable expectations for the future output volumes. Observing limiting factors, corporate managers stress the lack of skilled labor as a factor with highly negative impact in the fourth quarter (compared to the same period last year). **The results of the survey conducted in the first two months of the first quarter of 2015 point to further improvement of the developments of this sector.** Thus, in January - February 2015, the current economic situation of the businesses is found to be favorable, with higher average capacity utilization. Also, corporate managers form more optimistic expectations for the output volume and the number of employees in the next three months.

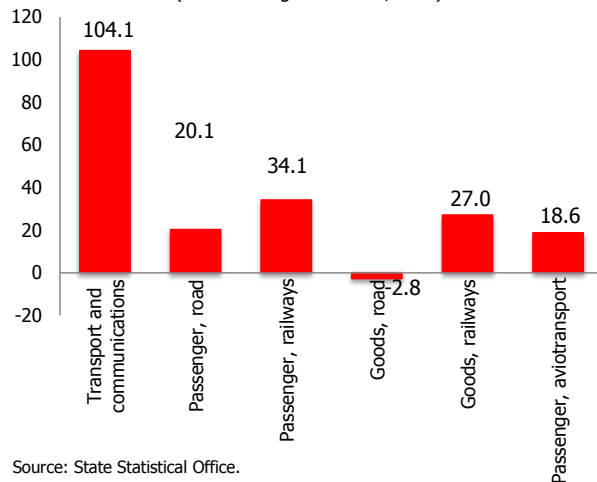
Trade sector trends from the third quarter of 2014 continued in the fourth quarter¹⁰. Namely, the turnover of wholesale trade and motor vehicles increased in this quarter. Simultaneously, the turnover in the retail trade continued going down, but at decelerating pace. The gradual improvement of retail trade is also confirmed by the results of the **Survey of Retail**

⁹ Refers to surveys conducted in the fourth quarter of 2014.

¹⁰ The analysis of trends in trade is based on data on the trade turnover.

Transports and communications in 2014-Q4

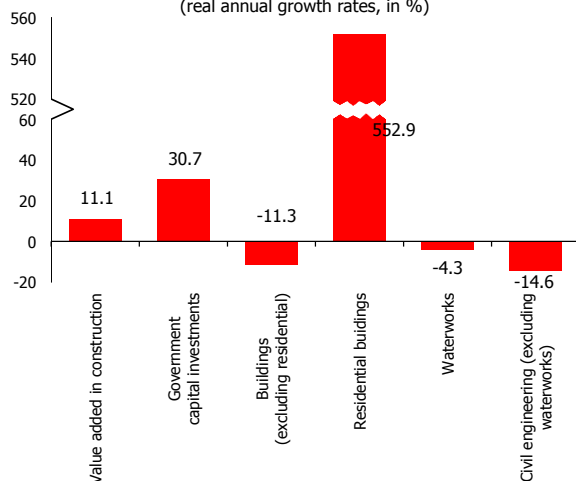
(real annual growth rates, in %)



Source: State Statistical Office.

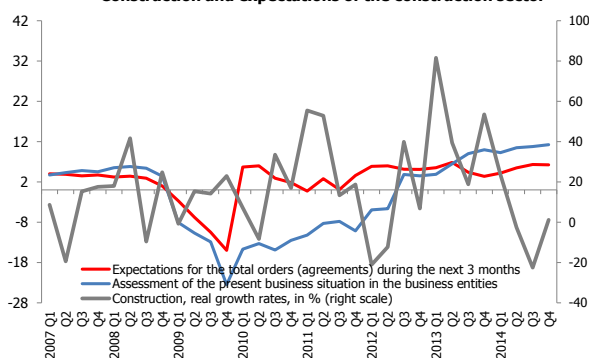
Construction in 2014-Q4

(real annual growth rates, in %)



Source: State Statistical Office and Ministry of finance

Construction and expectations of the construction sector



Source: State Statistical Office.

Trade Managers¹¹ conducted in the fourth quarter. Thus, in the fourth quarter, this sector's managers expressed favorable expectations for the future orders, sales prices and business conditions of this sector. However, in the fourth quarter, managers again identified the existence of a number of factors whose influence is still less favorable than the same period last year, and pinpointed the increased market supply, higher competitiveness, high labor costs and shortage of trained staff as highly relevant.

The analysis of trends in the transport and communication sector indicates growth in most communication categories of this sector, with highest growth in the area of passenger road transport.

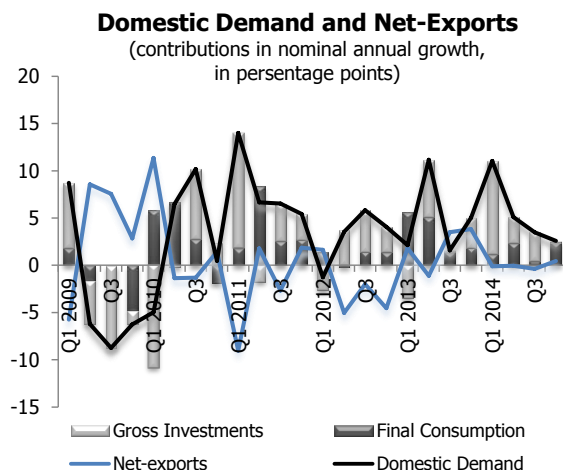
The growth of value added in construction accelerated in the fourth quarter both quarterly and annually. This performance is in line with the previous assessments for temporary nature of unfavorable trends in this sector during the second and third quarter of the year. Observing type of construction buildings, the annual growth is fully explained by the growth of the construction of residential buildings, which is partly attributable to the extremely low base effect from the previous year. On the other hand, other construction activities in the field of building construction and civil engineering decreased compared to the same period last year. The favorable developments in this sector in the last quarter of the year are in line with the results of the **Business Tendency Survey in construction¹²** according to which the current business and financial standing of the corporate sector is regarded as more favorable compared to the same period last year. However, in this quarter, managers again highlighted several limiting factors for the growth of construction such as insufficient demand, bad weather and increased labor costs. As for the construction trends in the coming period, signals obtained from the survey are in different direction, meaning that managers have less favorable expectations for the volume of orders and selling prices and more favorable expectations for the number of employees.

¹¹ SSO's Business Tendency Survey in retail trade for the fourth quarter of 2014. The balance of responses is the difference between weighted positive and negative responses of corporate managers. The balance is designed to show the movement of the observed economic indicator rather than its true size, i.e. it provides qualitative rather than quantitative (numerical) data from the corporate managers.

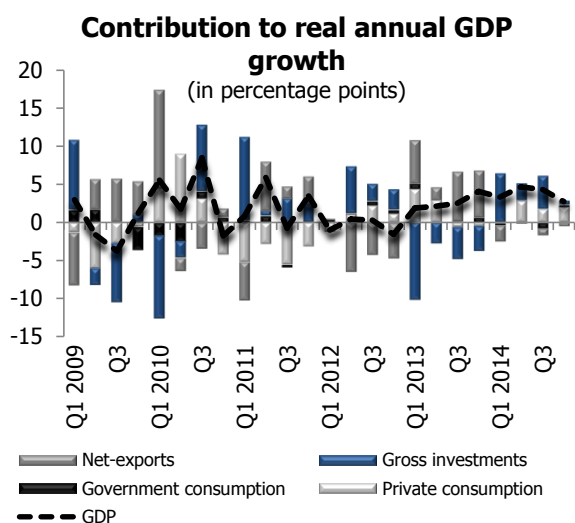
¹² Refers to surveys conducted in the fourth quarter of 2014.

1.3. Aggregate demand

Observing demand, the annual growth in gross domestic product of 2.7% in the fourth quarter of 2014 resulted from the positive contribution of domestic demand, unlike net export demand, which made negative contribution to growth. Analyzing individual components, export demand registered the highest growth, making it the main driver of economic activity. The significant export growth of 22.4% annually in the fourth quarter was largely attributable to the activity of the new production facilities and the gradual improvement of the external economic environment. All domestic demand components grew, with the biggest positive contribution and rapid growth (2.9%) of household consumption as a result of positive labor market developments. Gross capital formation remained in the zone of positive trends, but with a significant slowdown in growth (1.8%). After falling in the previous three quarters, public spending increased by 1.9% and contributed to the growth of total GDP. Decreased domestic and export demand, amid high dependence of domestic output on imports, brought about by 17.4% higher imports.



Source: State Statistical Office and NBRM calculations.



Source: State Statistical Office and NBRM calculations.

In the fourth quarter of 2014, gross domestic product (GDP) decreased by 0.2% compared to the previous quarter (seasonally adjusted), and increased by 2.7% compared to the same period last year, but at slightly slower pace compared to the annual pace of the previous four quarters. From the aspect of demand, GDP analysis shows that the increase in the fourth quarter of 2014 is the result of higher domestic and external demand, partially offset by the increase in imports. The previous three quarters registered a similar structure of economic growth. Analyzing individual components, exports, same as in the previous two quarters, made the greatest individual positive contribution to growth. Continuing favorable developments in the export sector are largely attributable to the operation of new production facilities, as well as the gradual improvement of the external economic environment. In the last quarter of the year, all domestic demand components reported a growth. Namely, the positive labor market trends and higher real wages increased household consumption (both quarterly and annually). Gross capital formation remained in the area of positive trends, but their growth slowed down significantly mainly reflecting the downward base effects of the substantial construction growth in the previous year. After declining in the previous three quarters, public consumption registered an annual growth and contributed to the growth of total GDP. Increased domestic and export demand intensified imports, but at a slower pace compared to the increase of exports. However, net exports made negative contribution to growth.

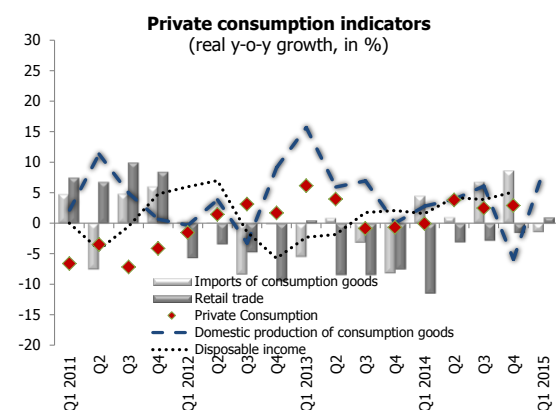
Real annual growth rates (%)

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

*decrease represents lower deficit

Source: SSO and NBRM calculations.

1.3.1. Private consumption

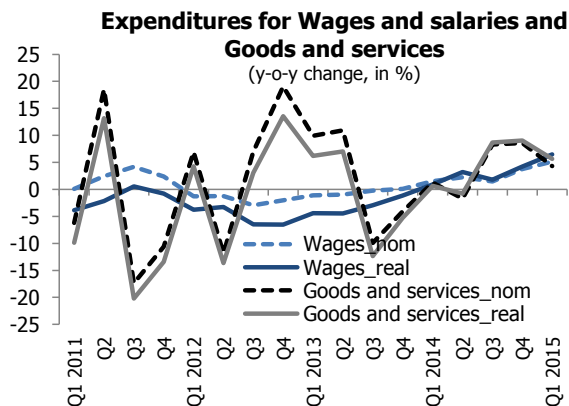


Source: State Statistical Office, Ministry of Finance and NBRM calculations.

In the last quarter of 2014, household consumption recorded a minor quarterly increase of 0.1% (seasonally adjusted) and a moderate acceleration of the annual growth of 2.9%. Such annual growth of private consumption corresponds to the increase of available funds, given the growth in the main components of disposable income. Thus, the acceleration of real growth of average paid wages, coupled with the higher employment brought about faster pace of growth of the wage bill in the economy. Also, growth of pensions continued in the last quarter of the year, albeit more slowly than in previous quarters. Additional positive contribution to the growth of household income was made by the higher inflows based on private transfers from abroad. Despite the growth of the main components of the household disposable income, the further real growth in lending to households, mainly in the form of consumer loans that are an additional source of funds, supported spending in the fourth quarter. The movement of short-term indicators of private consumption mostly corresponds to the growth in the last quarter of the year. Thus, an annual growth was recorded in import of personal consumption goods and net revenues from VAT. On the other hand, turnover in retail trade declined, at a slower pace though.

According to the recent available data, private consumption is expected to increase annually in the first quarter of 2015¹³. In fact, there are assessments for continuous growth of total funds available to households in the first quarter in line with the increase in real wages, pensions and transfers. According to lending data, in the period January-February, the growth of consumer loans to

¹³ Data on wages, private transfers and import of consumer goods are as of January, while other data are as of November.



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

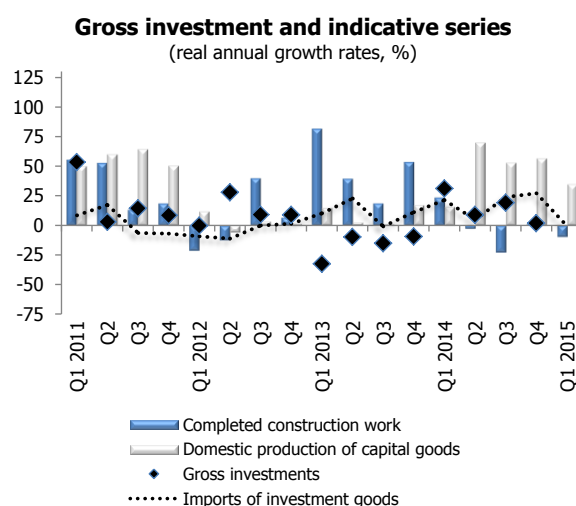
households is expected to continue in the first quarter of the year, which according to the Lending Survey¹⁴, corresponds to the banks' expectations for further growth in demand for loans and easing of credit conditions in this period. Analyzing the remaining short-term indicators of private consumption, retail trade registered a real annual growth after seven quarters of unfavorable trends, as well as in domestic production of consumer goods that are also in favor of the expectations for higher private consumption in the first quarter. On the other hand, adverse developments in the first quarter are recorded in net revenues from VAT and in import of consumer goods.

1.3.2. Public consumption

In the fourth quarter of 2014, public consumption recorded a quarterly growth of 8.7% (seasonally adjusted) and annual growth of 1.9% for the first time in three quarters. Real annual growth stems from the costs for wages, goods and services as well as the higher transfers for health care¹⁵. Available data for January and February 2015 indicate a further increase in annual public spending in the first quarter of 2015, given the real growth in wage costs and higher costs for goods and services.

1.3.3. Investment consumption

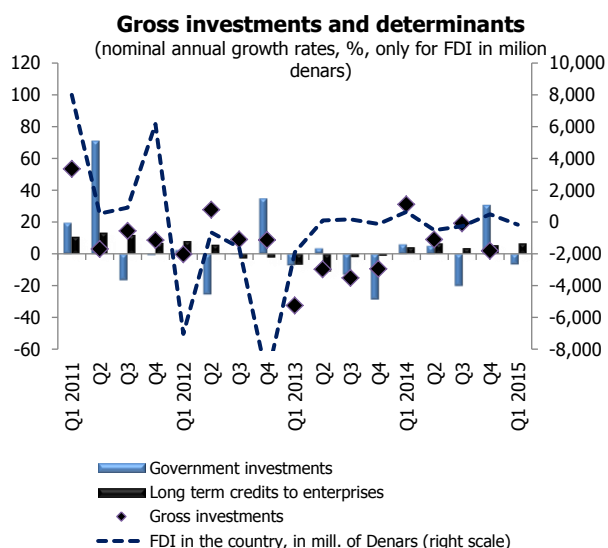
In the fourth quarter of 2014, the gross capital formation registered a quarterly decline of 11.8% (seasonally adjusted). Observed annually, the investments remained in the zone of positive trends with a growth of 1.8%, which is a substantial slowdown compared to the previous quarter. According to data on short-term indicators of investment activity, the growth probably reflects the increase of investments in fixed assets, amid decrease in completed construction works. Namely, import of capital goods, which is an indicator of investment in machinery and equipment continued to grow at an accelerated pace in the fourth quarter. Positive trends in investment in equipment and machinery are partly associated with foreign direct investments, which increased in the fourth quarter. Other short-term investment indicators also promote the growth of investments in the fourth quarter. Thus, the last quarter registered growth in domestic production of capital goods,



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

¹⁴ NBRM's Lending Survey conducted in December 2014.

¹⁵ Most of these assets relate to expenditures for goods and services.



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

government expenses for capital investments, as well as corporate loans. Moreover, according to the results of the Lending Survey¹⁶, amid mainly unchanged terms of lending, demand for loans increased, and a significant portion of loans to corporate sector were earmarked for investments in inventory and working capital.

Most of the available short-term indicators of investment activity point to a moderate annual growth of investments in the first quarter of 2015¹⁷. Thus, annual growth was observed in the domestic production of capital goods. Meanwhile, the period January-February registered a moderate strengthening of the annual growth of long-term corporate lending by banks, and a growth was registered in foreign direct investments and inventories of finished products. On the other hand, the value of completed construction works in January recorded a real annual decline, partly due to the worse weather conditions compared to the previous year. Also, the total projected value of approvals for construction in January declined on an annual basis fully derived from the decrease of building construction due to the high base effect, while civil engineering registered a significant increase associated with the announcements of major infrastructure projects. Additionally, the results of the Business Tendency Survey in construction¹⁸ give different signals about managers' expectations for this sector during the first quarter. Bearing this in mind, in the first quarter, the support of the construction sector for the total investment demand will most probably be relatively weak. Of the remaining short-term investment indicators, a minimal decline was registered in imports of capital goods and lower government costs for capital investments.

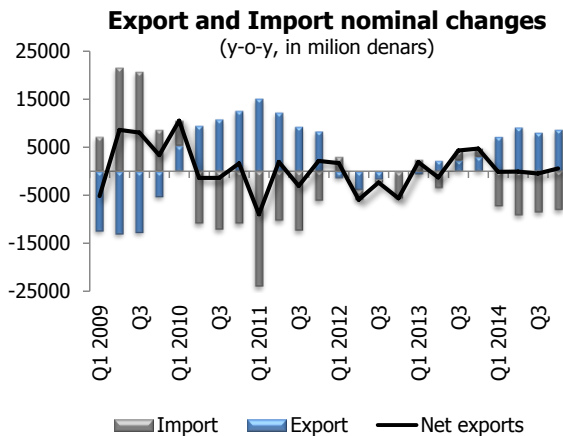
1.3.4. Net external demand

The situation in the external sector during the fourth quarter matched the shifts typical for the previous quarters of the year. Thus, in the last quarter, the level of foreign trade was again significantly higher than in the fourth quarter last year. The contribution of net exports to GDP growth remained in the negative zone. Real exports of goods and services recorded a high annual growth of 22.4% and strong acceleration of the quarterly growth pace (quarterly

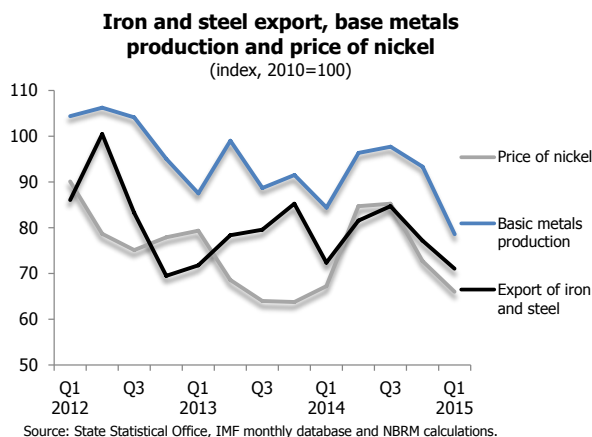
¹⁶ NBRM's Lending Survey conducted in December 2014.

¹⁷ Data on completed construction works, foreign direct investments and import of working capital are as of January, while other data are as of February.

¹⁸ Refers to the surveys conducted in the third quarter of 2014.



Source: State Statistical Office .



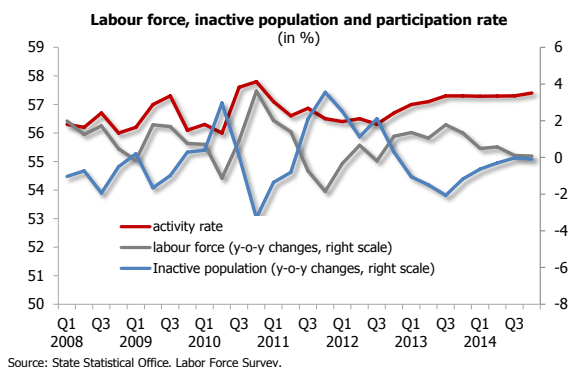
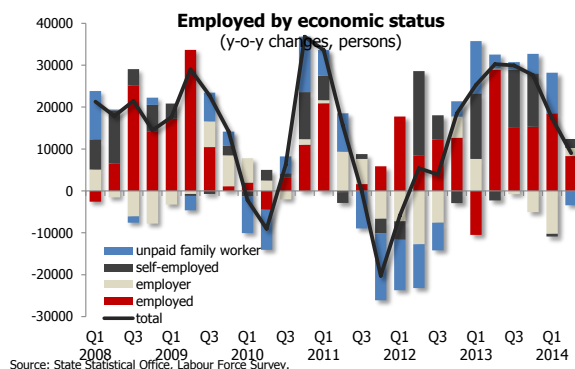
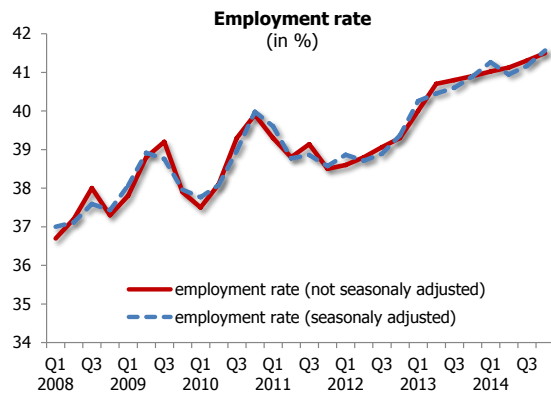
Source: State Statistical Office, IMF monthly database and NBRM calculations.

growth of 8.3%, seasonally adjusted). High annual growth is mostly due to increased exports of the new production facilities in the country. Analyzed by product category, the last quarter recorded the highest exports of machinery and equipment, and chemical products. Amid still weak global demand for metals and quarterly decrease of metal prices on the world market, the situation in the domestic steel industry remains unfavorable. Amid heavy import-dependence of the domestic production, the high annual growth of imports in the third quarter reflects the import of intermediate products. Imports registered a quarterly increase of 4.6% (seasonally adjusted).

The data for the first quarter point to continuation of favorable trends on the export side. Thus, amid increased utilization of capacities in the manufacturing industry, in January and February 2015, exports of goods registered a nominal annual growth. Generators of growth, as in the past year, include the new export capacities (higher export of machinery, electrical equipment and chemical products), with positive contribution to growth also being made by the facilities of other export sectors (moderate growth of export of furniture, tobacco and metals). Unlike exports, imports show nominal annual decline in the first two months of the first quarter, primarily due to the fast decline in energy imports associated with lower import prices of energy, and less with the lower investment import of equipment, machinery and vehicles. **Analyzing net export demand,** nominal data for January and February show expectations for narrowing of trade deficit in the first quarter, given the high growth in exports and decline in imports.

1.4. Employment and wages

In the fourth quarter of 2014, the number of employees grew on an annual basis, at a slightly stronger pace than the growth in the previous two quarters, while for the entire 2014, employment increased by 1.7%. Thus, this labor market indicator has continuously ranged in the zone of positive annual changes for almost three years. Such trends are in line with the real sector performance, which is also favorable. Improving some of the key labor market indicators for several years can be explained by the operation of the new facilities in the technological-industrial development zones. Moreover, for a longer period, fiscal policy has been aimed towards intensification of economic activity and employment through active employment measures, delivery of public infrastructure projects, as well as policies for subsidizing agricultural production. The aggregated signals from business tendency surveys point to some weakening of optimism regarding employment for the next three months.



In the last quarter, the number of employees registered an annual growth of 1.5%, a pace somewhat stronger than perceived in the previous two quarters. The quarterly dynamics show accelerating pace, as observed through the quarterly increase in employment of 1.3%¹⁹. Contrary to agriculture, which experienced an annual decline in employment, industry and services sector retain a positive contribution to growth. Analyzed by sectors, the annual employment growth is marked by a relatively high dispersion, with the public administration, defense and compulsory social security, real estate and other business sector, manufacturing and hotels and restaurants making the greatest contribution. In terms of economic status²⁰, the growth completely derives from the category of employees. These developments increased the employment rate by 0.6 percentage points annually, to 41.5%. The results of the Job Vacancy Survey confirm the positive developments in the employment²¹. Namely, the number of vacancies, as another indicator of the movement of labor demand, increased annually by 5.4% in the fourth quarter, while the rate of job vacancies²² only significantly rose to 1.37%.

The outlook of labor market developments for the first quarter of next year somewhat deteriorates. The aggregated signals from business tendency surveys²³ suggest weakening of optimism regarding the employment for the next three months. However, considering the improved expectations for orders in the next

¹⁹ The analysis of quarterly dynamics of employment, unemployment and total active population was made using seasonally adjusted data.

²⁰ The classification by economic status applies to the following groups: **employers** - persons who operate their own business entity or engages independently in their own shop, or farm owners who hire other employees; **employees** - persons who work in government institutions, business entities in public, mixed, cooperative and undefined ownership or for private employer; **own-account workers** - persons who operate their own business entity, company, engage independently in their own business and work on a farm in order to generate income, while not hiring other employees; **unpaid family workers** - persons who work without pay in a business entity, shop or farm (owned by a family member).

²¹ For the first time in 2012, the State Statistical Office began to conduct a Vacancy Survey as part of the labor market research. The purpose of this Survey is quarterly reporting on vacancies in companies in the Republic of Macedonia, as an important indicator for the macroeconomic developments and policies in the labor market.

²² The rate of vacancies is defined as the ratio between the number of job vacancies and the total number of jobs, i.e. both vacant and occupied jobs.

²³ Source: State Statistical Office, business tendency surveys in manufacturing industry (January 2015), construction (fourth quarter of 2014) and trade (fourth quarter of 2014).

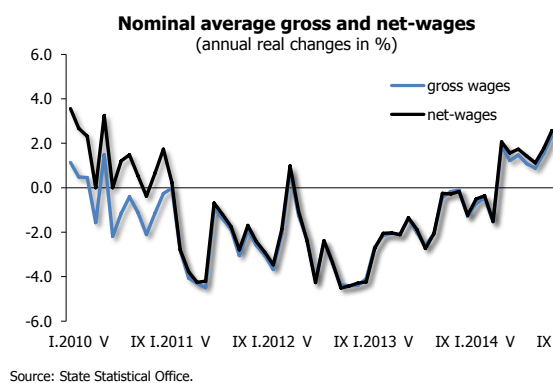
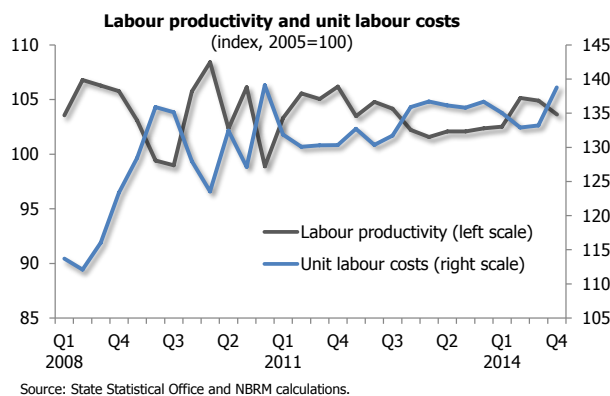
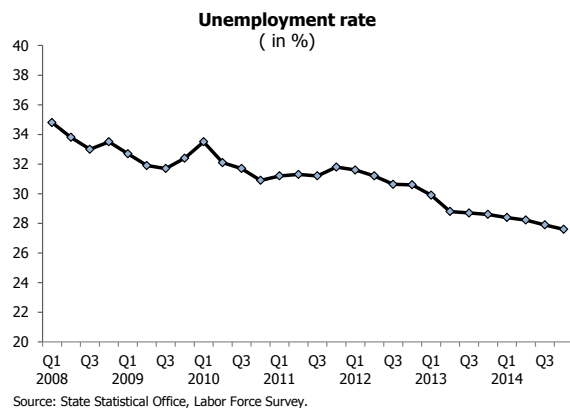
quarter, the decline in optimism in terms of employment is most likely temporary.

In the fourth quarter, there are no significant changes in labor supply Thus, compared to the same period last year, the total active population increased by merely 0.1%, which amid equal decline in inactive population, activity rate went up by 0.1 percentage points annually and positioned at 57.4%.

In the fourth quarter, the reduction of unemployment continued, amid further intensive growth of labor demand versus the growth of labor supply. Namely, the number of unemployed in the fourth quarter decreased by 3.6% annually, which is a faster decrease compared to the previous period. Consequently, the unemployment rate fell by 1 percentage point annually and reduced to 27.6%.

The average wages paid in the fourth quarter marked a further annual growth, at enhanced dynamics. Thus, in the last quarter, the nominal net and gross wages increased annually by 3% and 2.8%, respectively. With the exception of hotels and restaurants, wage growth was registered in all other sectors, with the professional, scientific and technical sector and the construction sector registering the greatest upward adjustment. Additionally, the public administration wages increased in the fourth quarter as announced²⁴. Nominal net and gross wages rose quarterly, with agriculture being the only sector where the shifts are downward. **In the last quarter, amid slightly faster fall in general price level, real net and gross wages recorded further strengthening of positive annual dynamics, i.e. went up by 3.4% and 3.2%, respectively.** Meanwhile, in the last quarter, real wages grew up by 2.9% on a quarterly basis, which comes after nearly stagnant performance in the previous quarter.

Labor productivity in the last quarter registered an annual growth of 1.2%, which is a slowdown compared to the previous quarter. The above results from the more intense annual growth of economic activity compared to the employment growth. Productivity deteriorated on a quarterly basis given the fall in economic activity and the faster growth in the number of employees. **After falling in the previous**

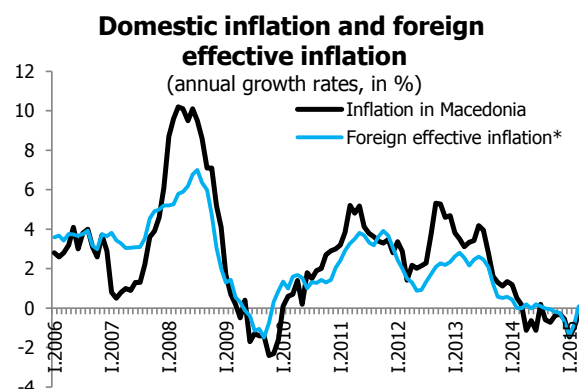


²⁴ In September 2014, the Assembly of the Republic of Macedonia passed legislative amendments that allowed an increase of wages of the public administration of 4%. The increase relates to the October wage paid in November.

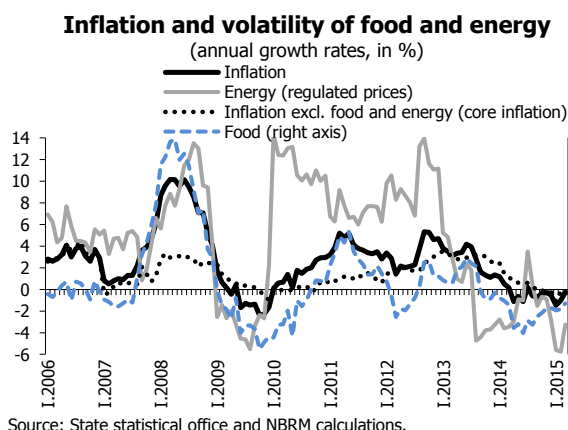
quarter, unit labor costs registered an annual growth of 1.5%. Upward adjustment is due to the faster growth of gross wages, compared to productivity growth. Labor costs show upward trend on a quarterly basis as well.

1.5. Inflation

Domestic prices continued to decline in the first quarter of 2015, being lower on average by 0.9% on an annual basis. Such developments represent a faster decline compared with 2014, when prices fell by 0.3%. Moreover, same as previous quarter, the decline was largely conditioned upon lower prices of energy component of inflation, reflecting the cut of crude oil price on world markets. Also, core inflation continued decelerating (price component excluding food and energy), with food prices making a neutral contribution to the overall price growth. Consumer prices declined on a quarterly basis by 0.6%. The decrease in prices in the domestic economy influenced the expectations of economic agents who expressed expectations for lower inflation for 2015 and 2016, with the movement of consumer prices in the domestic economy and the euro area in the past, the slow recovery of European economies and lower world prices of crude oil being the main factors for the downward revision of expectations. Producer prices continued to decline on an annual basis in the first two months of the year, with the largest contributors being the lower energy production prices, primarily oil derivatives influenced by movements in oil prices on global markets.



* 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.



Source: State statistical office and NBRM calculations.

The reduction in domestic consumer prices that started in the second quarter last year continued during the first quarter of 2015, when prices declined by 0.9% on an annual basis. An analysis by component shows that, as in the previous quarter, the downward movement in the first quarter reflects lower energy prices, with smaller contribution of core inflation. The negative contribution of energy component results from lower prices of liquid fuels and lubricants due to the drop in the price of crude oil on world markets. Downtrend of core inflation (price component without food and energy) that started in the previous quarter last year, driven primarily by lower prices of communications and transport continued in the first quarter of 2015. On the other hand, when it comes to food prices, after their decline in the previous three quarters, in the first quarter of the year these prices slightly went up. Yet, their contribution to the overall index of consumer prices is neutral. Growth in food prices is generally explained by the upward adjustments in vegetable prices, with downward adjustments in the prices of meat, and oil and fat. Lower consumer prices in the first quarter of 2015 were reported by the major trading partners, i.e. the **foreign effective**

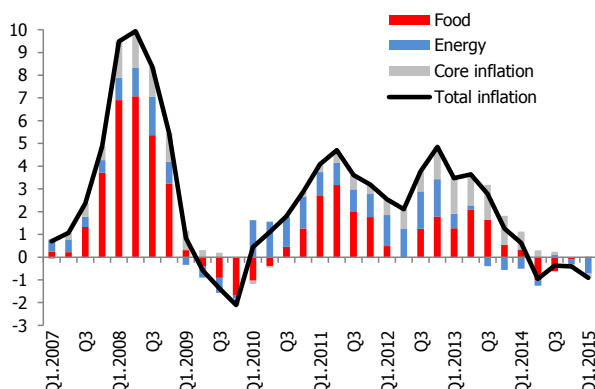
inflation²⁵ fell by 0.7%, which is an acceleration of the decline (0.4% in the previous quarter).

Price categories

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

Source: State Statistical Office and NBRM calculations.

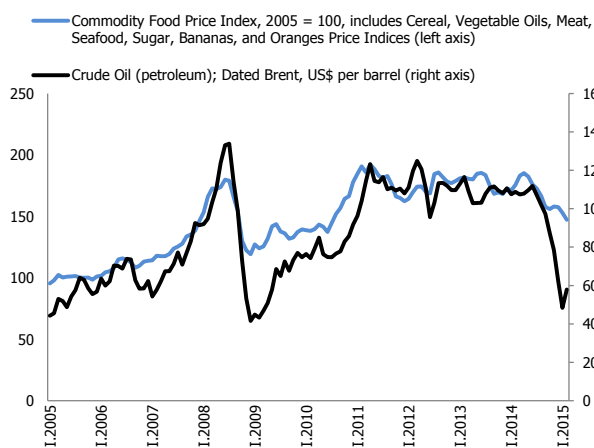
Volatile (food and energy) and core inflation (contribution to inflation, in percentage points)



Source: State statistical office and NBRM calculations.

Analyzed dynamically, the first quarter registered additional annual decline in prices, mainly due to the prices of energy component, with smaller contribution of core inflation. Thus, the acceleration of the decline in core inflation is small on an annual basis, from -0.2% in the fourth quarter to -0.4% in the first quarter of 2015. The moderate acceleration of decline of these prices was largely explained by changes in prices of handsets and services, with additional contributions made by lower prices of electrical appliances and personal hygiene goods, pharmaceutical products, and lower prices of cars.

Crude oil and food prices



Source: IMF Primary Commodity Prices.

In the first quarter of 2015, consumer prices registered a quarterly decrease of 0.6%. Similar to the annual change, the greatest contribution to the quarterly decrease was made by the energy component of inflation (quarterly decline of 3.5%) due to lower prices of liquid fuels and lubricants. Core inflation recorded a small quarterly decline (of 0.5%). On the other hand, food prices registered a quarterly growth of 0.3%, mainly reflecting seasonal increase in prices of unprocessed vegetables, while prices of most of the other food products went down corresponding to the movement of foreign effective food prices²⁶. **Similar quarterly decrease in consumer prices (of 0.8%) is obtained according to the seasonally adjusted data, given the decline in prices of all inflation components.**

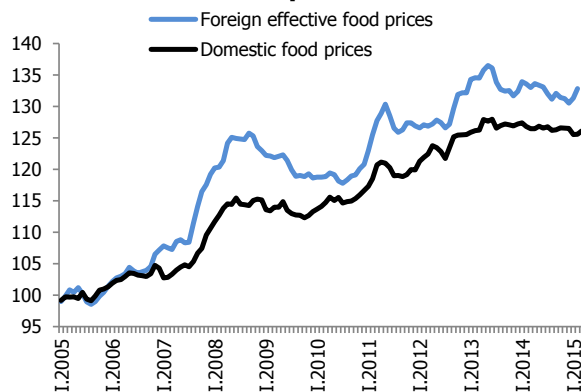
In the first quarter²⁷ of 2015, the change in producer prices in the domestic

²⁵The calculation of foreign effective inflation derives from the weighted sum of consumer price indices of countries that are most important partners of the Republic of Macedonia in the field of import of consumer goods. The weight structure is based on the normalized shares of nominal imports from each country in the total nominal imports in the period 2010-2012. The calculation of this indicator includes Bulgaria, Germany, Greece, France, Italy, Austria, Slovenia, Croatia and Serbia.

²⁶Data on foreign effective food prices refer to the first two months of the quarter.

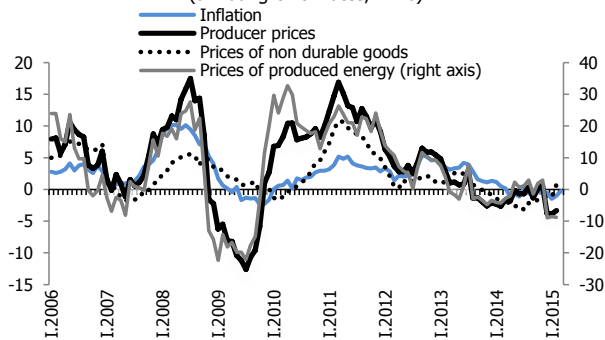
²⁷Refers to the first two months of the quarter.

Foreign effective food prices* and domestic food prices



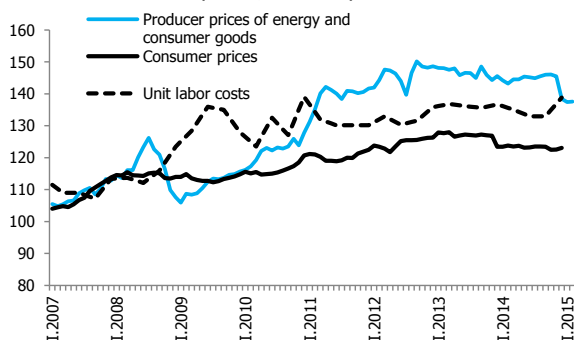
* Foreign effective food prices are calculated as weighted sum of food prices in countries that are major trade partners with Macedonia.
Source: State statistical office, Eurostat and NBRM calculations.

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



Source: State statistical office and NBRM calculations.

Factors affecting consumer prices (indices, 2005=100)



Source: State statistical office and NBRM calculations.

market remained in the negative zone for sixth consecutive quarter. The annual decline in producer prices in the first two months of the first quarter averaged 3.6%, which compared to the previous quarter, it is an acceleration of the decline (-1% in the previous quarter). The largest contribution to the annual decline was made by the lower energy production prices, mainly oil derivatives, with higher prices of electricity, coal and lignite acting in the opposite direction.

Producer prices also recorded a quarterly decrease (of 3.1%, while on seasonally adjusted basis, the decline is 3.3%) given the lower production costs in the manufacturing industry and the energy sector. **The movement of producer prices that affect domestic inflation component²⁸ indicates downward pressures.**

The annual decline in these prices accelerated to 4.3% (despite the fall of 1.4% in the previous quarter), amid simultaneous quarterly fall of 4% versus the fall of 1% in the previous quarter (seasonally adjusted). Keeping these prices in the negative zone indicates lower inflationary pressures in the coming period.

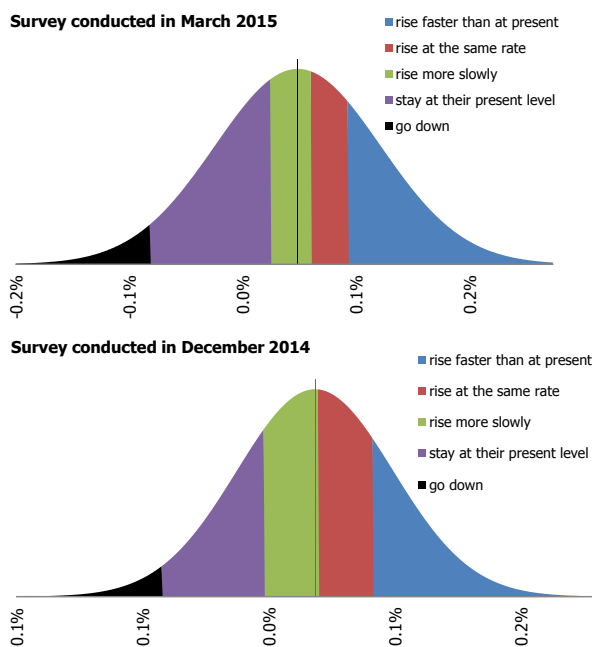
In the last quarter of 2014, unit labor costs increased on a quarterly and annual basis (4.4% and 1.5% respectively). However, amid still negative output gap²⁹ there are still no expectations for inflationary pressures on prices of final products through this channel.

²⁸ Consumer goods (durable and non-durable) and energy.

²⁹ The NBRM's estimates show that domestic output is still below the potential level (negative output gap).

Box 1: Inflation Expectations Survey³⁰

Inflation Expectations Survey includes three groups of respondents: economic analysts, companies and financial institutions. The questionnaire contains two questions to measure inflation expectations, one qualitative and one quantitative in nature. For the first question on inflation



expectations, the respondents indicate the direction and extent of price changes compared with the change in the previous 12 months³¹. Carlson and Parkin (1975) probability approach has been used for quantification of qualitative answers, which assumes that at a sufficiently large number of respondents, the expected change in prices is normally distributed among the population. The second question requires from the respondent to quantify precisely the expected average rate of change of prices in the next two years³². The overall expected rate is calculated as a simple average of the responses of all participants. The resulting indicator is useful for obtaining indications for the direction of the respondents' expectations.

The Inflation Expectations Survey was conducted in March 2015³³. As in the previous survey cycle, **the negative average inflation rate for the previous 12-month period remained in March³⁴, and the results of the**

March survey showed unchanged inflation expectations compared with the December survey. Thus, in the next 12-month period, same as in December, respondents expect the inflation in the next 12 month period to be around 0%. There are similar expectations with respect to different surveyed groups (economic analysts, companies and financial institutions) who expect the rate of inflation in the next 12-month period (to February 2016) to average around 0%.

Analyzing the quantitative question on expected inflation rate for 2015 and 2016, shows that respondents have lower inflation expectations. Namely, in the period between the two surveys, the respondents' expectations for inflation for 2015 and 2016 decreased by 0.5 percentage points, on average. According to respondents, **factors that explain the lower inflation expectations in March include** the movement of consumer prices in the domestic economy and the euro area in the past, the slow recovery of European economies and lower world prices of crude oil, amid high inventories and stagnant global demand.

³⁰ In order to improve the survey measure of inflation expectations, in 2013, the Monetary Policy and Research Department of the National Bank of the Republic of Macedonia started an in-depth analysis of the experiences of other central banks associated with conducting surveys. On that basis, the existing survey was redesigned and starting from October 2013, data were collected for the new survey, thus ensuring greater approximation to the European practice.

³¹ The qualitative question of expectations reads as follows: "Compared with the past 12 months, how do you expect consumer prices to change in the next 12 months? a) will have a faster growth; b) will grow at the current pace; c) will grow at a slower pace; d) will remain almost unchanged; e) will decrease; f) it is difficult to determine "

³² The quantitative question reads as follows: "What are your expectations/forecasts for the average inflation rate for 2015 and 2016?"

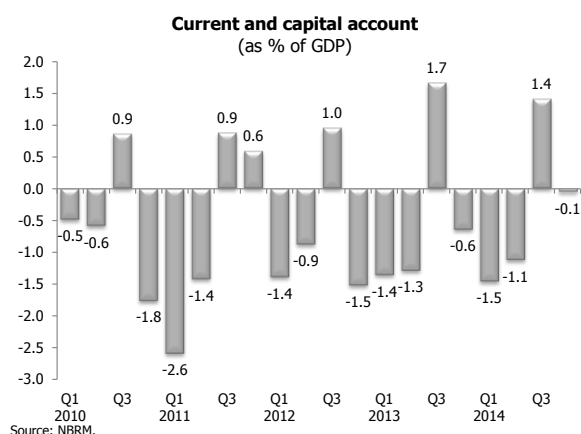
³³ Refers to the period March 2014 to February 2015. The percentage of responsiveness to the Survey conducted in March was 33.9%, which compared to the previous quarter, represents an increase of responsiveness. Analyzed by groups of respondents, the financial institutions' responsiveness is 55.6%, followed by economic analysts with 38.2% and companies with 27.2%.

³⁴ In circumstances of a negative price growth, the interpretation of the results of the survey can be blurred, and therefore, it is necessary to change the method of calculation of the indicator for inflation expectations. Thus, in the procedure for quantification, the negative rate is replaced with the last growth rate. This is the way to avoid any contradictory responses from the survey that indicate positive price growth. Taking into account that changes in the method are of a purely technical nature, the quantification of qualitative answers for the expected rate of inflation in periods of negative inflation should be taken with caution, while the indicator for inflation expectations as approximate.

1.6. Balance of payments³⁵

After the surplus in the previous quarter, current and capital account of the balance of payments in the fourth quarter registered a small deficit, which is usual seasonal trend. However, the quarterly deterioration is smaller than usual, while annually, the current and capital account deficit decreased significantly given the lower trade deficit in goods and services and higher inflows in secondary income. Amid ongoing but slow recovery of foreign demand, improved balance in the trade of goods and services is a reflection of the structural changes in the export sector and the strong decline in stock prices of crude oil. Cumulatively, for entire 2014, the current and capital account registered a small deficit of 1.2% of GDP. Notwithstanding the inflows of direct investments and financing through commercial loans, in the last quarter, the financial account recorded outflows as a result of changes in currency and deposits. In such conditions, the last quarter witnessed a slight decrease of foreign reserves.

1.6.1. Current account



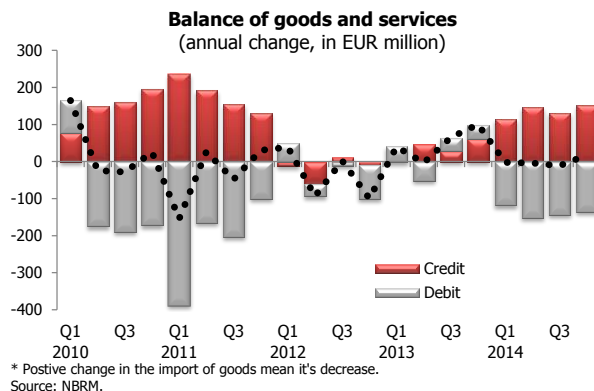
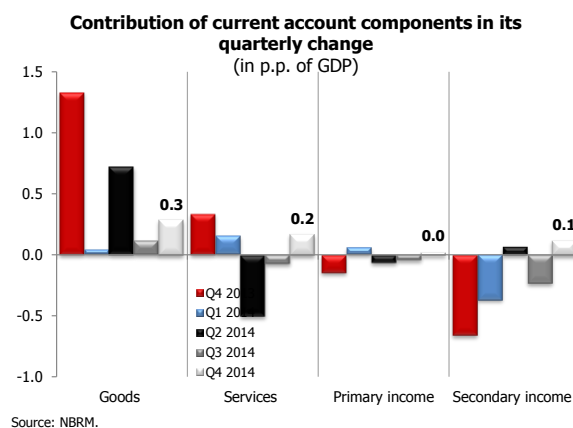
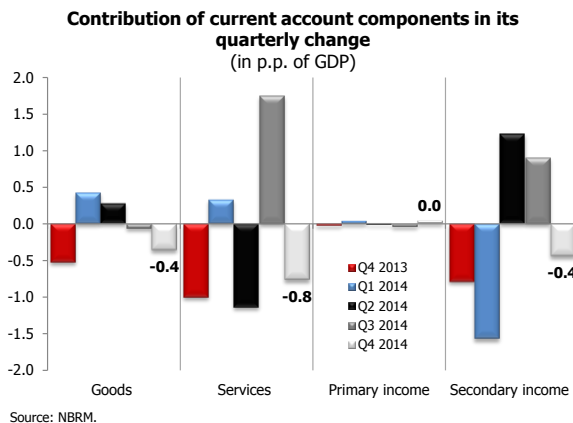
In the last quarter of 2014, the current and capital account position was almost balanced, with a small deficit of Euro 4.5 million or 0.1% of GDP³⁶. Seasonal factors acted towards higher deficit in trade in goods and services and reduced inflows of secondary income, thus deteriorating the current balance by 1.5 percentage points of GDP relative to the third quarter. However, the quarterly expansion of current account deficit is significantly lower than usual, driven by the performance in the balance of trade in goods and in secondary income. The more moderate deterioration in the trade balance, as compared with the record highs, is a combination of the export effects of the new facilities and the favorable effects of the fall of world oil price on imports. As for secondary income, while the typical seasonal factors caused a decline in foreign currency purchased on the exchange market³⁷, the high official transfers from IPA funds earmarked for support of rural and institutional development slowed down such negative dynamics.

Changes in current and capital account indicate significant annual

³⁵ Starting from the Quarterly Report, October 2014, the analysis of the movements in the balance of payments is based on data compiled under the Manual on the Balance of Payments and International Investment Position, sixth edition (IMF, 2009) (IMF, 1993). For more detailed information on the methodological changes, visit the NBRM website (http://nbrm.mk/WBStorage/Files/Statistika_Informacija_zapr_omenite_vo_platnot_bilans_megunarodnata_investiciska_pozici_ja_i_nadvoresnot_dolg_koisto_proizleguvaat_od_primenata_na_novite_megunarodni_statisticki_standardi.pdf).

³⁶ The calculations use official data for the nominal GDP.

³⁷ Foreign cash purchased on the currency exchange market is used to estimate private transfers in cash.



improvement of 0.6 percentage points of GDP, driven by improved performance of all individual components. Exports of investment goods continued to be a driver of the good export performance, amid moderate growth of import component. Import pressures created by higher imports of raw materials by the domestic industry and imports of capital goods were mitigated by lower energy imports caused by the fall in world prices of crude oil. On a net basis, changes in both exports and imports resulted in annual narrowing of the trade balance in goods. Higher surplus in services, driven by the growth of net inflows in construction services acted in the same direction³⁸. Sectoral analysis of secondary income suggests positive contribution to the annual change in the government sector, i.e. higher net inflows based on official transfers due to inflows of European funds. On the other hand, other sectors in the economy³⁹ have not registered any significant change on an annual basis. Primary income has not registered any visible aggregate changes.

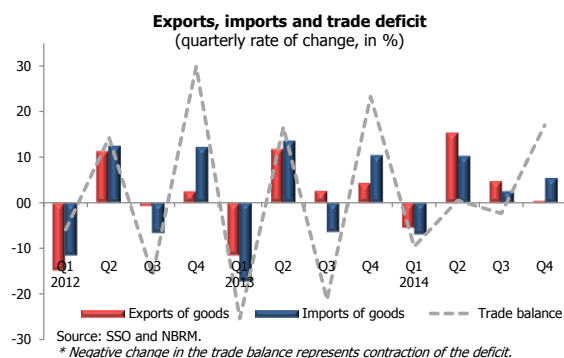
According to the latest data on the balance of payments, in January 2015, the current and capital account registered a significant surplus of Euro 39.4 million, which was the first positive current balance registered in January. Accordingly, the annual analysis indicates improved performance, driven by significantly lower trade deficit in goods and services and moderate growth in secondary income. The improvement in the sub-balance of goods is driven by the dynamic growth of the export component, with a simultaneous decline in imports, particularly energy imports. Additionally, the higher services surplus was due to manufacturing services on physical inputs owned by others, while the growth of net inflows in secondary income was driven by transfers of other sectors of the economy⁴⁰.

³⁸ After the high April outflow in construction services due to advances paid for construction works on highway construction projects, the fourth quarter recorded reversible process. Namely, this service component registered exports, as a result of the payment to domestic companies for completed construction works on behalf of the foreign contractor of the road infrastructure.

³⁹ Secondary income of other sectors of the economy includes secondary income of financial companies, non-financial companies, households and non-profit institutions serving households classified as private transfers (current transfers between resident and non-resident households), net cash on the currency exchange market as an indicator of private transfers executed through informal channel and other current transfers of the private sector.

⁴⁰ Leaving the exchange rate target by the central bank of Switzerland led to a strong appreciation of the Franc in mid-January. Accordingly, such change brought about higher purchase of francs on the currency exchange market and appropriate growth of net inflows in secondary income during January.

Box 2: Foreign trade of goods and movement of the Nominal and the Real Effective Exchange Rate (NEER and REER)⁴¹



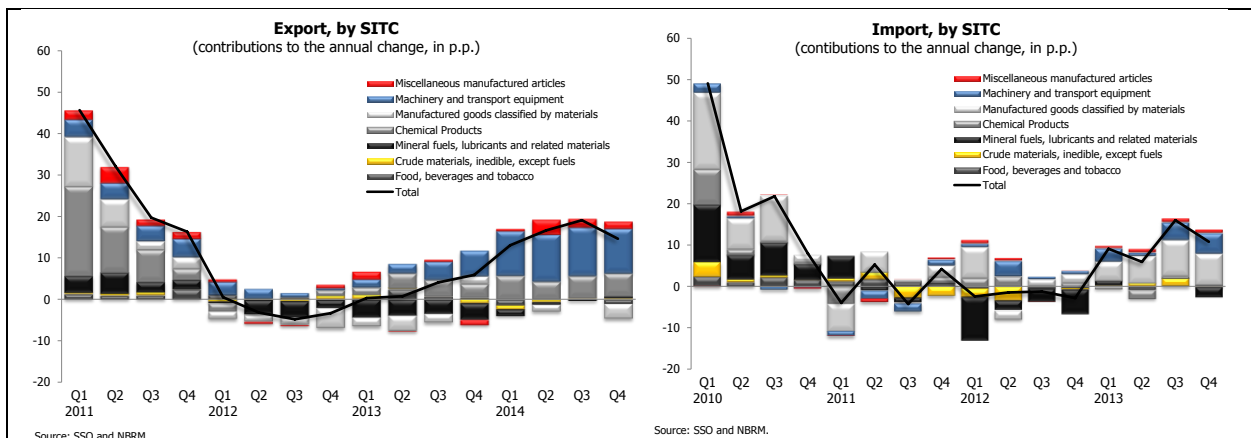
In the fourth quarter of 2014, foreign trade amounted to Euro 2,463.8 million (or 28.9% of GDP), which is by 3.3% more compared to the previous quarter. The quarterly increase of foreign trade was primarily driven by higher imports, with minor growth in the export component. The positive change in exports of 0.4% compared to the third quarter of the year is a result of increased exports of machinery and equipment, and chemical products, amid lower export of traditional export sectors, particularly pronounced

in the metal manufacturing and the tobacco industry. On the other hand, imports recorded a more dynamic quarterly growth of 5.4%, driven by higher import of raw materials by the new facilities in the economy and textile industry, as well as the seasonal increase in food imports, amid significantly lower energy imports. Namely, the further reduction in market prices of crude oil in the fourth quarter of 2014⁴², led to a quarterly decline in energy imports. Such performances in both trade components led to **significant quarterly expansion in trade deficit in goods of 17%, entirely driven by the non-energy balance, amid significant narrowing of the energy component.**

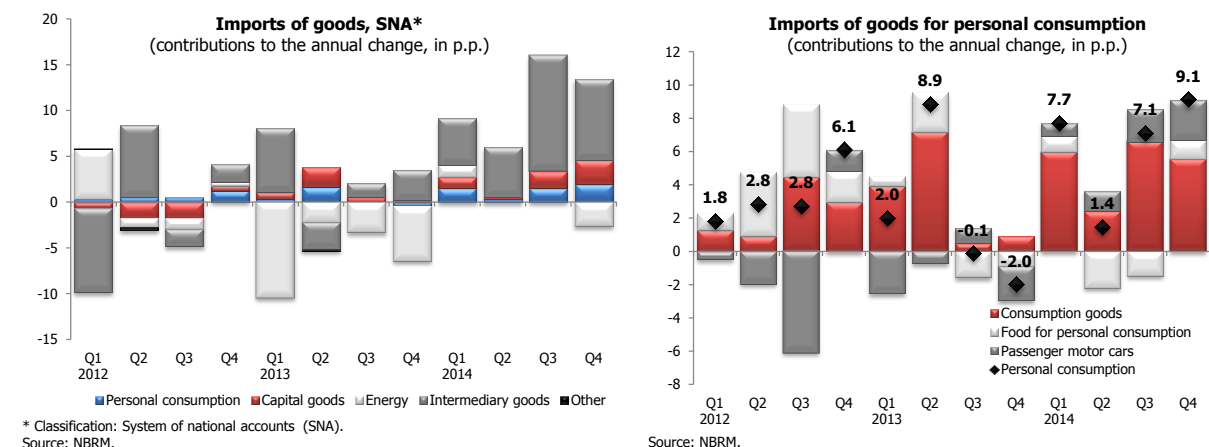
Analyzed on annual basis, exports continued to register two-digit growth rates, with higher performance relative to the fourth quarter of 2013 of 14.6%. Factors of export growth in the fourth quarter remain unchanged, reflecting the increasing export capacity of new foreign companies in the economy. Their contribution continues to generate high export growth, amid an annual decline in exports of traditional sectors. Notwithstanding the slow recovery of the conjuncture of metal manufacturing industry in the second half of the year, the decline in exports in this sector has intensified during the fourth quarter, leading to a significant reduction in export of iron and steel, and a simultaneous decline in export volumes and export prices. Additionally, unfavorable annual trends were also observed in the export of tobacco, partly due to the high base effect from the last quarter of 2013, when there was untypically high export of tobacco for this time of year. **High import dependence of the export sector was also confirmed through the annual growth of import component.** Higher imports (by 10.8%) remain driven by production inputs of the new export facilities, that was effectuated through the higher imports of equipment and machinery, and nonferrous metals. Unlike the decline registered in export of iron and steel, import component of this industry once again registered a slight annual growth, amid higher import volumes and higher import prices in this category of products. Contrary to import pressures from non-energy components, energy imports significantly dropped, driven primarily by lower import of oil derivatives and less by the decreased imports of electricity. The fall in market prices of crude oil during the fourth quarter of 2014 reduced the cost of this fuel to its lowest level in the past five years. Accordingly, such drastic market changes also brought down imported prices of oil derivatives in the domestic economy, which coupled with the reduced quantity imports acted towards significant reduction of import pressures. **Given the high growth of both foreign trade components, the foreign trade deficit moderately expanded by 3.8% annually,** driven entirely by the deterioration in the non-energy balance, amid significantly lower energy deficit.

⁴¹ According to the Foreign Trade Methodology, data on the export of goods are published on a f.o.b. basis, and on the import of goods, on a c.i.f. basis.

⁴² In the fourth quarter compared to the previous quarter, crude oil price substantially dropped by 25.6%.



Analysis of import components classified according to the System of National Accounts (SNA) indicates further dominant contribution of intermediate products to the annual growth of total imports in the last quarter of 2014. The contribution of capital goods and personal consumption goods is positive, but significantly lower, while the annual decline in energy imports act towards reduction of import pressures. The growth of import component for personal consumption in the most part is driven by personal consumption goods, with additional positive contribution of the other two components, vehicles and personal consumption food. The performance of this import component indicates a gradual acceleration of growth, but the still small contribution to the growth of total imports indicates absence of significant pressures from the imports to the personal consumption.

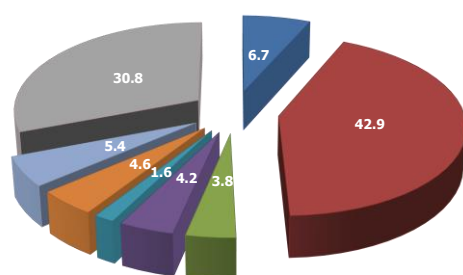


The last available data on foreign trade indicate further growth of exports in January and February, amid annual import reduction. The export of goods in the first two months of the year increased by 14.4% compared to the same period last year, mainly driven by higher exports of the new facilities in the economy. Unlike the exports growth, imports of goods recorded an annual decline of 2.7%, due to the lower energy imports, driven by the further decline in market prices of crude oil.

The foreign trade analysis by trading partner suggests that the EU countries remained major trading partner in the last quarter of 2014, accounting for 67.3% of total foreign trade in goods. Analyzing exports, the annual increase was mostly driven by the further growth in exports to Germany and the significantly lower contribution of goods exported to Belgium and Spain. The positive performance of exports towards these European economies reflects intensive exports of the new industrial facilities in the domestic economy, aimed primarily to the German market, but also the increasingly pronounced dispersion to other EU markets. In addition, growing exports to Taiwan made positive contribution to the annual growth of exports, driven by the diversification of exports of metal manufacturing business to Asian economies. On the other hand, despite the stronger

export position in the EU countries, further decrease of the importance of traditional trading partners in the region is apparent, particularly the decreasing importance of Kosovo⁴³ as an export market. On the import side, the annual growth was driven by higher imports from the EU, largely due to higher imports from Germany, but also from the growth of raw materials imported by the new export facilities from the Netherlands and the UK, compared to the decrease of energy imported from Greece. However, the highest contribution to the annual growth was made by the imports of platinum from the Republic of South Africa, as non-traditional trading partner of the Macedonian economy and the growth of import of goods from Russia and China in the fourth quarter. According to the analysis of the foreign trade balance by trading partner, the slight annual expansion of trade deficit was caused by the increase of the negative balance in the trade with the Republic of South Africa, China, Russia and the Western Balkans, due to the higher trade deficit with Serbia and further reduction of surplus with Kosovo. On the other hand, the trade deficit with the EU economies continued the trend of annual decrease typical for the past two years. Higher trade surplus with Germany, and further narrowing of the deficit with Greece, despite the deterioration in the trade deficit with Italy, Romania, the Netherlands and the UK remain generators of favorable performance.

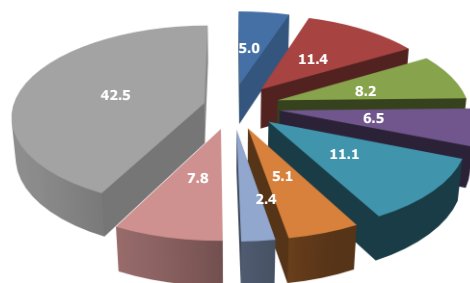
Export of goods, by countries in the fourth quarter of 2014 (share, in %)



Source: NBRM.

■ Bulgaria
 ■ Italy
 ■ Serbia
 ■ Germany
 ■ Croatia
 ■ Kosovo
 ■ Greece
 ■ Other countries

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

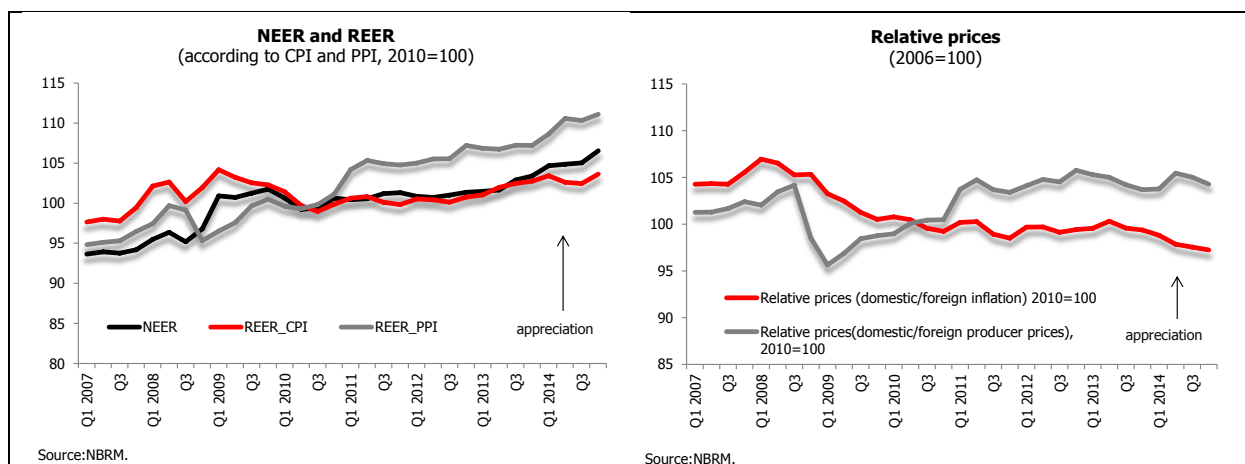


Source: NBRM.

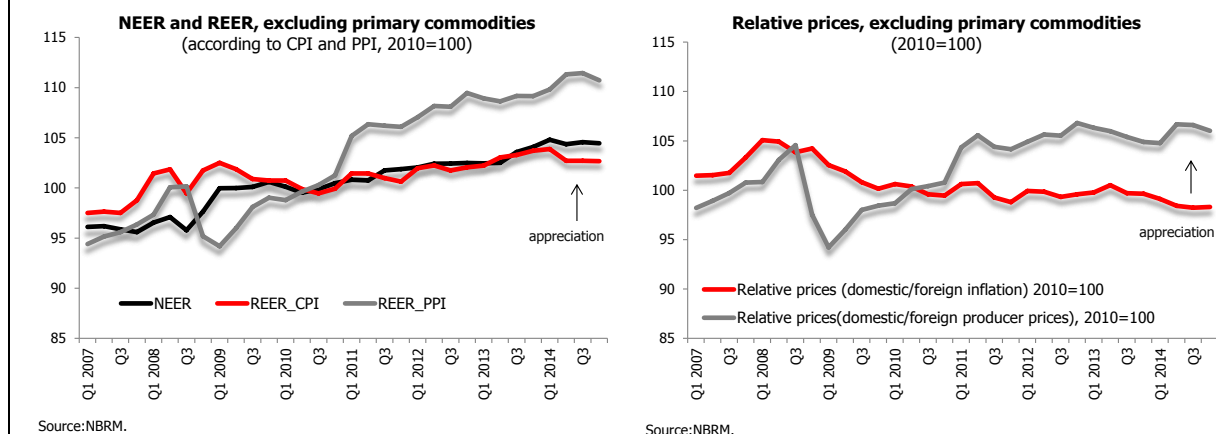
■ Bulgaria
 ■ Italy
 ■ Russia
 ■ Germany
 ■ Great Britain
 ■ Serbia
 ■ Greece
 ■ Turkey
 ■ Other countries

Indicators of price competitiveness of the Macedonian economy point to moderate deterioration compared to the third quarter of the year. Moreover, both price indices registered a quarterly appreciation. REER deflated by consumer price index appreciated by 1.2% and REER deflated by the producer price index appreciated by 0.7%. This change is predominantly driven by the nominal effective exchange rate whose growth of 1.5% compared to the previous quarter was caused by the sharp appreciation of the Denar against the Russian ruble. Low market prices of oil and the continuation of the Ukrainian crisis led to a dramatic drop of the ruble in the last quarter of 2014, which had an adequate effect on the indicators of price competitiveness of the domestic economy. On the other hand, relative prices changed favorably compared to the previous quarter, amid declined relative producer prices by 0.3% and reduced relative producer prices of 0.7%.

⁴³ Continued decline in exports to Kosovo in the past three years, is mostly due to the lower exports of oil derivatives in this market.



Significant depreciation of the Russian ruble in 2014, driven by factors which are not purely economic, highlights some concerns when analyzing indicators of price competitiveness of the domestic economy by including volatile currencies such as the ruble. Consequently, it is more appropriate to analyze price competitiveness indicators through the real effective exchange rate indices calculated using weights based on the foreign trade without primary commodities⁴⁴. This is the way to eliminate some volatility related to changes in currencies sensitive to trends in world stock prices and appropriate attention is paid on structural factors that drive competitiveness of the economy. **Moreover, this indicator suggests moderate improvement of price competitiveness relative to the previous quarter, particularly the REER deflated by producer prices (0.7%) compared to the nearly unchanged position of REER deflated by consumer prices.** The nominal effective exchange rate, according to this calculation method, depreciated (by 0.1), and in terms of relative prices, there has been a drop in prices of industrial products and a slight increase in relative consumer prices.



In the period January-February 2015, price competitiveness indicators suggest divergent changes in the real effective exchange rate as calculated using two methodologies. Namely, REER calculated by weights based on the total foreign trade slightly appreciated compared to the fourth quarter of 2014, and the index deflated by consumer prices rose by 1%, while the index deflated by producer prices appreciated by 0.2% as a result of the 1.8% appreciation of NEER. On the other hand, REER calculated using foreign trade based weights without primary commodities depreciated, particularly the index deflated by producer prices (1.6%) compared to the index deflated by consumer prices (0.5%). Increasing competitiveness of the domestic economy as measured by these indicators is

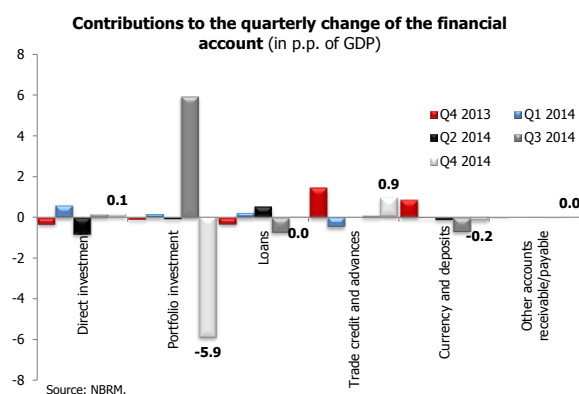
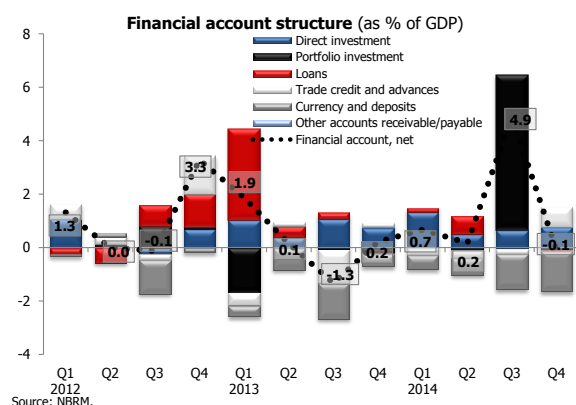
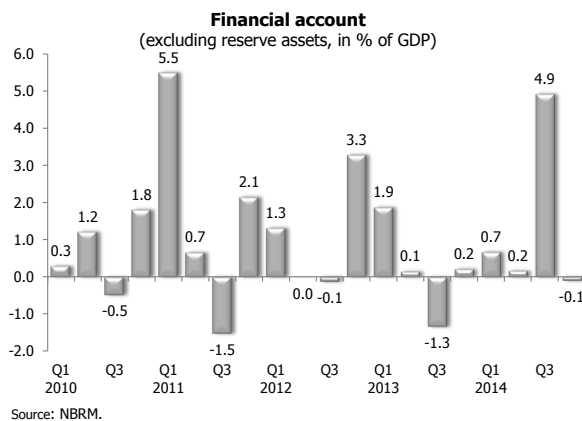
⁴⁴ Primary products that are not included in the calculation are: oil and oil derivatives, iron and steel, ores and imported raw materials for the new industrial facilities in the free economic zones. For more detailed information on the methodology for calculating the real effective exchange rate visit: http://nbrm.mk/WBStorage/Files/Statistika_REDK_Informacija_za_promenite_na_metodologijata_za_presmetuvanje_na_realno_t_efektiven_devizen_kurs_na_denarot_mak.pdf

due to favorable movements in the nominal effective exchange rates and the relative prices compared to the last quarter of 2014.

1.6.2. Financial account

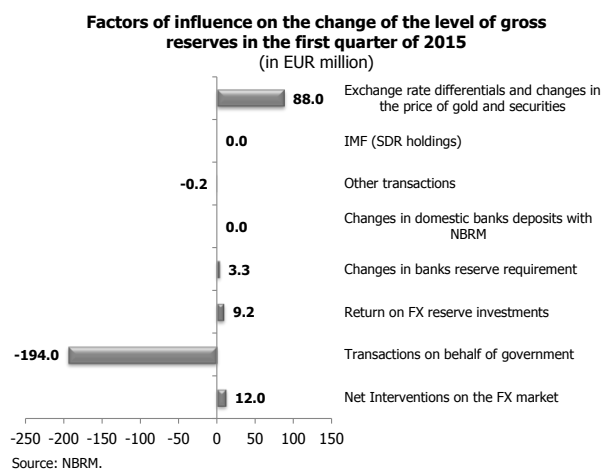
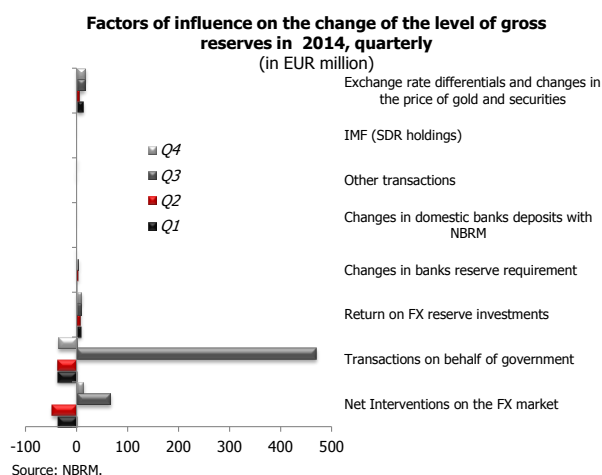
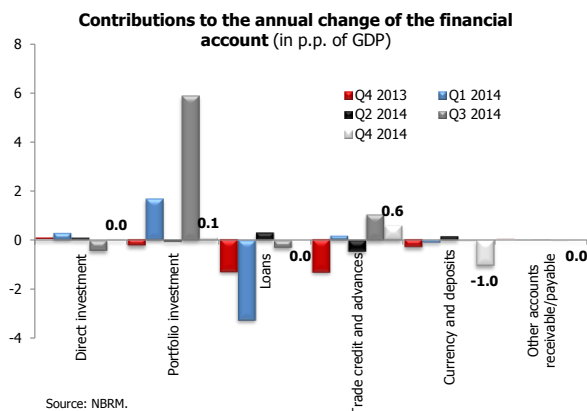
After the high net financial inflows registered during the third quarter, the last quarter of the year recorded moderate net outflows of Euro 8.4 million or 0.1% of GDP.

If we exclude the effect of government borrowing in the third quarter through the issuance of the Eurobond, the quarterly comparison would show decreased net outflows in the financial account in the last quarter as a result of the increased trade credits. Structurally analyzed, in the last quarter, trade credits and foreign direct investments were sources of net inflows in the financial account. On the other hand, net outflows were observed in currency and deposits, portfolio investments and loans. Continued negative flows in the category of currency and deposits reached a historical peak in the fourth quarter of 2014, caused both by net outflows in other sectors and in depository institutions. Financial loans registered net outflows, albeit with significantly lower intensity, driven by long-term component of this category. Sectoral structure indicates that the deleveraging abroad in the fourth quarter of the year is due to the government sector and other sectors, amid intensive incurrence of long-term net liabilities by depository institutions. Payment of the third installment of the precautionary credit line to the IMF was the major outflow that drove the government performance in the fourth quarter, while net outflows of other sectors are due to outflows of private corporate sector, amid further net borrowing of the public sector. On the other hand, deposit institutions created sources of financing the economy through borrowing of the private banking sector, and by withdrawing additional funds from the fourth credit line for support of small and medium enterprises, marketed through the Macedonian Bank for Development Promotion. Unlike the negative financial flows in currency and deposits and financial loans, foreign direct investments registered significant net inflows. Debt FDI component was again prevailing in the fourth quarter, as a result of the further reduction of approved loans by domestic entities in favor of parent companies. Non-debt categories registered divergent shifts, i.e. net inflows in share capital, whilst reinvested earnings in the last quarter also recorded a negative net worth, due to high dividend payments at this time of year. Additionally, the intensification of imports of goods





created positive financial flows based on trade credits and advances.

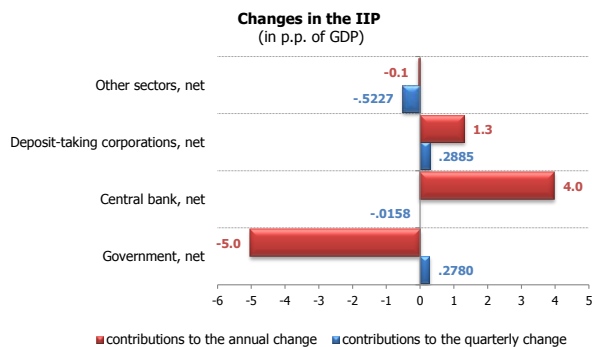
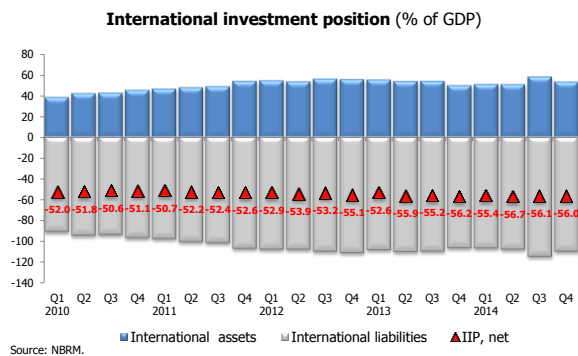


The annual analysis of financial account indicates a slight deterioration of 0.3 percentage points of GDP compared to the last quarter of 2013 that recorded small net inflows. The change was driven solely by the performance in currency and deposits, with significant positive trends in trade credits, which cushioned the deterioration annually. Higher outflows in currency and deposits were generated by the change in the behavior of domestic banks i.e. accumulation of deposits in foreign banks, despite their withdrawal in the fourth quarter of 2013. Unlike the net outflows registered in this category, net inflows in trade credits significantly increased. The annual change in foreign direct investments is negligible at an aggregate level, but there are significant changes in the structure. While in the last quarter of 2013, net inflows in this category were predominantly driven by non-debt components, i.e. positive reinvested earnings and equity, the FDI debt component was driving net inflows in the last quarter of 2014, amid negative reinvested earnings. **The latest balance of payments as of January 2015 suggests net outflows of Euro 73.2 million in the financial account.** Outflows were dispersed among individual components, with the exception of direct and portfolio investments, which registered net inflows.

At the end of 2014, the gross foreign reserves amounted to Euro 2,436.5 million, recording a small quarterly growth of Euro 1.5 million. The change compared to the previous quarter was driven by positive price changes and foreign exchange differences, and income from investment of foreign reserves and the net purchase by the NBRM on the foreign exchange market. On the other hand, transactions for the account of the government decreased foreign reserves. *According to the latest available data, at the end of the first quarter of 2015, foreign reserves amounted to Euro 2,354.8 million, which is by Euro 81.6 million less compared to the end of 2014.* The reduction of foreign reserves is entirely driven by net outflows of assets based on transactions on behalf of the government⁴⁵, which were partly mitigated by the high positive price changes and exchange rate differences and the moderate net purchase by the NBRM on the foreign exchange market.

⁴⁵ In February 2015, early repayment was made of the outstanding portion of the IMF Precautionary Credit Line, in the amount of Euro 153.4 million.

1.6.3. International investment position⁴⁶ and gross external debt



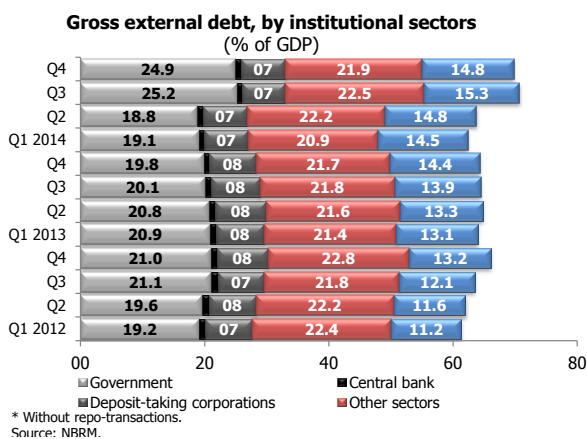
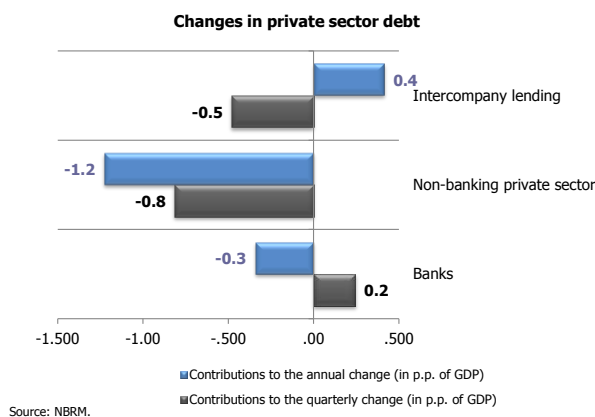
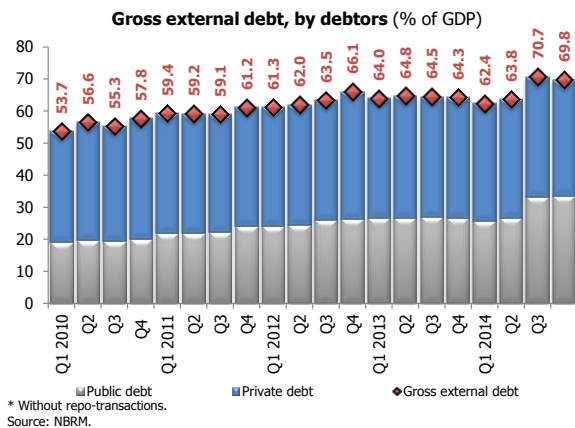
At the end of 2014, the **negative international investment position⁴⁷ of the Republic of Macedonia amounted to Euro 4,781.6 million, or 56% of GDP.** Compared to the previous quarter, it remained almost unchanged, given the equal decrease of **international assets and international liabilities.** Despite the unchanged aggregate position, *the sector-by-sector analysis shows some shifts on a quarterly basis.* Thus, net liabilities of depository institutions decreased amid accumulation of funds on the foreign exchange accounts abroad. Net government liabilities went down mainly due to reduced liabilities on long-term loans, i.e. repayment of the IMF's PCL. On the other hand, the growth of debt position of other economic sectors is largely due to the increased net liabilities on direct investments.

Compared to the end of 2013, net liabilities to the rest of the world slightly declined by 0.2 percentage points of GDP, given the faster growth of international assets than that of international liabilities⁴⁸. *Sector-by-sector analysis* of the international investment position of the economy indicates improvement in the central bank and depository institutions, while changes in the government sector and other sectors acted in the opposite direction. The favorable change in the central bank is due to the high annual growth of

⁴⁶ The analysis in this section is entirely based on data on the international investment position compiled under a new methodology. Namely, in July 2014, the NBRM started disseminating data on the international investment position (IIP) and gross external debt of the Republic of Macedonia, according to the new international statistical standards defined by the Balance of Payments and International Investment Position Manual (BPM6) and the External Debt Statistics (2013). For more detailed information on the methodological changes, visit the NBRM website (http://nbrm.mk/WBStorage/Files/Statistika_Informacija_zapr_omenite_vo_platnot_bilans_megunarodnata_investiciska_pozicija_i_nadvoresniot_dolg_koisto_proizleguvaat_od_primenata_na_novite_megunarodni_statisticki_standardi.pdf).

⁴⁷ In the second quarter of 2011, the NBRM began concluding repo and reverse repo transactions. These transactions represent an investment opportunity to use portfolio securities to provide additional income. Conclusion of repo transactions incurs liabilities. At the same time, the claims created from entering into reverse repo agreements increase gross claims. The NBRM simultaneously carries out matched conclusion of repo and reverse repo agreements in nearly identical amounts. In general, as they are concluded concurrently, these transactions have a neutral net effect on net basis, i.e. they appear in almost identical amount on both liabilities and assets side, and therefore do not affect the total net IIP nor the total net external debt.

⁴⁸ The analysis of negative debt investment position in nominal terms indicates moderate annual growth of 4.9%.



net assets, driven by higher foreign reserves, and by the positive change in depository institutions, where lower net liabilities were mostly driven by the growth of assets in the form of currency and deposits. The annual deterioration in the government sector was fully caused by the growth of liabilities based on debt portfolio investments⁴⁹, while slightly higher net liabilities in other sectors are due to the higher net liabilities to foreign direct investors and liabilities based on long-term loans.

At the end of 2014, the gross external debt stood at Euro 5,954.4 million, or 69.8% of GDP, which is a decrease of 4.5 percentage points of GDP, compared with the previous quarter. If we exclude repo transactions of the monetary authority, the decline would be significantly lower and amount to 0.9 percentage points of GDP⁵⁰. The quarterly decrease of gross external debt results from the lower private debt, amid a small increase in public sector debt. The moderate decline in private debt is due to the lower long-term liabilities on loans and lower short-term trade credits and advances to non-banking private sector, with simultaneous decline in liabilities to foreign direct investors. On the other hand, the quarterly growth of public debt stems mainly from the growth of long-term liabilities to public companies and the MBDP, largely in the form of financial support of investments in road and railway infrastructure and support of small and medium enterprises.

Annually, the gross external debt grew up by Euro 734.7 million or 5.4 percentage points of GDP. The annual growth of gross debt is due solely to the higher public debt (by 6.6 percentage points of GDP) amid annual drop (1.2 percentage points of GDP) of private sector debt. Analyzing public debt, it increased due to the intensive growth of long-term liabilities of the central government in the form of debt securities as a result of the issued Eurobond, with an additional contribution of the higher debt on long-term financial loans to public enterprises⁵¹.

⁴⁹ During the third quarter of 2014, the government borrowed on the international financial markets through the issuance of the third Eurobond in the amount of Euro 500 million, resulting in an increase of government liabilities on portfolio investments. At the same time, despite the increase in liabilities, it also caused high accumulation of foreign reserves, and accordingly, higher net assets.

⁵⁰ The overall analysis below relates to gross external debt without the central bank liabilities based on repo transactions.

⁵¹ Higher liabilities on long-term foreign loans are mainly due to the borrowing of public enterprises for financing the construction of road infrastructure.

Observing the private sector debt, decrease was registered in both the banking and non-banking sector, while liabilities to foreign direct investors increased.

Generally, the external indebtedness indicators of the national economy still show that the gross external debt is in the safe zone. The only indicator that classifies the economy in the group of highly indebted countries is the share of the gross external debt in GDP. The analysis of the dynamics of foreign indebtedness indicates⁵² moderate deterioration in all solvency indicators for 2014, compared to end of 2013. On the other hand, liquidity indicators suggest a more favorable external position, given the improvement in the provided indicators and full coverage of short-term debt liabilities with residual maturity with the foreign reserves. At the end of 2014, net external debt, as an additional indicator of external vulnerability of the economy, amounted to Euro 1,812.8 million or 21.2% of GDP, which is a slight annual growth of 2.6 percentage points of GDP. Slower growth of net external debt relative to the growth of gross debt is due to the higher level of gross external claims (by 2.9 percentage points of GDP).

⁵² The analysis of external indebtedness indicators uses balance of payments data in accordance with the Balance of Payments and International Investment Position Manual (BPM6) and data on gross external debt according to the External Debt Statistics (2013). The methodological changes caused no changes in the overall level of external debt, but only affected the maturity and sector structure of the debt. Accordingly, under the new methodology, the level of short-term debt is lower at the expense of the increase in long-term debt component, which caused changes in the liquidity indicators, i.e. their improvement relative to the analyses based on data from the previous methodological framework. On the other hand, methodological changes in the export of goods and services and other inflows caused deterioration of the indicators for the share of export of goods and services and other inflows in the gross external debt and debt service in relation to export of goods and services and other inflows, compared with the indicators relevant prior to the methodological changes.



Indicators for external indebtedness	Solvency				Liquidity		
	Interest payments/ Export of goods and services and other inflows	Gross debt/ Export of goods and services and other inflows	Gross debt/ GDP	Debt servicing/ Export of goods and services and other inflows	Foreign reserves/ Short-term debt	Foreign reserves/ Short-term debt, with residual maturity	Short-term debt/ Overall debt
	in %				ratio	ratio	in %
31.12.2004	2.41	129.3	47.3	12.4	1.14	0.89	30.3
31.12.2005	2.66	147.0	54.2	11.06	1.67	1.04	26.7
31.12.2006	3.44	131.3	49.8	21.7	1.95	1.34	29.0
31.12.2007	2.78	119.3	51.3	19.4	1.35	1.08	39.8
31.12.2008	2.66	116.9	54.1	10.2	1.29	0.95	35.2
31.12.2009	2.43	131.0	57.8	11.8	1.29	0.94	32.9
31.12.2010	3.22	140.4	59.7	13.9	1.49	0.99	27.9
31.12.2011	3.12	148.4	64.6	16.8	1.78	1.18	25.2
31.12.2012	2.92	141.9	67.6	13.1	1.64	1.03	26.7
31.12.2013	2.51	137.6	67.4	15.8	1.64	1.08	23.3
31.03.2014	3.00	133.4	65.9	17.1	1.41	0.95	25.8
30.06.2014	3.00	136.3	67.4	17.1	1.33	0.90	25.8
30.09.2014	3.00	151.2	74.7	17.1	1.75	1.16	23.1
31.12.2014	3.00	149.2	73.7	17.1	1.88	1.15	21.7
<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.

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

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

Source: NBRM.

II. Monetary policy

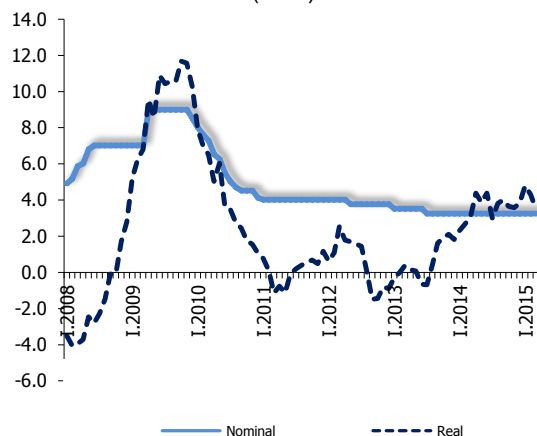
During the first quarter of 2015, the NBRM kept its policy rate unchanged at 3.25%. This decision was based on the latest macroeconomic projections of October and the recent performances of the key macroeconomic and financial indicators. Analyzes have shown that the economy continues to recover at a solid pace, in part supported by the credit activity of the domestic banks. Economy recovers without price pressures and with adequate level of foreign reserves. Such trends indicated existence of appropriate environment for sustained recovery of private sector, and it was again assessed that the domestic economy is sufficiently supported through the monetary policy measures. The NBRM will continue to monitor closely the situation in order to make timely and adequate accommodation of monetary policy.

Based on the regular assessment of recent macroeconomic and financial developments, at the meeting held during the first quarter⁵³ of 2015, the NBRM Operational Monetary Policy Committee decided to keep CB bill interest rate at 3.25%. Short-term indicators that became

⁵³ During the quarter, the NBRM's Operational Monetary Policy Committee held three sessions on 13 January 2015, 10 February 2015, and 10 March 2015, when it reassessed the monetary policy setup.

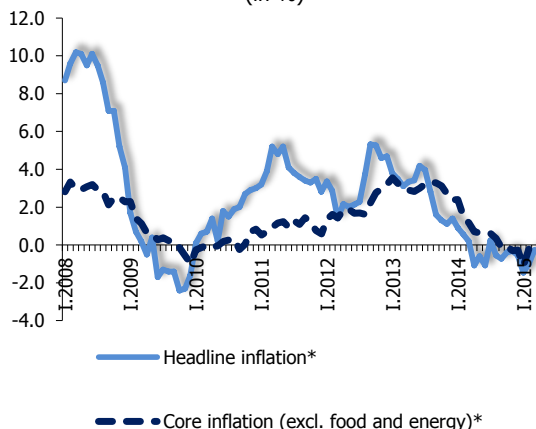


Nominal interest rate on CB bills and inflation (in %)

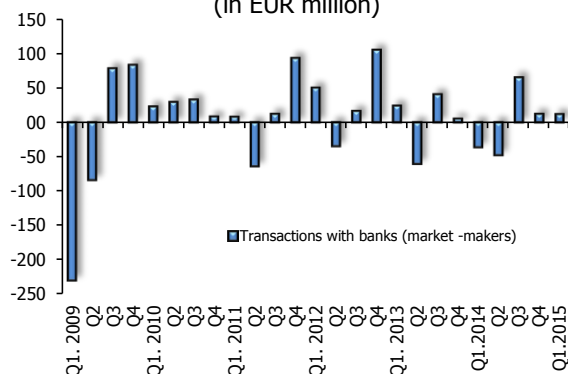


Source: NBRM.

Inflation (in %)

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

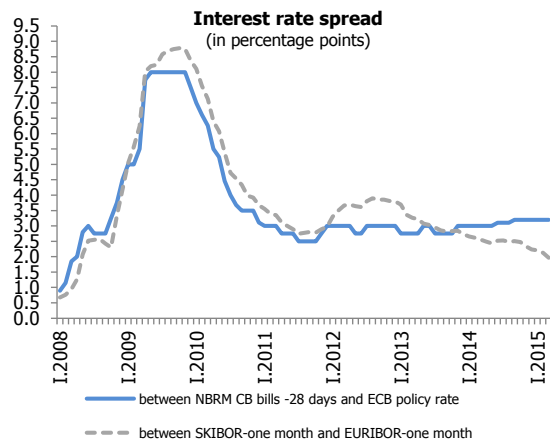
Interventions on the foreign exchange market by NBRM (in EUR million)



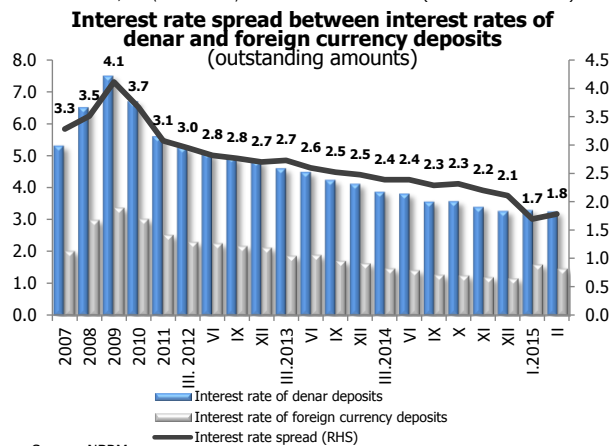
Source: NBRM

available during the quarter did not suggest significant changes in the environment for conducting monetary policy compared to the October projection. Foreign exchange market developments in the first quarter were favorable, and the NBRM purchased net amount of foreign currency (totaling Euro 12 million). Foreign exchange reserves declined in the first quarter, mostly due to the early repayment of a loan from the IMF, used within the precautionary credit line⁵⁴. Without this effect, the fall of foreign reserves would be moderate, as projected in October. Reserve adequacy indicators still indicate appropriate level of foreign reserves for managing any shocks. Inflation continued to decline in the first quarter of 2015 and averaged 0.9% annually. The decrease of annual inflation in the first quarter was predominantly driven by the lower energy prices in line with the reduction of world oil prices. Spillover effects of the decreased food and energy prices brought about deceleration of core inflation, which in the first quarter averaged -0.4% on an annual basis. Inflation performance are weaker than projected and along with the changes in external assumptions still point to downward risks related to inflation for 2015. However, changes in inflation are mainly driven by factors on the supply side. It is assessed that the adjustment of the general price level is temporary and creates no risks of prolonged deflation. Namely, real sector performance remains favorable. Enhanced economic activity continued in the fourth quarter, and the GDP growth in 2014 was as expected. For the first quarter of 2015, the number of available real sector high frequency indicators is still limited. However, the very few information that became available during this period, pointed to retention of the positive trends since the beginning of 2015. Observing credit market, in the first quarter of 2015, total loans recorded solid cumulative growth compared to the end of the previous year, mainly due to the increase of loans to households, amid small growth of loans to corporate sector. The annual growth rate of total loans in March was above the projection for the first quarter, largely explained by the strong credit growth in the last quarter of 2014. The global environment has not undergone significant changes compared to the last assessments, amid continuous uncertainty about the pace of global growth and changes in the prices of primary commodities. However, the latest information on the international environment showed some risk reduction. This primarily relates

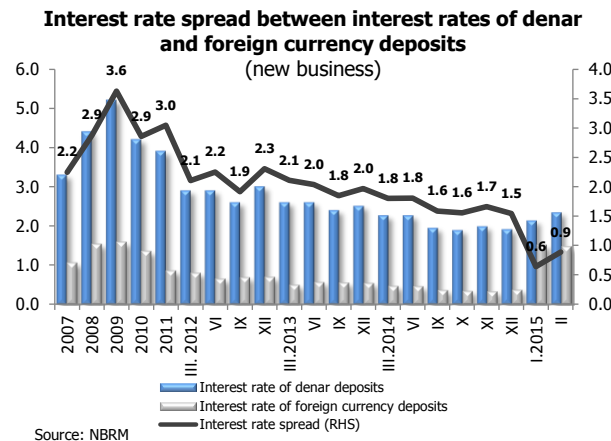
⁵⁴ On 27 February 2015, the government made early repayment of the liabilities to the IMF, based on the Precautionary Credit Line (PLC), which decreased the foreign reserves by Euro 153.4 million.



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



Source: NBRM



Source: NBRM

to developments in the euro area, where recent ECB projections show slightly higher growth for the period 2015-2016, compared to previous expectations. In such circumstances, **it was assessed that the economy has created conditions for a sustained recovery of the private sector, i.e. there is no need for additional monetary stimulus. Hence, it was assessed yet again that the support of the monetary policy measures for the domestic economy is sufficient. Leaving the zone of accommodative monetary policy in the next period will depend on the changes in the external position of the economy and the effects on foreign reserves.**

After the latest cut in policy rate in September 2014 (to 0.05%), during the first quarter of 2015, the ECB kept its policy rate unchanged. In January, the ECB decided to expand the securities purchase program⁵⁵ with a new program for purchase of securities issued by the member states of the euro area and some European institutions. This program aims to increase liquidity in the euro area, and to encourage credit activity. According to the ECB, the positive effects of this measure will be experienced in March, along with the further easing of the conditions in the financial markets and significant improving of the terms of lending to the private sector.⁵⁶ Consequently, the interest rate spread between the CB bill interest rate and the ECB policy rate in March remained at the level of September 2014 and equaled 3.2 percentage points. Movements of short-term interest rates in the domestic and the European financial market have been relatively stable, which contributed to maintaining a stable interest difference between the one-month SKIBOR⁵⁷ and the one-month EURIBOR of 2 percentage points in March. Within the banking sector, since the beginning of the year, deposit interest rates remain relatively stable, with the interest rate spread between the interest rate on the newly accepted Denar deposits

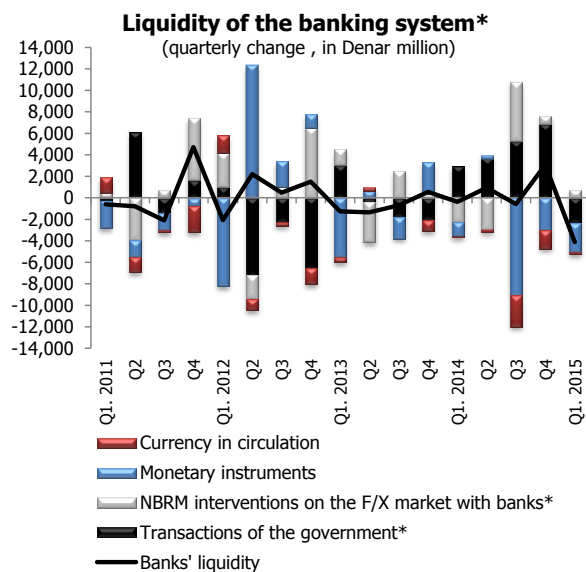
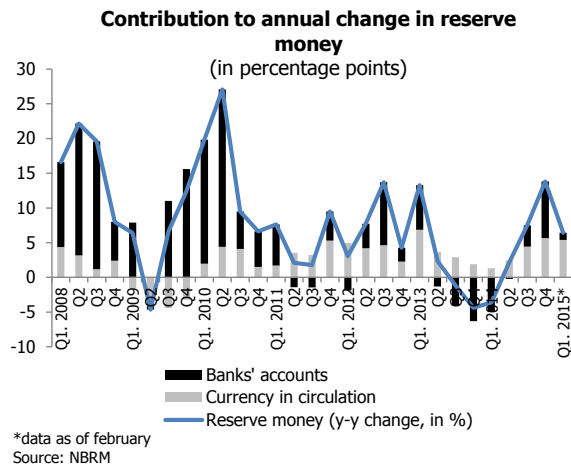
⁵⁵ In the last quarter of 2014, the ECB launched two programs for purchase of asset-backed securities and covered bond issued by financial institutions in the euro area denominated in euros. The new program is expected to be implemented in the period from March to September 2016 with an option for its extension until sustained convergence of the rate of inflation in the euro area to the level of about 2% in the medium term is ensured. All three programs are expected to provide a monthly purchase of financial assets of Euro 60 billion, and it is assessed that the total amount of the ECB's purchase program to total around Euro 1,000 billion.

⁵⁶ <https://www.ecb.europa.eu/press/pressconf/2015/html/is150305.en.html>

⁵⁷ Interbank interest rate on denar deposits, calculated using the quotations of reference banks.

and the interest rate on newly accepted foreign currency deposits in January-February 2015 averaged 0.8 percentage points.⁵⁸

2.1. Banks' liquidity and interbank money market developments



During the first quarter of 2015, banks' liquidity⁵⁹ decreased by Denar 4,125 million compared to the end of the fourth quarter. Thus, in March, banks' account balances with the NBRM⁶⁰ amounted to Denar 15,783 million. In February, reserve money⁶¹ increased by 6.4% on an annual basis, compared to December 2014, when it increased by 13.8%.

During the first quarter of 2015, autonomous factors acted towards withdrawal of net liquidity of Denar 1,421 million. Within their frameworks, government transactions reduced liquidity, mainly due to the increase of Denar deposits with the NBRM (Euro 2,151 million). Currency in circulation also acts towards withdrawing liquidity (of Denar 171 million). According to the NBRM's net purchase of foreign currency on the foreign exchange market, the NBRM's foreign currency transactions with market makers again acted towards creating liquidity in the amount of Denar 737 million.

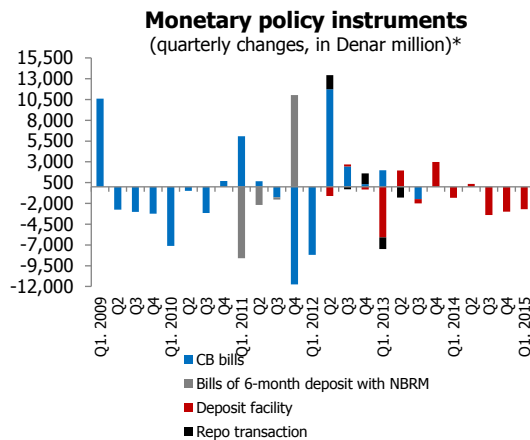
In the first quarter, the NBRM's monetary instruments contributed towards withdrawing net liquidity of Denar 2,704 million. Given the further stable level of CB bills, the change in the total monetary instruments in this period arises solely from changes in the NBRM's deposit facility. In the first quarter, three CB bill volume tender auctions were held with fixed interest rate of 3.25%, where the NBRM determined the supply of CB bills in the due amount. Thus, CB bills had a neutral effect on the level of liquidity in the banking system. At the auctions held in January and February, the demand was higher than the supplied amount of CB bills. The demand was also higher than the

⁵⁸ In December 2014, the spread between these interest rates equaled 1.5 percentage points. The spread narrowing since the beginning of the year is largely due to methodological changes with the introduction of the new interest rate methodology in January 2015. For more detailed information on the new methodology visit:
<http://www.nbrm.mk/default.asp?ItemID=29C1C73ED1A4B745B70FE9C3E423029A>

⁵⁹ Refers to the change in banks' account balances with the NBRM

⁶⁰ Refers to Denar accounts of banks required to allocate reserve requirement.

⁶¹ Includes reserve requirement in foreign currency.



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

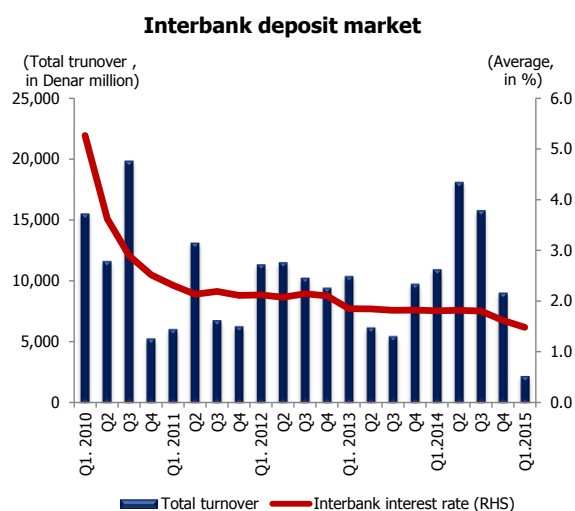
potential, requiring from some banks to allocate funds in seven-day deposit facility with the NBRM⁶². In such conditions and amid continuous creation of excess liquidity through autonomous factors since the third quarter of 2014⁶³, banks actively used seven-day deposit facilities for short-term liquidity management. In the first quarter of 2015, the seven-day deposit facility increased by Denar 2,864 million on a quarterly basis. The overnight deposit facility rose moderately by Denar 160 million compared to the previous quarter. Such deposit facility performance indicated a trend of continuous investments of relatively high amounts of funds in these instruments by banks, contrary to their primary role to ensure flexibility in managing short-term excess liquidity within the reserve requirement period. Therefore, in March, the NBRM decided to cut the interest rates on these two instruments, namely from 1% to 0.5% on seven-day deposits and from 0.5% to 0.25% on overnight deposits. In March, the NBRM adopted a Decision amending the Decision on CB bills that introduces a new manner of establishing banks' bids at the CB bill auctions. The amendments allow the NBRM, when applying limited volume tender and fixed interest rate, to be able to determine a way of establishing banks' bids according to the share of reserve requirement in denars of each bank relative to the reserve requirements of the overall banking system, which is valid for the period of fulfillment that begins on the day of the CB bill auction⁶⁴. This new way of establishing banks' bids according to the share of

⁶² The banks' obligation to allocate funds in seven-day deposit facility of the NBRM stems from the Methodology for determining the potential demand for CB bills, which the NBRM adopted in November 2013. For the method of determining the potential demand for CB bills see the Decision on CB bills, (Official Gazette of the Republic of Macedonia No. 166/13).

⁶³ In the period from the third quarter of 2014 through the first quarter of 2015, total autonomous factors created total liquidity of Denar 8,485 million.

⁶⁴ According to the Decision, the amount of supply of individual bank is calculated by applying its appropriate percentage share in the total supply of treasury bills, reduced by the amount of past due CB bills of the Macedonian Bank for Development Promotion AD Skopje. In order to ensure operational efficiency in conducting auctions of this type and greater transparency toward banks, before the auction the NBRM shall inform the banks on the maximum offer that can be submitted by each bank. This opportunity for setting the supply of banks is expected to stabilize the demand at the level of the amount offered, which eliminates the need for calculation of potential demand and subsequently it repeals the obligation for mandatory seven-day deposits for banks when demand at the auction exceeds the potential demand. For more details about the changes in the setup of the auctions of CB bills and seven-day deposit facilities see the Decision amending the Decision on CB bills (Official Gazette of the Republic of Macedonia No. 35/15) and the Decision amending the Decision on deposit facility (Official Gazette of the Republic of Macedonia No. 35/15).

reserve requirement in denars began to be applied from the CB bill auction held in March 2015. It is expected to contribute to overcoming the trend of excessive demand at the CB bill auctions, amid intense growth of bank liquidity and increased preference for CB bills. Results from the auction held in March, when the demand for CB bills reduced to the level of the supplied amount, goes in favor of such expectations. The new design of CB bill auctions may have an additional contribution towards encouraging the growth of the deposit base of banks, given that the growth in balance sheet liabilities of banks will provide a corresponding increase in their share in CB bills. During the first quarter of 2015, banks allocated excess liquid assets over the reserve requirement (in Denars) of 0.5% on average, which is almost at the level of the average of the previous quarter.



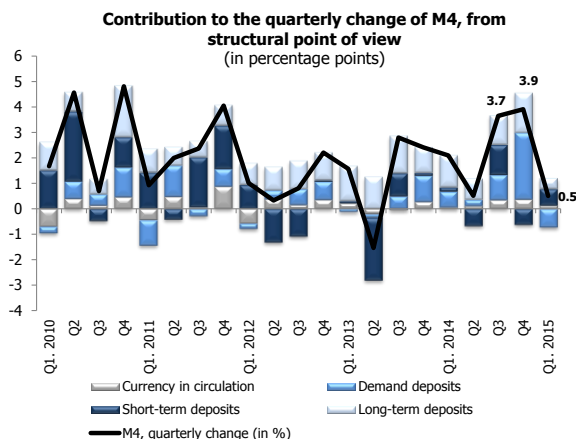
Source: NBRM.

In the first quarter of 2015, the interbank deposit market (unsecured segment) reported a total turnover of Denar 2,178 million, which is by 75.9% less compared to the fourth quarter of 2014. In the first quarter of 2015, the activity at the interbank money market decreased by 80.1%, compared to the first quarter last year. The low market activity in the first quarter is mostly explained by relatively high liquidity position of banks, which corresponds to the creation of liquidity through autonomous factors since the second half of 2014. Analyzed by maturity segment, in the first quarter, transactions up to seven days had a dominant share in the total turnover of the interbank money market, making up 64.9% of the total transactions, followed by intraday transactions, with a share of 35.1%. The interbank interest rate on overnight transactions (MKDONIA) averaged 1.48% in the first quarter (1.62% on average in the fourth quarter). The interbank interest rate (MBKS) averaged 1.36%, in the first quarter (1.61% on average, in the previous quarter). In the first quarter of 2015, the secondary money market reported transactions in the amount of Euro 665,5 million (transactions in government bonds in the amount of Denar 385.5 million and transactions in treasury bills in the amount of Denar 280 million). In the previous quarter, the secondary money market reported execution of repo transactions, transactions in government bonds and transactions in treasury bills. The total amount traded in the first quarter of 2015 is lower by 74.7%, on a quarterly basis.

2.2. Monetary and credit aggregates

Broad money M4 continued to grow during the first quarter of 2015, but at a significantly lower quarterly growth rate compared with the previous quarter. The slowdown in the quarterly pace of monetary growth is partly driven by seasonal factors and corresponds with the real and external sector performances, where the first quarter was marked by nominally slower economic growth and weaker inflows of private transfers compared with the last quarter of the previous year. Structural analysis of money supply shows reduction of its most liquid component (monetary aggregate M1), while short-term and long-term deposits contributed towards expanding the broad money. Observed by sector, the further increase of banks' deposit potential is fully due to the new household savings, amid a decline in corporate deposits, which corresponds with the credit market developments in this period. Thus, credit support to the household sector in the first quarter remained solid, while corporate loans recorded a minor increase compared to the end of the previous year. In such conditions, the annual growth rate of total loans amounted to 9.2% at the end of March (10% in December).

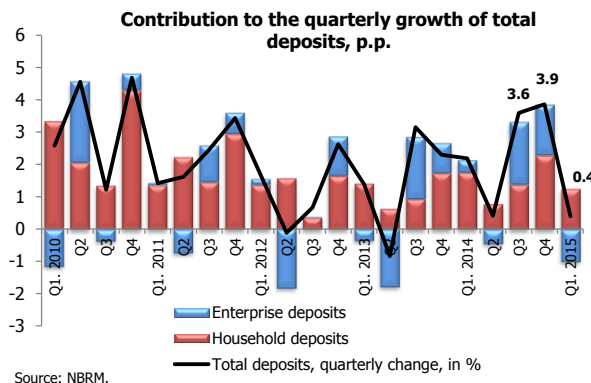
2.2.1. Monetary aggregates



After the intense growth registered during the last quarter of 2014, in the first three months of 2015, the quarterly growth rate of broad money M4 significantly slowed down from 3.9% at the end of December to 0.5% in March. Part of the weaker pace of growth in this monetary aggregate is the usually seasonal adjustment and corresponds to changes in economic activity, i.e. usually weaker nominal GDP growth in the first quarter compared with the last quarter of the previous year. Lower foreign currency inflows through the balance of payments in the form of private transfers are also typical for the first quarter, suggesting smaller capacity of the domestic economy to create additional income in the first quarter. However, the slowdown in growth is due to the high base effect of the previous quarter, when deposits registered an exceptionally high growth. Structurally analyzed, changes in the dynamics of money supply are driven by its most liquid component, money aggregate M1, which decreased on a quarterly basis (high positive contribution of 76% in the previous quarter). Private sector savings continued to grow during the first quarter at a slower pace, amid growth of short- and long-term deposits (in the previous quarter, short-term deposits declined on a quarterly basis). Analyzing currency structure, following the continuous growth in the third quarter of 2009, in the first quarter of 2015, Denar deposits registered a relatively large reduction, which still predominantly results from the fall in demand deposits. On the other hand, foreign currency deposits registered a

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

Source: NBRM.



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

Source: NBRM.

more intensive quarterly growth (a decrease in the previous quarter), which also affected the level of euroization measured by the share of foreign currency deposits in the money supply M4. Thus, the degree of euroization at the end of March rose to 38.2% from 37.3% in December. **On an annual basis**, the growth of broad money slowed down to 8.8% in March from 10.5% at the end of 2014.

During the first quarter of 2015, total deposits of the banking system recorded further growth of 0.4% on a quarterly basis, which compared to the previous quarter is a significant slowdown in the quarterly growth rate. Namely, the last quarter of 2014 registered the most intensive quarterly growth of total deposits in the period after the acute phase of the crisis, and the quarterly growth rate at the end of December equaled 3.9%. Typical for the expansion of the deposit base in the first quarter is the further solid increase of the new household savings amid quarterly decrease of corporate deposits. **Given the continuation of favorable trends in the real economy, the further financial support through lending by domestic banks and the positive contribution from the government sector through regular payment of subsidies, in the first quarter, the total household deposits further increased by 1.8% (3.2% in December).** Analysis of the growth structure indicates a positive contribution of both short- and long-term deposits (accounting for 64% and 32%, respectively, of total growth) despite the quarterly reduction in short-term deposits in the previous quarter. Demand deposits, which in the last quarter of 2014, accounted for much of the quarterly growth of household deposits, according to the usual seasonal adjustment of the demand for liquid assets, in the first quarter of 2015, registered a slight quarterly increase. Analyzed by currency structure, about 58% of new household savings was marketed in the form of foreign currency deposits, which is a deviation from the performance in the previous quarter when Denar deposits made up about 95% of the total growth of household deposits. However, the greater contribution of foreign currency deposits is mainly due to the performance in January⁶⁵ when foreign currency household deposits recorded a relatively high growth, probably in part under the influence

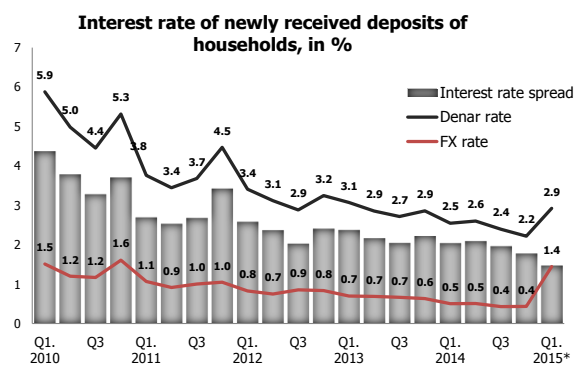
⁶⁵ In January, monthly growth of total household deposits was solely driven by higher savings in foreign currency while Denar deposits decreased on a monthly basis as a result of the fall in demand deposits (household term deposits registered a moderate growth on a monthly basis).



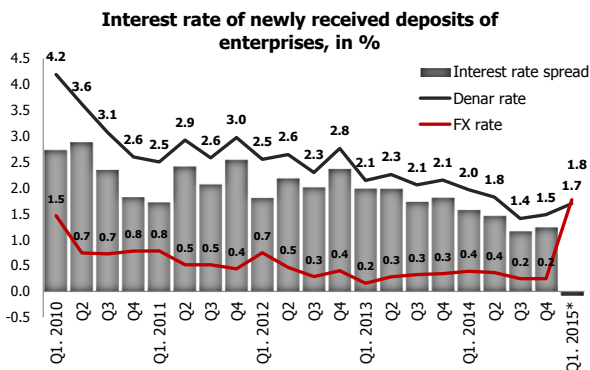
Enterprise deposits

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

Source: NBRM.



*Q1 2015 refers to February. Source: NBRM.



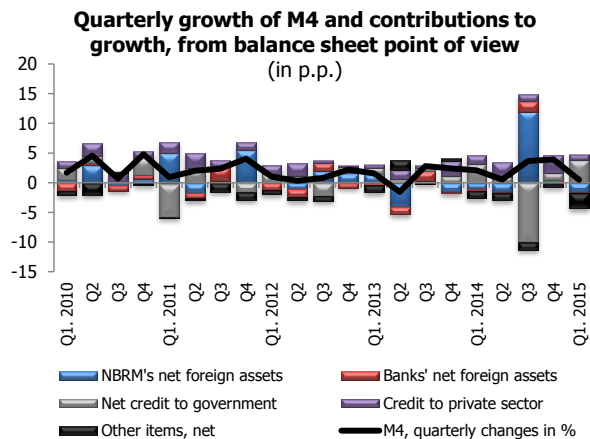
*Q1 2015 refers to February. Source: NBRM.

of international market developments⁶⁶. In February and March, the growth was again driven by Denar deposits, indicating a temporary shift in the currency structure and continuous propensity of households to save in domestic currency. **On an annual basis**, at the end of the first quarter, total household deposits grew by 8.1% (8.9% in December).

In the first quarter of 2015, total corporate deposits recorded a quarterly decrease of 4.2%, unlike the relatively high growth of 6.8% in the previous quarter.

Amid solid growth rates in the real economy, such deviation in corporate deposits probably stems from the corporate sector's regular operations and its inflows and outflows, which not always match in time. These assessments are also underpinned by the fact that changes in the dynamics of total deposits in the last two quarters are primarily determined by changes in demand deposits. Namely, in December, the corporate sector deposited greater amount of money in the form of most liquid funds, which resulted in untypically high monthly growth of demand deposits, partly as a result of higher fiscal spending. Afterwards, during the first three months of 2015, there was a gradual reduction of these funds when demand deposits contributed to the quarterly reduction of total corporate deposits. On the other hand, as a continuity of the performances in the previous quarter, the growth of long-term deposits continued in the first quarter, while short-term deposits again recorded a quarterly decline. Analyzed by currency, there are divergent movements of Denar and foreign currency deposits compared to their performance in the previous quarter. Thus, total quarterly decrease of corporate deposits fully arises from the fall of Denar deposits, with a positive contribution of foreign currency deposits, as opposed to the trends in the previous quarter (in the fourth quarter, deposits in domestic currency explain the overall quarterly increase amid registered decline in foreign currency deposits). **On an annual basis**, corporate deposits growth rate significantly slowed down and reduced to 9% at the end of March (15.7% in December).

⁶⁶ In January 2015, the central bank of Switzerland decided to leave the target of the Swiss franc against the euro that resulted in appreciation of the Swiss franc against the euro and most other currencies.



Source: NBRM.

Total credits of private sector

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

Source: NBRM.

According to the analysis of return on new savings, interest rates⁶⁷ on newly accepted Denar and foreign currency household deposits at the end of February amounted to 2.9% and 1.4%, respectively. Analyzing newly accepted corporate deposits, the interest rates on Denar and foreign currency deposits equaled 1.7% and 1.8%, respectively⁶⁸

Analyzing the balance sheet, the quarterly increase in money supply in the first quarter is mainly due to net loans to the government, and less to the loans to private sector. Net foreign assets of the monetary system, mainly of the NBRM⁶⁹, and less of the banking sector, acted towards reducing the money supply.

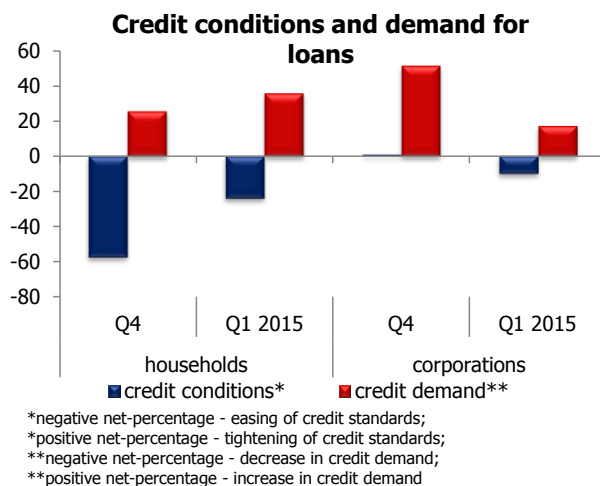
2.2.2. Lending activity

The favorable developments in the credit market registered during 2014 continued in the first quarter of 2015, but at a slower pace compared to the average quarterly increase achieved last year. Thus, **the quarterly growth rate of total loans extended to the private sector as of March was 1.1%, which**

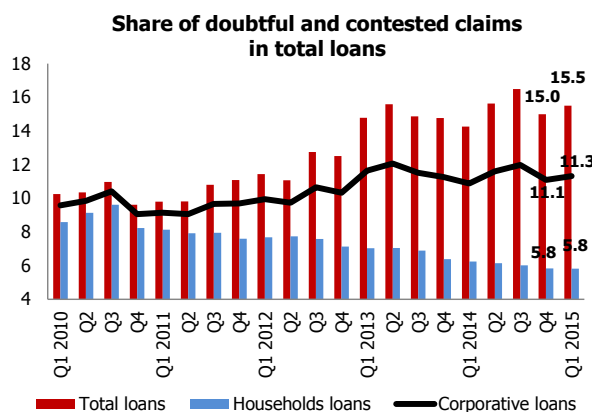
⁶⁷ As of January 2015, interest rate data of banks and savings houses have been collected under the new interest rate methodology, while data for the previous period were collected under the old methodology. Data obtained under the two methodologies are not fully comparable, so the quarterly difference for February 2015 (compared to December 2015), despite the change in relevant interest rate, includes the effect of the methodological difference. Differences between the old and the new methodology include: 1) banks and savings houses are now considered reporting entities, unlike previously when this function was performed only by banks; 2) household sector, besides natural persons and self-employed professionals, includes non-profit institutions serving households, unlike the old methodology; 3) inclusion of financial lease in the financial instrument - loans; 4) interest rates on sight deposits and overnight deposits are not included in the calculation of total deposits as in the old methodology, but are being reported in a separate form; and 5) revolving loans are not included in the calculation of interest rates on overdrafts (as was the case in the old methodology), but are reported in a separate form. Also, the new methodology provides more analytical data used for monitoring and analyzing the interest rate movements, especially in case of new loans and deposits in terms of sector, maturity, initial rate fixation period, currency structure and purpose of the loans.

⁶⁸ The new interest rate methodology had the greatest effect on the level of deposit interest rates because interest rates on demand deposits and overnight deposits are no longer included in the calculation of interest on total deposits. Hence, the growth of deposit interest rates in February compared to the end of the previous year can also primarily be explained by the methodological changes.

⁶⁹ The reduction in the NBRM's net foreign assets in the first quarter mostly reflects the effect of the early repayment of the loan to the IMF used within the Precautionary Credit Line in February.



Source: Bank lending survey, NBRM.



Source: NBRM.

Total credits of households

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

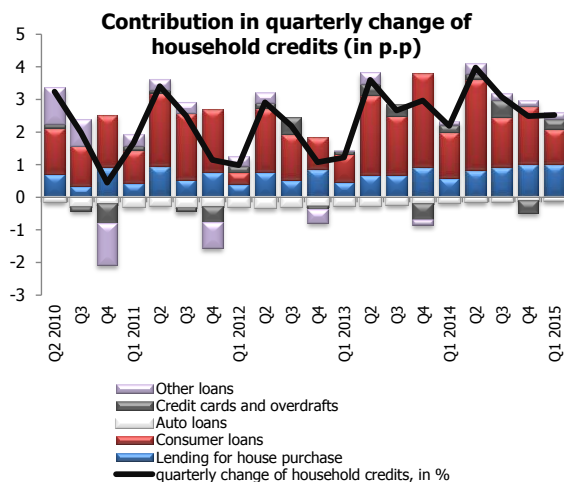
Source: NBRM.

represents a slowdown compared to the growth realized in the fourth quarter (of 3.6%). Amid further maintenance of the solid pace of recovery of the domestic economy, slower growth of credit activity of the private sector is partly explained by the high performances at the end of the year (bearing in mind that in the last quarter of 2014 the highest credit flows since the beginning of the crisis were registered) but also by seasonal factors. Namely, during the first months of the year a slowdown in lending activity in particular to the corporate sector is common, which may indicate a temporary lower lending to this sector of the economy. Thus, the quarterly growth of total loans in this period is predominantly explained by the increase in household loans while corporate loans account for only 6% of the realized growth (share of 72% in the previous quarter). Maintaining of the positive trends in lending is confirmed by the results of the latest Lending Survey⁷⁰ conducted in late March, which indicate favorable banks' perceptions for the supply of and demand for corporate loans and household loans. Furthermore, in this period, relative stabilization of the share of non-performing loans in total loans is registered, at the level of 11.3% in March (11.1% at end December 2014).

The analysis of the maturity structure of total loans shows further growth of long-term loans amid realized reduction of short-term loans, despite the intense growth of both categories in the previous quarter. In terms of currency structure, the Denar loans still explain most of the approved loans in the first quarter amid more significant increase in the contribution of foreign currency loans compared to the previous quarter (accounting for 35% versus 14% as of December). Such intensification corresponds to higher growth in banks' foreign currency deposits in this period. The realized quarterly growth of total loans is higher compared to the increase in the deposit base in the first quarter, causing an increase in the use of the deposit potential for lending to the private sector. Thus, at the end of March, the loans/deposits ratio was 90% versus 89.3% at the end of December. **On annual basis**, total loans registered slower growth rate of 9.2% (10% at the end of last year).

During the first three months of 2015, loans to the household sector recorded further quarterly increase of 2.4%,

⁷⁰ For more detailed information see the Lending Survey at <http://nbrm.mk/?ItemID=F7AC78DEE498764FBAF39049F726CE3C>

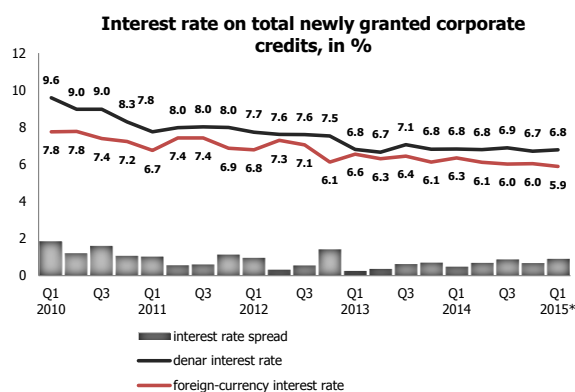


*Total loans to households do not include loans to self-employed individuals.
Source: NBRM.

Total credits of corporations

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

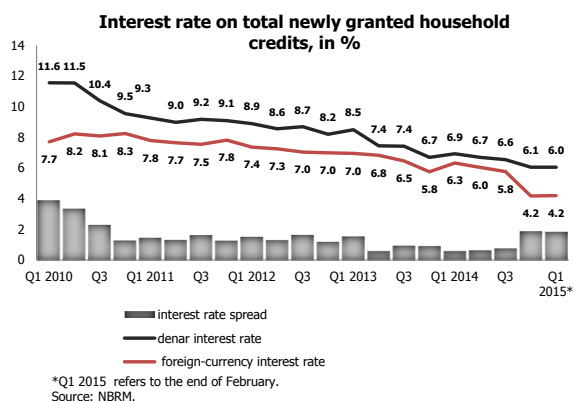
Source: NBRM.



*Q1 2015 refers to the end of February.
Source: NBRM.

which represents a similar pace of growth as in the previous quarter. The growth of total loans to households remained mostly driven by the higher level of consumer loans, followed by lending for house purchasing, but in the first quarter significant increase was noted also in the overdrafts on current accounts, despite their decline in the previous quarter. Such movements are confirmed by the results of the Lending Survey, which indicate a further net easing of credit conditions for approving loans, but at a slower pace than in the previous Survey. In terms of demand, banks point to higher demand for consumer and house purchasing loans while there is slight net reduction in demand for other loans. The analysis of the maturity structure of the quarterly growth rate of loans to households points to long-term loans as major driver of the growth, and short-term loans act in the same direction (contrary to their decline in the previous quarter). In terms of currency structure, similar to the previous quarter, there was a dominant share of loans in domestic currency amid slight increase also in the foreign currency loans. **On an annual basis**, total loans to households recorded a moderately accelerated growth rate from 11.8% in December to 12.1% at the end of March.

After the considerable acceleration in the last quarter of 2014, lending activity aimed at the corporate sector registered a more dynamic slowdown in the quarterly growth rate of 4.5% in December to 0.1% at the end of March. The quarterly growth was fully realized in February and especially in March, while during the first month total loans to enterprises recorded a more significant decrease on a monthly basis. Weaker performances in January were typical in recent years, which suggests temporary adjustment of corporate loans in this period. On the other hand, lending to companies was still supported through the undertaken monetary policy measures, including the non-standard measure for encouraging the credit activity for net exporters and producers of electricity. Thus, in the period from January to February, new loans extended under this measure registered a more significant growth of Denar 2,550 million. Regarding the use of the funds from the credit line from the EIB 4, during the first quarter banks placed new Denar 700 million (Euro 11.5 million) to support 36 new investment projects. According to the results of the Lending Survey, further positive trends in corporate lending result from the improvements on the supply side and the retained positive developments in demand for all types of corporate loans. Thus, banks

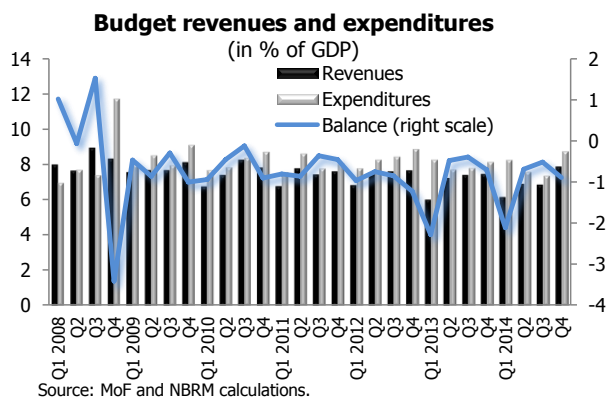


indicate a moderate net easing of credit conditions for businesses in the first quarter (compared to the minimum net tightening in the fourth quarter) amid further net increase in their demand but at a slower pace compared to the previous Survey. The analysis of the maturity structure in the first quarter shows a reduction of short-term loans and further, but significantly slower growth in long-term loans, versus the strong growth in both categories in the previous quarter. In terms of currency structure, realized quarterly growth stems entirely from the increase in foreign currency loans, while Denar loans decreased on a quarterly basis, after seven quarters of continuous growth. **On annual basis**, the growth rate of corporate loans slowed down to 7.1% at end-March from 8.5% in December.

According to the latest data as of February, **the interest rates on total loans to households and companies** amounted to 7.3% and 6.8%, respectively. In terms of newly granted loans, the interest rates were 5.9% and 6.5% for loans to households and companies, respectively⁷¹.

III. Public finances

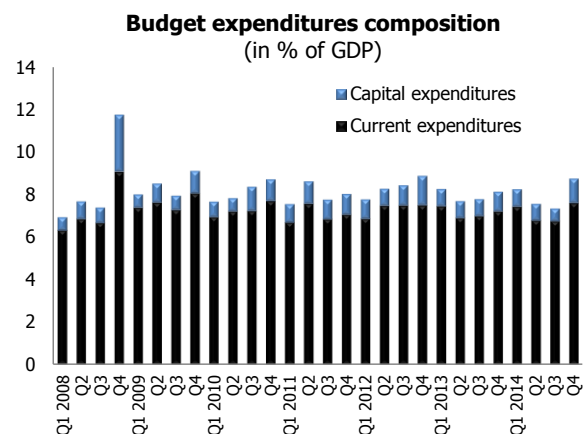
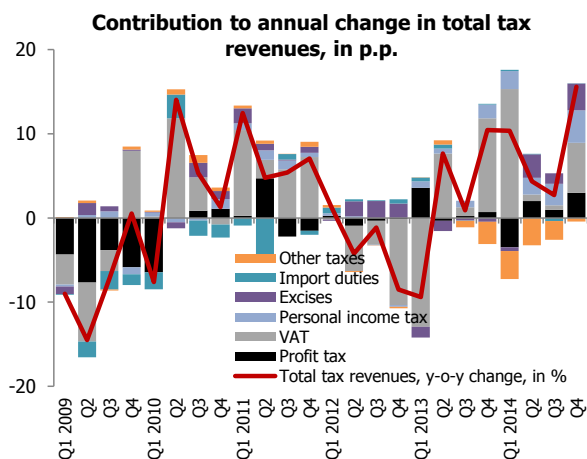
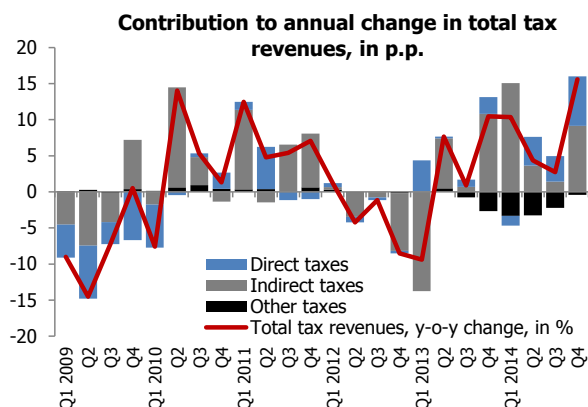
In the fourth quarter of 2014, the Budget of the Republic of Macedonia (central budget and budgets of funds) generated higher revenues by 11.1%, while the budget expenditures increased by 13.1% compared to the same period last year. In this period, the budget deficit accounted for 0.9% of GDP, entirely financed from government deposits. Growth in total budget revenues continued also in the period January-February 2015, and amounted to 7.4%, with their realization representing 13.9% of the total projected revenues for the entire year. In the same period, budget expenditures declined by 5%, but their realization was higher and amounts to 15% of the total budgetary expenditures projected for 2015. The budget deficit in the two months of the year amounted to 0.8% of GDP, or about 25% of the deficit planned in the state budget for the year.



In the fourth quarter of 2014, a significant increase in total revenues in the Budget of the Republic of Macedonia was registered⁷². Thus, after the fall in the previous quarter, budget revenues grew by 11.1% on an annual basis, which is the highest growth rate in the last three years. This resulted in a growth of their share in GDP, which reached 7.9%, compared with 6.8% in the third quarter of 2014 and 7.5% in the fourth quarter of 2013. A more

⁷¹ As of January 2015, interest rate data of banks and savings houses have been collected under the new interest rate methodology, while data for the previous period were collected under the old methodology. For more detailed information see page 51.

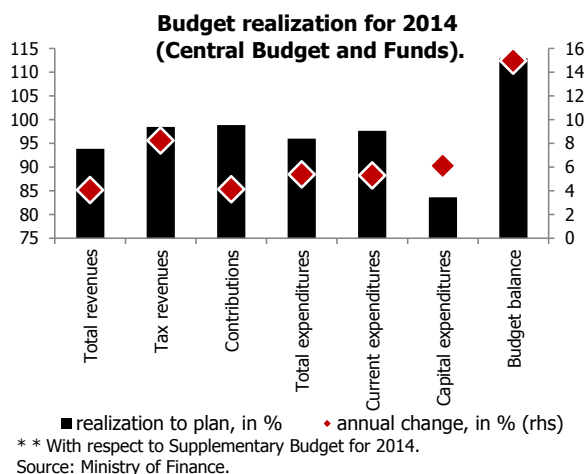
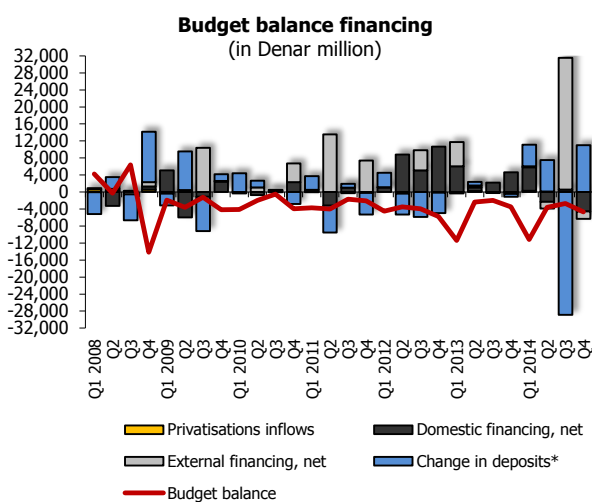
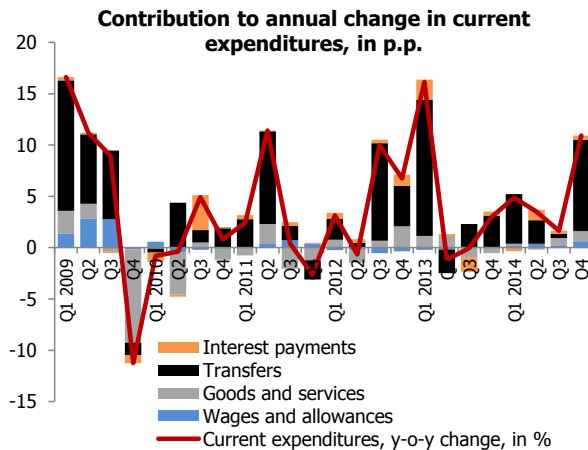
⁷² Central budget and budgets of funds.



detailed analysis of the revenue side of the budget shows that the largest contribution to the growth was that of tax revenues (of 8.7 percentage points), which registered fast growth of 15.6% on an annual basis. The main driver of tax revenues in this quarter was the income from VAT, which increased by 11% compared to the same quarter of the previous year, which is in line with the growth of the two categories that are the basis for its collection, private consumption and imports. Fast growth of 27.4% was registered also in the revenues on the basis of personal income tax, which thus made the second largest contribution to the growth of tax revenues. The growth in revenues from this tax is explained by the increase in nominal wages and the number of employed persons in this period. A certain part of the increase is probably due to the obligation of employers to pay personal income tax on the vacation subsidy paid to the employees in the private sector⁷³. Compared to the same period last year, revenues from corporate income tax in the fourth quarter increased by 73.1% on annual basis, probably due to higher taxes collected on paid dividends and other distribution of profits. At the same time, revenues from excise taxes were higher by 15.2%, as opposed to import duties, whose changes were marginal (0.6% growth). Total social contributions rose as much as in the previous quarter (3.6%), amid slower growth in contributions for pension and disability insurance and faster growth of contributions for health insurance and insurance in case of unemployment. After the significant decline in the previous quarter, non-tax revenues in the last quarter of 2014 grew by 9.3% on an annual basis, primarily due to the growth in the category "other non-tax revenue".

In the fourth quarter of 2014, total budget expenditures increased by 13.1% on annual basis. Moreover, their share in GDP reached 8.8%, which is higher compared with 7.4% in the third quarter of 2014 and 8.1% in the fourth quarter of 2013. In terms of the structure of budget expenditures, most of the growth was due to the significant increase in current expenditures, which increased by 10.9% compared to the same period last year. Within the current expenditures a high growth of 12.9%, and thus the greatest contribution, was noted in the

⁷³ Pursuant to the Agreement Amending the General Collective Agreement for the private sector of the economy (Official Gazette of RM no.189-13) starting from 1.1.2014, all companies are required to pay an annual vacation subsidy to the employees who have worked at least 6 months continuously in the calendar year. At the time of payment, personal income tax of 10% is calculated, retained and paid.



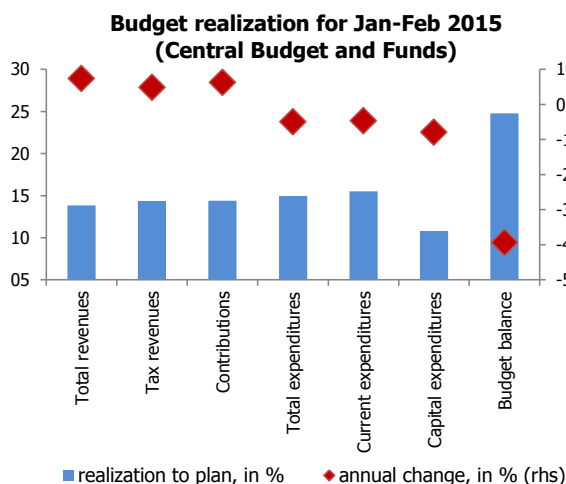
category of "transfers", which was affected equally by the higher social transfers and other transfers. The growth of social transfers in the fourth quarter was 8.4% on an annual basis, mainly due to the higher amount of budget funds allocated to the Health Insurance Fund, while other transfers were higher by 27.3%⁷⁴. Increased realization of current expenditures was further fueled by the intensive growth of the categories "goods and services" and "wages and compensations"⁷⁵ during this period. On the other hand, in the fourth quarter growth of **capital expenditures** by 30.2% on an annual basis was registered, as opposed to the decline in the previous quarter. As a result, the share of capital expenditures in GDP in this quarter increased to 1.1% (0.6% in the previous quarter), and their share in the total expenditures of 13.1% exceeded the share of the expenditures for wages and compensations (12.8%) and for goods and services (9.6%).

After the decline registered in the previous quarter, in the last quarter of 2014 the budget deficit significantly increased and reached Denar 4,680 million, which represents approximately 20% of the deficit for the whole year, i.e. 0.9% of GDP. The negative budget balance in this period was fully funded through government deposits, which were used in the amount of Denar 10,999 million. On the other hand, net domestic borrowing in the fourth quarter was negative and amounted to Denar 4,533 million, amid higher repayments of government liabilities on the basis of short-term government securities. In the last quarter, repayments of external debt were higher than the realized inflows, which contributed external borrowing also to be negative on a net basis, amounting to Denar 1,795 million.

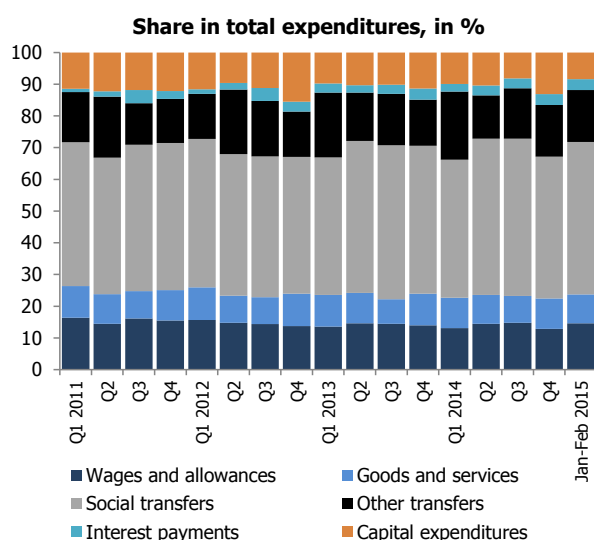
In the first two months of 2015, total budget revenues continued to register solid growth rates, and they increased by 7.4% compared to the same period last year. Higher tax revenues, which registered an annual growth of 4.8%, again made the largest contribution to the growth of total revenues in this period. In terms of individual taxcategories, total revenue growth largely resulted from the high

⁷⁴ The fast growth recorded in the category "other transfers" in this period was probably due to the payment of subsidies for tobacco producers for the period when it was stopped due to the spring elections, as well as for finalization of the payment of purchased tobacco for the harvest of 2013 to those producers to whom payment was not made due to technical problems.

⁷⁵ At the end of the fourth quarter wages in the public sector were increased by 4%.



* With respect to the Budget plan for 2015.
Source: Ministry of Finance.



Source: Ministry of Finance.

inflows based on excises (56.4%), and were further influenced by the higher collection of direct taxes (personal income tax and profit tax). Among the reasons for the fast growth of excise revenues could be the lower comparison base, as well as recent changes in the excise policy⁷⁶. In contrast, revenues from VAT registered an annual decline of about 10% in the analyzed period, whereby they negatively affected the growth of budget revenues. Inflows on the basis of social contributions continued to grow in the beginning of the year, when higher performances in all social funds were reported. **Unlike revenues, in the January-February 2015 period, total budget expenditures decreased by 5% on an annual basis, amid a decline in both current and capital expenditures.** Moreover, within current expenditures, the decline stems entirely from the lower realization in the "other transfers" category, which is explained by the higher comparison base from the last year⁷⁷. On the other hand, other expenditure categories recorded moderate growth. Regarding the plan for 2015, in January and February, 13.9% of anticipated revenues and 15% of anticipated expenditures for the year were realized. **In the first two months of the year the budget deficit amounted to Denar 4,583 million (0.8% of GDP⁷⁸),** which represents about 25% of the projected deficit for 2015. During this period, the budget deficit was financed mainly through government deposits, and to a lesser extent through new issuance of government securities. On the other hand, external borrowing declined on a net basis, amid high amount of outflows realized in this period⁷⁹.

The total public debt outstanding⁸⁰ as of 31.12.2014, increased by 5.5 percentage

⁷⁶ At the end of the last year amendments to the Law on Excise (Official Gazette no.167 and 188) were adopted, which introduced a new excise good - petroleum coke which will be subject to excise of 84.6 den/gigajoule, while the excise duty on cigarettes was increased as well, by 0.053 denars per piece, i.e. by 4%.

⁷⁷ At the beginning of last year, a significant amount of expenses were realized within this category, which were linked to the payment of subsidies in agriculture.

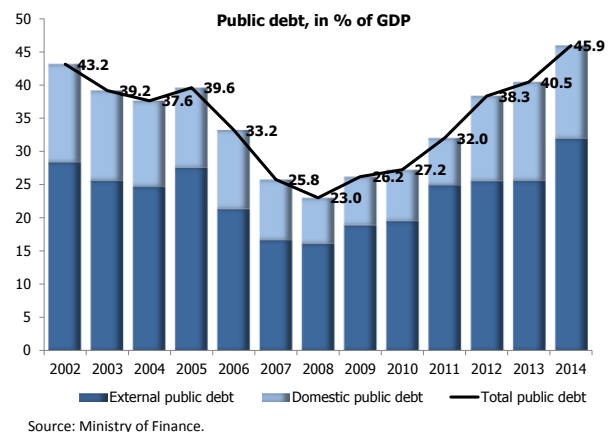
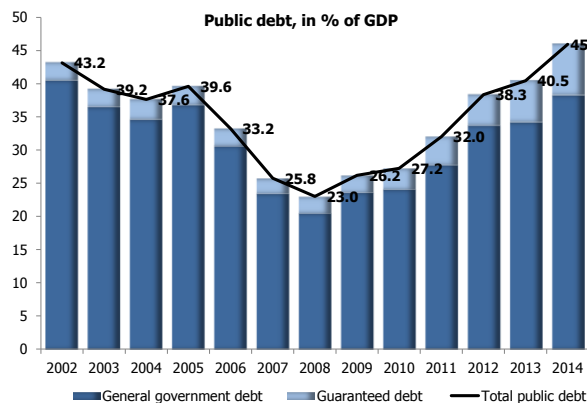
⁷⁸ Also, 0.8% of GDP according to the GDP projection of the Ministry of Finance.

⁷⁹ In February the state made an early repayment of the remaining debt to the IMF on the basis of the precautionary credit line, in the amount of US Dollars 174 million.

⁸⁰ The public debt is defined under the Law on Public Debt (Official Gazette of the Republic of Macedonia No.165/14), according to which it is the sum of the government debt and the debt of public enterprises established by the state or municipalities, municipalities within the city of Skopje and the city of Skopje, and companies that are wholly or predominantly owned by the state or by the municipalities, the municipalities within the city of Skopje and the city of Skopje, for which the Government has issued a state guarantee.



points compared to the same period last year and reached 45.9% of GDP. This shift is mainly due to the rising external debt of the central government as a result of the borrowing made on the international financial market. Consequently, the share of external public debt in GDP significantly increased and reached 31.9%, while the share of domestic public debt moderately decreased and amounted to 14%. At the end of the year, growth was observed in both components of public debt (government⁸¹ and guaranteed), with their share reaching 38.2%, and 7.7% of GDP, respectively.



Budget of Republic of Macedonia (Central budget and Funds' budgets)

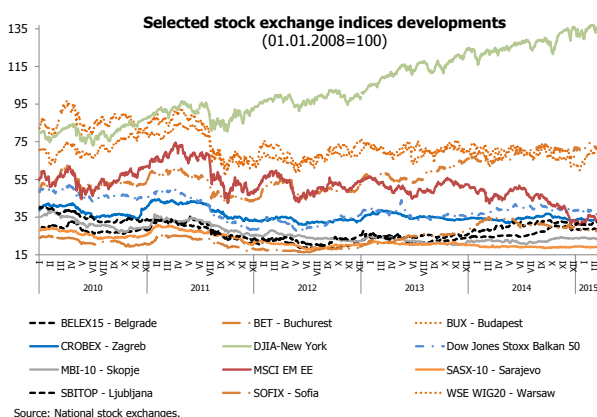
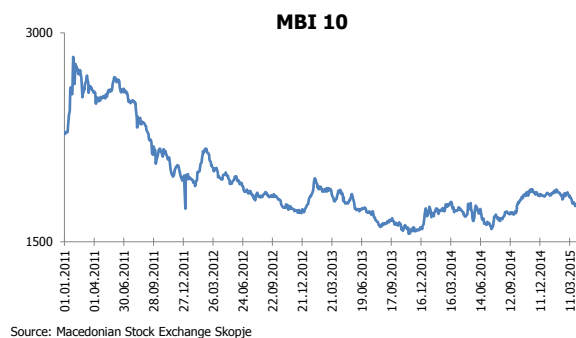
	Budget for 2014	Supplementary Budget for 2014	Q1	Q2	Q3	Q4	2014	Budget for 2015	Jan.-Feb.	Y-o-Y changes, 2014 period over the same period of the previous year, in %	Contribution to y-o-y change, 2014 period over the same period of the previous year, in p.p.	Y-o-Y changes, 2015 period over the same period of the previous year, in %	Contribution to y-o-y change, 2015 period over the same period of the previous year, in p.p.
	planned, in Denar million	planned, in Denar million	realized, in Denar million					planned, in Denar million	realized, in Denar million	Q1 Q2 Q3 Q4 2014	Q1 Q2 Q3 Q4 2014	Jan-Feb	Jan-Feb
TOTAL BUDGET REVENUES	158,243	155,554	32,291	36,257	36,016	41,365	145,929	163,280	22,616	7.9 0.4 -2.6 11.1 4.1	7.9 0.4 -2.6 11.1 4.1	7.4	7.4
Revenues base on taxes and contributions	133,859	131,376	28,704	32,081	32,146	36,379	129,310	137,672	19,914	8.4 4.6 3.4 11.0 6.9	7.4 3.9 2.9 9.7 5.9	6.0	5.3
Tax revenues	87,222	85,189	18,216	20,887	20,745	23,997	83,845	87,465	12,568	10.4 4.4 2.7 15.6 8.2	5.7 2.4 1.5 8.7 4.5	4.8	2.8
Contributions	45,153	44,703	10,211	10,891	11,052	12,031	44,185	48,717	7,007	5.1 4.4 3.6 3.6 4.1	1.6 1.3 1.0 1.1 1.2	6.3	2.0
Non-tax revenues	14,973	14,697	2,598	2,436	2,645	2,955	10,634	17,078	2,102	-2.6 11.1 -41.8 9.3 -12.2	-0.2 0.7 -5.1 0.7 -1.1	17.8	1.5
Capital revenues	5,290	4,177	174	1,041	348	311	1,874	4,152	132	-25.3 -56.7 56.1 11.5 -40.3	-0.2 -3.8 0.3 0.1 -0.9	-2.2	0.0
Donations from abroad	3,521	4,504	612	534	766	1,471	3,383	3,578	441	34.2 -29.0 -24.0 19.1 -2.0	0.5 -0.6 -0.7 0.6 0.0	86.1	1.0
Revenues of recovered loans	600	800	203	165	111	249	728	800	27	101.0 51.4 -13.3 13.2 30.5	0.3 0.2 0.0 0.1 0.1	-77.3	-0.4
TOTAL BUDGET EXPENDITURES	176,514	175,157	43,428	39,878	38,712	46,045	168,063	181,777	27,199	5.0 3.6 -0.6 13.1 5.4	5.0 3.6 -0.6 13.1 5.4	-5.0	-5.0
Current expenditures	154,137	154,073	39,120	35,739	35,565	40,016	150,440	160,569	24,909	4.9 3.5 1.6 10.9 5.3	4.4 3.1 1.5 9.7 4.7	-4.7	-4.3
Capital expenditures	22,377	21,084	4,308	4,139	3,147	6,029	17,623	21,208	2,290	6.5 4.0 -20.4 30.2 6.1	0.6 0.4 -2.1 3.4 0.6	-7.9	-0.7
BUDGET DEFICIT / SURPLUS	-18,271	-19,603	-11,137	-3,621	-2,696	-4,680	-22,134	-18,497	-4,583	-2.4 51.4 37.3 34.2 14.9			
Financing	18,271	19,603	11,137	3,621	2,696	4,680	22,134	18,497	4,583				
Inflow	29,131	30,463	12,006	7,444	5,175	7,600	32,225	44,667	14,916				
Revenues based on privatisation	0	440	310	130	0	9	449	0	0				
Foreign loans	5,276	36,449	994	908	33,301	993	36,196	16,159	80				
Deposits	13,915	-12,676	5,060	7,391	-28,842	10,999	-5,392	23,321	13,084				
Treasury bills	9,840	6,150	5,642	-985	706	-4,403	960	5,137	1,751				
Sale of shares	100	100	0	0	10	2	12	50	1				
Outflow	10,860	10,860	869	3,823	2,479	2,920	10,091	26,170	10,333				
Repayment of principal	10,860	10,860	869	3,823	2,479	2,920	10,091	26,170	10,333				
External debt	9,133	9,133	737	2,503	2,347	2,788	8,375	20,001	10,201				
Domestic debt	1,727	1,727	132	1,320	132	132	1,716	6,169	132				

Source: Ministry of Finance.

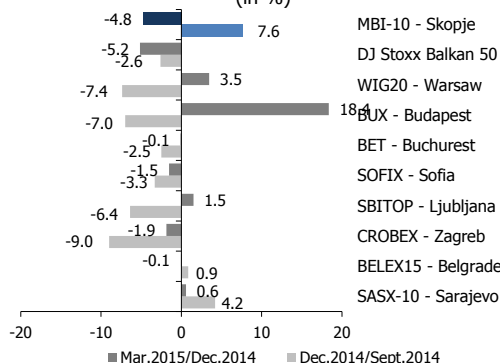
⁸¹ Government debt is defined as a sum of debts of the central and the local government.

IV. Stock exchange indices and real estate prices

In the first quarter of 2015, Macedonian Stock Exchange Index MBI-10 registered a slight decline, as opposed to the increase in the second half of 2014. This movement was followed by lower total turnover on the stock market in the first quarter, and a decline in turnover was registered also in traditional trading. The values of the regional stock exchange indices moved in different directions, primarily as a result of specific local factors. Real estate prices in the domestic market recorded positive changes, a movement which in the absence of significant changes in supply and demand for real estate, may be of a temporary character.



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



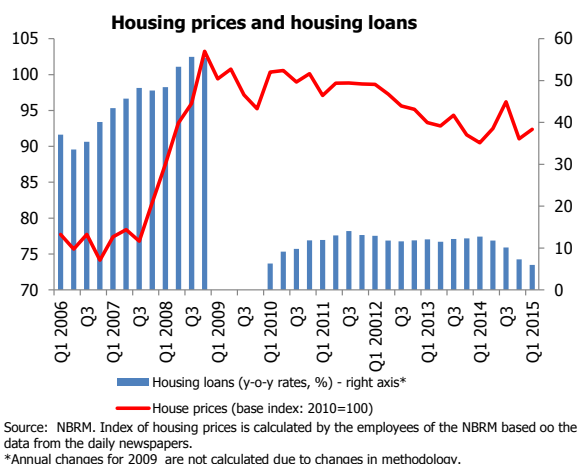
During the first quarter of 2015, the value of the Macedonian Stock Exchange Index MBI-10⁸² dropped by 4.8%, as opposed to its growth in the second half of 2014. Analyzing the pace, in the first quarter, the stock exchange index registered various periods of movement. Namely, in January the stock index moved in an upward direction, while starting from February there was a gradual reduction in value - a trend that continued in March. At the end of the quarter the value of the index stood at 1,755.5, a lower level compared to the level registered at the end of the fourth quarter. Such trends in the index could be linked to the still weak interest of domestic investors and the absence of larger foreign institutional investors, despite better economic performance in the last quarter of 2014. The total stock exchange turnover decreased by 90.3% compared to the previous quarter, which is generally linked to the high base effect from the last quarter when higher turnover through public offering of shares of one company was realized. Turnover from traditional trading also declined, but at a more moderate pace compared to the total stock exchange turnover (34%). Unlike the MBI-10, the bond index (OMB) registered a small increase of 1.3% at the end of March 2015, compared to the end of December 2014.

In the first quarter of 2015 divergent trends in the values of the regional stock exchange indices were registered. Thus, growth in the value of stock indices was registered in the stock exchanges in Budapest, Warsaw, Ljubljana and Sarajevo. Upward movements in these indices partly reflect specific local⁸³ factors. In addition, this trend of regional markets could be

⁸² On 15 December 2014, the MBI-10 index was revised, and as of 30 December 2015, the index includes the following companies: Alkaloid AD Skopje; Replek AD Skopje; Granit AD Skopje; Komercijalna Bank AD Skopje; Makpetrol AD Skopje; Stopanska Bank AD Bitola; Macedonian Telecom AD Skopje; Makedonijaturist AD Skopje; Tutunska Bank AD Skopje; Skopski Pazar AD Skopje.

⁸³ <http://wire.seenews.com/>

partly linked to the fall in the value of the euro, a factor that positively affected the movements of European stock exchanges⁸⁴. On the other hand, the decline in the value of the index was recorded on the stock exchanges in Zagreb, Sofia, Bucharest and Belgrade.



In the first quarter of 2015, there was an increase in the prices of apartments, i.e. the home price index⁸⁵ increased by 1.5% on a quarterly basis (as opposed to the quarterly decline of 5.4% in the previous quarter) and by 2.1% on an annual basis (as opposed to the annual decline of 0.6% in the fourth quarter). This increase is probably temporary, given that the supply of and demand for real estate remains similar as in the previous quarter. Namely, the cumulative value of the buildings constructed in the period 2011 - 2014 is higher by 96.3% compared with the period 2007 - 2010, and data show similar dynamics in building permits⁸⁶. In terms of demand for apartments, the permanent solid growth in lending for house purchase, a trend that is common for the entire 2014, continued also in the first quarter of 2015 and suggests further strengthening of demand.

V. Macroeconomic forecasts and risks

In 2014, the domestic economy grew by 3.8%, which was in line with the expectations within the October forecast. High frequency data available for the first quarter of 2015, and estimates for the future path of key external and domestic factors suggest keeping the pace of economic growth in the next two-year period. Thus, **estimates for the economic growth for 2015 and 2016 are unchanged compared to the previous projection, with expected growth of the domestic economy of 4.1% in 2015 and further acceleration of growth to 4.5% in 2016.** No major changes have been made either in terms of the sources of growth, so that exports, investment and private consumption remain major factors that would support further recovery of the real sector. The export activity of present foreign investors and the gradual recovery of the foreign effective demand are expected to contribute to the export growth, which together with the strong investment impetus by the Government and the entry of new investments in the export-oriented sectors, would lead to growth also in the investment activity. These factors are expected to lead to improved conditions in the labor market and thus stimulate the households consumption in the next two years. Additional support for the domestic demand is expected also from the increased lending activity, so that within this projection the expectations for solid growth of loans and deposit potential of the banking system are retained. In

⁸⁴ <http://money.cnn.com/2015/03/09/news/economy/europe-stimulus-qe-three-things/>

⁸⁵ Hedonic index of housing prices, prepared by the NBRM on the basis of the notices of sale in the capital city, and published by the agencies dealing with trade in real estate. The price of the apartment is a function arising from the size of the apartment, the neighborhood in which it is located, the floor, whether the apartment has central heating and whether the apartment is new.

⁸⁶ It should be borne in mind that the data on the construction of residential buildings and building permits apply to the whole country, while the index of apartment prices has been calculated only for the Skopje region.

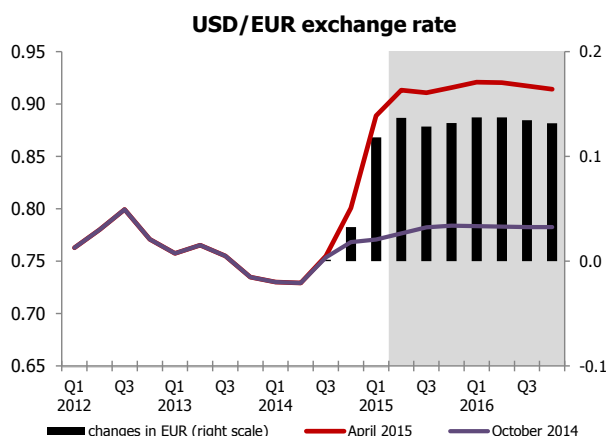
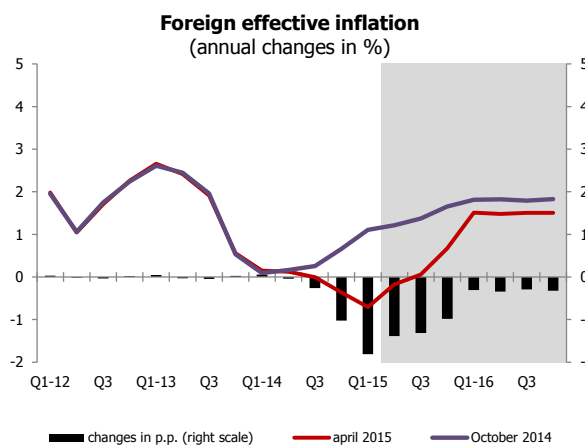
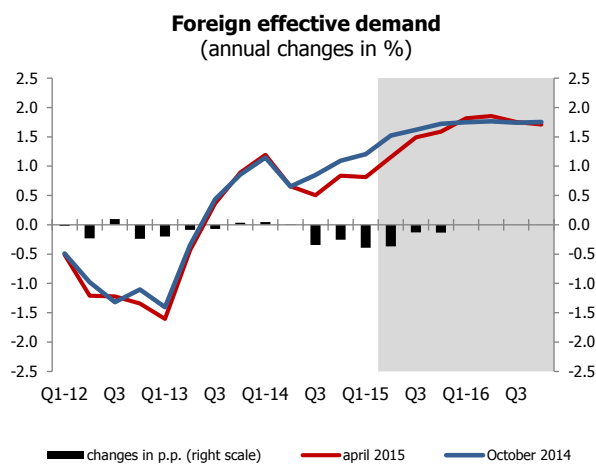
2014, the current account deficit amounted to 1.3% of GDP, and it was lower than expected in the October forecasting round (2.7% of GDP) amid improved energy, but also non-energy trade deficit, and downward revisions are made also for the next two years. In 2015, despite further narrowing of the deficit in the trade in goods and services, a slight widening of the **current account deficit to 1.6%** is expected, amid stabilizing inflows of private transfers and reduction of their share in GDP. The deficit **in current transactions is expected to be further widened in 2016 and reach 3.1% of GDP, reflecting the expectations for increased investment imports.** The sources of financing the current account gap in the next two years is expected to be a combination of debt and non-debt flows, **with the projections for the foreign reserves showing their constant maintenance at an adequate level.** In the first three months of 2015, inflation was lower than expected in the October projection, which combined with the new assessments for the input import prices have resulted in a moderate downward revision of inflation for 2015 and unchanged growth for 2016. **Thus, latest estimates for the inflation point to average change in prices of 0.5% in 2015 and an acceleration of inflation to around 2% in 2016 (about 1% and 2% in 2015 and 2016, respectively in the previous projection).**

5.1. Assumptions in the external environment forecast⁸⁷

In the course of 2014, growth of global economic activity⁸⁸ of 3.4% was registered, which reflects the intensified growth of the developed economies, as opposed to the moderate slowdown of the economic activity in emerging and developing economies. However, emerging and developing economies contribute with three quarters to the total growth for 2014. The estimates for the global economic growth for the next period are still directed toward its moderate recovery, with different dynamics between individual countries and regions. **Thus, the latest assessments for the global growth point to further positive developments, i.e. acceleration of the global growth to 3.5% and 3.8% in 2015 and 2016, respectively. The expected global growth is moderately lower than in the October forecast.** The latest estimates reflect the positive revisions of growth in the developed economies, while the estimates for growth in the emerging and developing economies have been revised downward, primarily reflecting the weaker outlook for some of the larger emerging economies and oil exporting countries. The risks around the projections for global growth are more balanced relative to the October projection, but downward risks still prevail.

⁸⁷Sources of historical data on foreign demand, foreign inflation and exchange rate of the US Dollar against the Euro include Eurostat and national statistical offices of the countries, while IMF statistics is a source of these data on prices of oil, food and metals. Estimates of foreign demand, foreign inflation and foreign exchange rate of the US Dollar are based on the Consensus Forecast, while the projections of the prices of oil, food and metals are based on the projections of market analysts.

⁸⁸World Economic Outlook, IMF, April 2015.



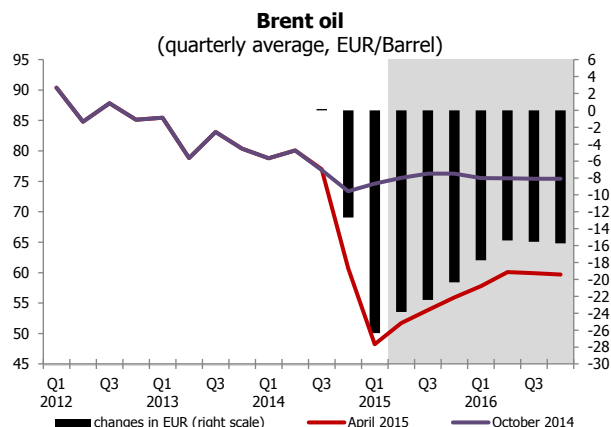
April assessment of the effective foreign demand for Macedonian products in 2015 was slightly lower compared with the October projections. Thus, now foreign demand is expected to grow by 1.3% in 2015, unlike the October projections for growth of 1.5%. These adjustments are mainly related to the downward revisions to the movements of the Serbian, Bulgarian and Greek economies during 2015. On the other hand, expectations about the pace of recovery of the economic activity in 2016 among our trading partners have not changed, i.e. it is still expected that foreign demand will grow by 1.8%. However, it should be noted that given the quantitative easing by the ECB at the beginning of the year, depreciation of the euro and fall in the oil prices, the growth estimates for the Euro area for the period 2015-2016 were revised upwards. These shifts in the expectations for the Euro area can favorably affect the domestic economy.

Foreign effective inflation has been revised downwards compared with the October projections. Thus, as a result of the lower projected inflation with all our import partners, it is now expected that foreign inflation in 2015 will equal 0% instead of 1.3% as expected in October. This downward revision is mainly due to the latest expectations about price movements in Germany, Serbia, Croatia and Bulgaria. Expectations for 2016 are that foreign inflation will reach 1.5%, which is also a downward deviation compared to the October projection when growth of foreign prices of 1.8% was envisaged.

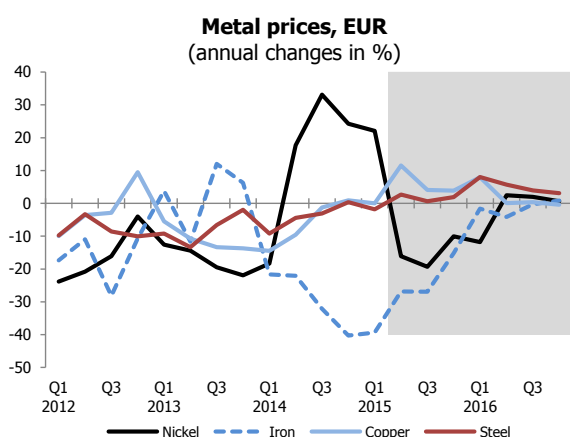
April assessment indicates a greater change in the expectations for the movement in the US dollar/euro exchange rate in 2015, i.e. it is expected that the dollar will appreciate strongly by 20.4% on an annual basis (4.4% in the October projection)⁸⁹. The appreciation of the US dollar is in accordance with the different policies that the Fed and the ECB are expected to continue to implement by 2016, and which mean normalization of monetary policy in the USA amid still present monetary stimulus in the Euro area. The trend of strengthening the value of the US dollar is expected to continue in 2016, when it is expected to appreciate by 1.2% on an annual basis (0.6% in the October forecast).

In the first quarter of 2015, sharper decline in oil prices compared to the October projection was registered, and sharper decline is expected also throughout the

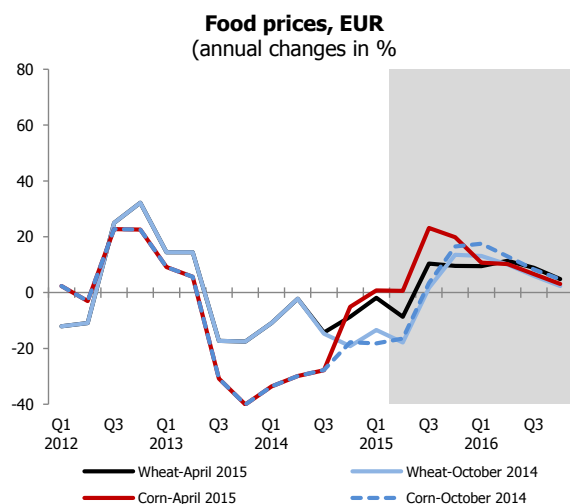
⁸⁹Source of projection is "Consensus Forecast".



year. Downward pressures primarily reflect the high production of shale oil in the United States and the high global oil inventories. On the other hand, it is expected that in the coming period downward pressures on oil prices will be gradually exhausted, primarily due to the expected decrease in production, especially in the USA⁹⁰. In nominal values, the average oil price is forecasted at 52.4 euros per barrel in 2015 and 59.4 euros in 2016 (compared to the expected significantly higher levels of around 75 euros per barrel in 2015 and 2016 in the October projection).



Metal prices continued to register mainly downward movements⁹¹ at the beginning of 2015, mostly due to the reduced demand, primarily in China, as well as the continuous increase of new supply. Expectations suggest divergent movements in the average metal prices during 2015. Namely, the latest forecast envisages a significantly slower growth of steel prices and a significantly sharper decline in the price of iron as a result of the weaker demand and increased supply. Also, a decline rather than growth in the price of nickel is expected, as a result of the increased inventories amid weak demand. Upward adjustment in the prices in 2015 is carried out only in relation to the price of copper, which is expected to register faster growth compared to the October projection as a result of the uncertain supply due to the floods in Chile. In 2016, stabilization of prices in the global metal market and relatively stable trends in average prices of metals are expected.

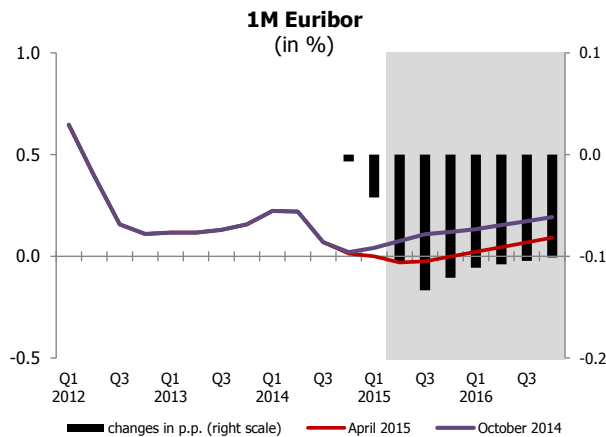


Recent estimates indicate growth of average prices of corn and wheat in euros during 2015, as opposed to the projected decline in the previous cycle. Given that the average annual prices of primary products denominated in US dollars decreased on the global market due to factors on the supply side⁹², upward pressures on the prices in euros are related to the expectations for a significant appreciation of the US dollar against the euro during 2015. On the other hand, prices of corn and wheat are expected to grow in the course of 2016, with higher growth of wheat and lower growth of corn prices compared to the October projection.

⁹⁰ Projections and risks to the prices of primary products, IMF, April 2015.

⁹¹ Monthly report on the primary products market, IMF, April 2015.

⁹² Projections and risks to the prices of primary products, IMF, April 2015.



After the decline registered at the end of the previous year, in the first quarter, **foreign interest rate on the one-month Euribor⁹³** declined further, and in March 2015 it entered the negative zone, a situation which was noticed in the European money market for the first time. This is completely due to the quantitative easing program⁹⁴ by the ECB. Given that the stimulating monetary policy of the ECB will continue over the next period, it is estimated that the one-month Euribor will remain in the negative zone for most of the year and will significantly deviate from the October projection. It is estimated that the foreign interest rate will be low also in 2016, with a tendency of relatively slow growth.

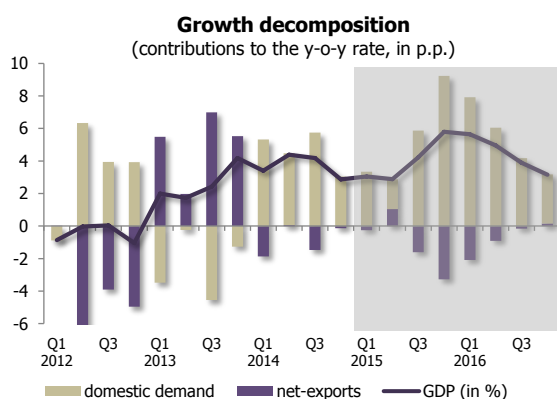
5.2. Forecast and effects on monetary policy

The latest macroeconomic indicators do not point to major changes in the monetary policy setup. Namely, the new estimates for the external sector point to maintaining of foreign reserves at an adequate level in the next period. Although it is expected that in the forthcoming period the stronger demand in the economy will create import pressures, they are not expected to cause major external imbalances. For the next two-year period, direct investment and borrowings are expected to be the key sources of funding the needs for external financing, in a volume sufficient for further maintaining of foreign reserves at an adequate level. **In light of the foreign interest, as an important factor for the domestic monetary policy, there are no major changes in this projection either.** Amid expectations for a negative inflation rate in 2015 in the Euro area and low inflation in the coming period, as well as the launch of the program for quantitative easing by the ECB in March 2015, it is expected that the ECB will retain the accommodative monetary policy at least until September 2016. Hence, it is expected that the interest rate on the one-month Euribor will be negative for most of 2015, with minimal growth in the forthcoming period. This movement is similar to the path envisaged with the October projection, but the foreign interest rate is however lower than the previous estimates. **Key risks to the baseline macroeconomic scenario are similar to those of the October forecasting round.** Amid still present uncertainty about the global recovery and continued downward revisions of foreign effective demand, there are adverse risks

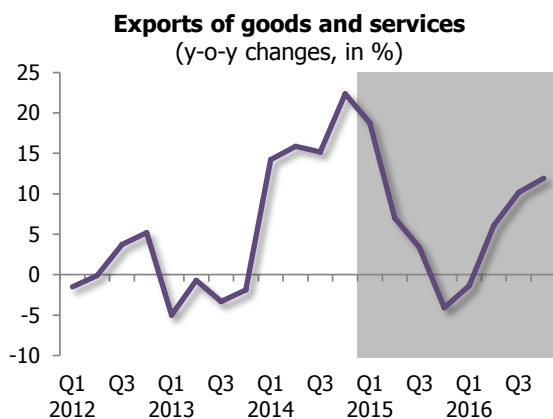
⁹³ Historical data were taken from Eurostat. Source for projections is Consensus Forecast.

⁹⁴ Started on 9 March 2015.

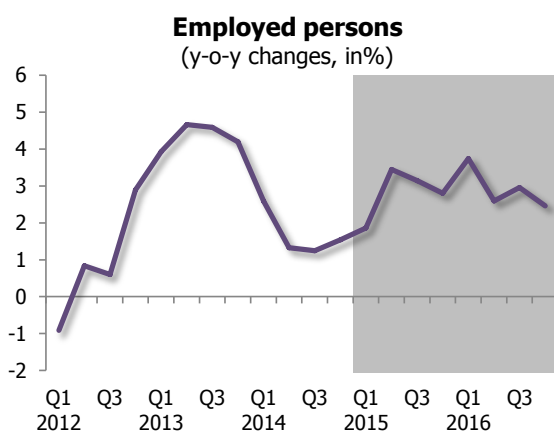
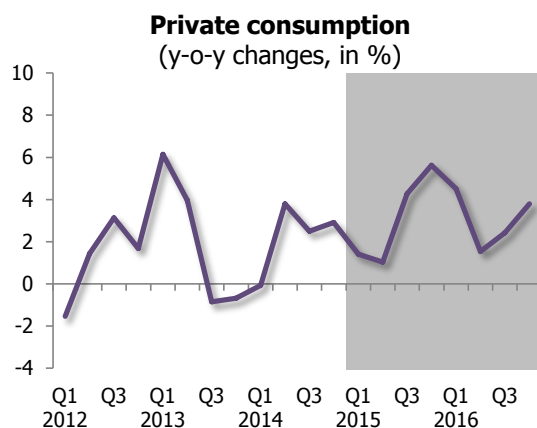
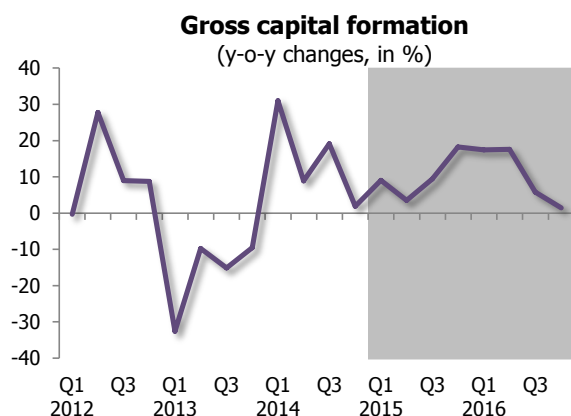
to the external position of the economy. However, they are more moderate compared to the October projections, which is largely associated with more rapid than previously expected recovery of the Euro area in circumstances of further monetary easing, depreciation of the euro and falling oil prices. Additionally, within the domestic economic factors, amid inability to fully assess the potential effects of the announced new facilities, there are risks to the projection of the external position from this source, for the time being assessed as favorable. Besides, unlike previous cycles, there are additional risks from domestic non-economic factors in the primary macroeconomic scenario (uncertainty about the political developments) that could adversely affect the domestic economy. These risks point to the need for continuous monitoring of possible changes in the domestic and external economic conditions in the future and taking prompt and appropriate measures.



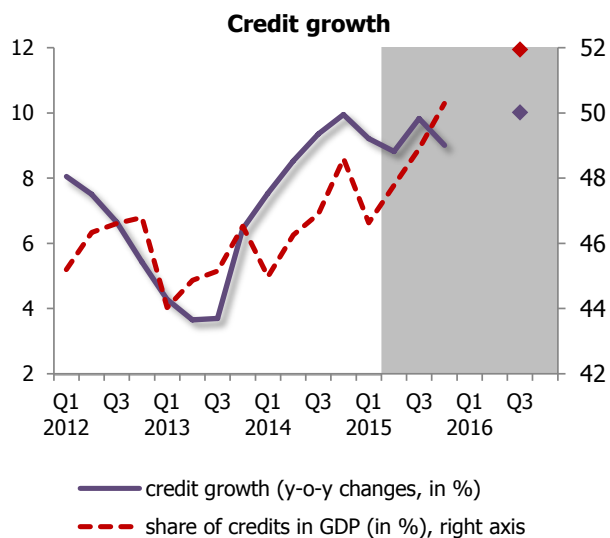
In the last quarter of 2014, the trend of growing economic activity continued, and the GDP growth of 3.8% for the whole of 2014 is almost identical to the October projections. Key determinants of the growth in 2014 were the fast growth of exports and investment, as well as the positive contribution of private consumption. Taking into account the latest indicative high frequency data it is estimated that the growth will resume in the first quarter of 2015, probably at a similar pace as in the previous quarter. Furthermore, **on average, for the whole of 2015, GDP growth of 4.1% is expected, which will further accelerate to 4.5% in 2016.** The cumulative growth in this and next year will be mostly due to the relatively strong positive contribution of investment and exports, and to a smaller extent to the growth of private consumption.



During 2014, relatively high **growth rates of real exports of goods and services** were recorded, which largely reflects the structural changes in the export sector and greater use of the new foreign export-oriented production facilities. The growth of their activity, combined with the expectations for the entry of new facilities in the export sector, as well as the expected moderate recovery of foreign demand, are expected to contribute to a **solid growth in real exports in 2015, while in 2016 moderate acceleration the growth in exports is expected, whereby export will be one of the main drivers of the overall economic growth in these two years.**



In 2015, slight acceleration of the growth of domestic demand is expected, amid growth in all of its components. It is expected that gross investments will maintain the dynamics of solid growth in 2015, which makes them the most significant factor in the projected growth of domestic demand. This investment activity will be supported primarily by government investments in road infrastructure, which are expected to intensify this year. Additionally, the inflow of foreign capital is expected to continue, and it will be partly directed toward the construction and investment in equipment and machines, which together with the favorable expectations among domestic enterprises and increased credit activity will result in an increase also of private investments. Therefore, the investment activity will reflect primarily the factors related to the domestic economy, contrary to the anemic recovery of global demand. **In 2015, the pace of growth of private consumption is expected to accelerate.** Growth in household consumption primarily reflects the favorable developments in the labor market, amid expectations for rapid growth in real wages and the number of employees. Namely, in 2015, faster growth of nominal wages is expected, as a combination of several factors - second-round effect from the growth of wages in the public administration at the end of 2014, the expected growth of wages in the private sector as a result of the more intensive economic activity, announced wage increase in public administration in the last quarter of the year and the effect of the higher amount of minimum wage from January 2015. Moreover, amid projected low inflation, real wages are expected to register solid growth, leading to an increase in the disposable income of employees. In addition, employment growth is expected also in the private sector, amid expectations for more intensive economic activity, as well as a positive effect from the active government employment measures. Positive contribution to the growth of household consumption is expected also from the increase in pensions, which includes the announced increase of pensions by 5% (with indexation included), which will start to be paid in October. In addition, the growth of private consumption will be supported by further credit activity by domestic banks directed to the household sector. **The growth of domestic demand will continue during 2016, amid almost the same rates of growth in private consumption and gross investment, compared with 2015.** It is still expected that higher investment activity will result mainly from government capital investments in



road infrastructure, which are expected to have positive effects in the future, according to the longer period needed for the realization of infrastructure projects. Investments in new production facilities with foreign capital, as well as the accelerated growth in export demand are additional factors for the growth of gross investments. These factors, as well as the active employment measures will result in increased employment and wages, which will affect the further increase in household consumption. **Also, it is expected that public consumption in 2015 and 2016 will register positive growth rates**, as opposed to the fall in 2014, whereby it will have a positive, but minimal contribution to the GDP growth.

The continued recovery of the economy and stabilization of the banks' risk perceptions will contribute to the continuation of the solid credit growth in the forthcoming period. Namely, it is estimated that at the end of 2015, credit growth will be 9%, while in 2016, the credit dynamics is expected to accelerate to 10%. The projected credit growth reflects the positive signals on the sides of both supply and demand. Namely, the positive achievements and expectations for the continuation of favorable trends in the labor market, and the projected solid growth in investment activity will contribute to a stable demand for loans. On the supply side, a positive contribution is expected from the further growth of the deposit base, as well as the banks' stable risk perceptions. In addition, favorable effects on the credit activity are still expected, from the standard and non-standard measures undertaken by the NBRM so far. In terms of the deposit potential, **it is estimated that the solid deposit growth will continue in 2015, and will further accelerate in 2016.** Thus, according to the expected positive trends in the domestic economy, at the end of 2015, deposit growth of 9.1% is expected, as well as a slightly accelerated growth of the deposit base in the next year, which for the end of 2016 is projected at 9.7%. Downward risks around the projection of the credit and deposit growth are still present. Possibly weaker than expected recovery of the economy may limit the sources of funding of banks, exacerbate perceptions of risk and reduce the private sector's willingness for borrowing. The materialization of these risks could reflect unfavorably on the credit market.

In 2015, the real imports of goods and services are expected to grow, but at a



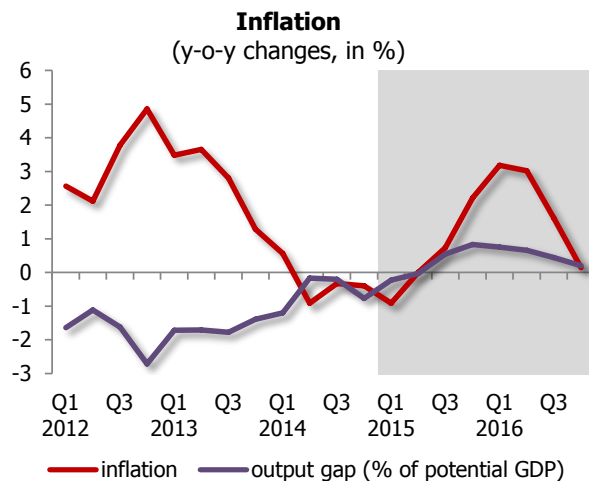
Balance of Payment Forecast (% of GDP)

	2011	2012	2013	2014	2015	2016
Current account	-2.5	-2.9	-1.8	-1.3	-1.6	-3.1
Balance of goods & services	-20.5	-22.4	-18.5	-17.5	-16.2	-16.8
Goods, net	-25.2	-26.5	-22.9	-21.7	-20.8	-21.4
Services, net	4.8	4.1	4.4	4.2	4.7	4.7
Primary income, net	-1.7	-1.9	-2.6	-2.6	-3.0	-3.1
Secondary income, net	19.7	21.4	19.3	18.9	17.5	16.7
Private sector, net	18.7	20.6	18.3	17.9	16.9	16.1
Capital account	0.0	0.1	0.2	0.1	0.0	0.0
Financial account	-6.8	-4.5	-0.9	-5.6	0.3	-4.3
FDI, net	-4.6	-1.5	-3.3	-3.3	-3.3	-3.5
Portfolio Investment, net	1.0	-1.0	2.0	-5.7	1.5	-0.1
Other Investment, net	-3.2	-1.9	0.4	3.3	2.1	-0.7

slower pace. The growth reflects the trends of the components of domestic demand and the export demand. The more intensive export growth in 2016 and further growth in all components of domestic demand, will cause **growth of imports also in 2016 with almost the same intensity as in 2015.** As a result of these developments, **the contribution of net exports to growth will be negative over this two-year forecasting period, but relatively lower in 2016.**

According to recent assessments, in 2015 the current account deficit is expected to be 1.6% of GDP, which represents an annual increase of 0.3 percentage points of GDP relative to 2014. The widening of the current account deficit results mainly from the reduced surplus in secondary income, and the higher deficit in primary income (higher expected interest payments) has an additional effect. On the other hand, the deficit in the foreign trade in goods and services is expected to narrow on an annual basis, which stems from the significantly improved energy deficit, given the extremely low price of crude oil on world markets. Thus, the negative balance of goods and services would amount to 16.2% of GDP, compared to 17.5% of GDP in 2014. By contrast, in 2016, the trade deficit in goods and services is expected to deteriorate and equal 16.8% of GDP. The deepening of the trade deficit in 2016 is expected to be mainly driven by the increased investment imports of new foreign investment, and an additional effect is expected also from energy imports. An important part of this deficit will continue to be funded by the secondary income, which is expected to remain at a relatively high level. Regarding the dynamics, its share in GDP is expected to reduce gradually, which will further contribute to the deterioration of the current account deficit. **Such shifts in 2016 are expected to result in a current account deficit of 3.1% of GDP.**

The financing of the current account in the period 2015-2016, is expected mostly to be covered through foreign direct investment and public sector external borrowing in the long term. Direct investment is expected to gradually increase from 3.3% of GDP in 2015 to 3.5% of GDP in 2016. **Main risks** to the external position of the economy in this period still come from the pace of the global recovery, and thus the domestic economic growth and their impact on the perceptions of investors.



In the 2015-2016 period, it is expected that the higher current account deficit relative to the financial flows will lead to a slight reduction of foreign reserves. Nevertheless, throughout the entire period of projections, foreign reserves adequacy indicators are maintained in a safe zone.

After the decline in 2014, **in 2015, gradual growth of the price level and inflation rate of 0.5% are expected.** Price increase will result primarily from the price changes of the food component amid growth of import prices. To a smaller extent, effects on inflation are expected also from the further growth of domestic demand and increase in core inflation. On the other hand, amid expectations for a decline in world oil prices, it is expected that energy prices will have a negative contribution to the overall rate of inflation also in 2015⁹⁵. The risks to the projected path of inflation in 2015 are mainly downward and related to the movement of oil prices. However, the uncertainty about the global economy and fluctuations in world prices of primary products remains, which suggests close monitoring of possible changes in external factors. On the other hand, the effect on prices, which could arise from the adverse weather conditions in the country since the beginning of the year is considered to be an upward risk, but it is still difficult to assess. **In 2016, inflation is expected to accelerate and equal around 2%, amid growth in import prices of food and energy and recovery of domestic demand.**

5.3. Comparison with the previous forecast

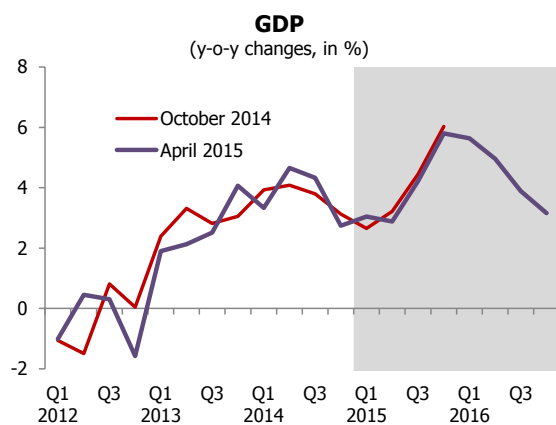
Forecast of selected macroeconomic variables

annual rates of change (in %)	2015 forecast		2016 forecast	
	Oct.	Apr.	Oct.	Apr.
GDP	4.1	4.1	4.5	4.5
Private consumption	3.6	3.1	3.3	3.0
Gross capital formation	14.2	10.0	9.3	10.1
Public consumption	1.2	1.3	1.4	1.4
Exports of goods and services	5.0	5.9	9.6	6.5
Imports of goods and services	7.4	6.3	8.0	6.2
Inflation	1.0	0.5	2.1	2.0
Current account deficit (% of GDP)	-3.9	-1.6	-4.6	-3.1

The projection for the growth of the domestic economy in the period 2015-2016 remains unchanged compared with October assessments. *Regarding the movement of prices, the latest assessments suggest a somewhat lower rate of inflation in 2015 and unchanged price growth in 2016. In this forecasting round, assessments point to smaller current account deficit in 2015 and 2016. Regarding the international financial flows, net inflows of cumulative basis in the period 2015-2016 are again expected, but in a smaller scale compared with the October projection. In a relatively unchanged macroeconomic environment, the*

⁹⁵ The possible increase in electricity prices may also affect the energy component of the inflation. The estimated effect on the average annual inflation from the possible increase in the price of electricity in mid- 2015 of 10% would equal 0.4 percentage points.

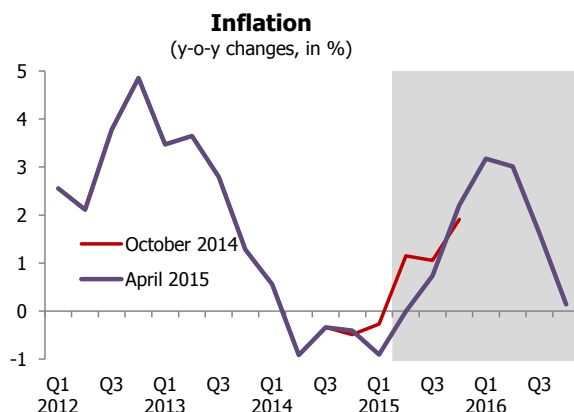
projected credit growth for the 2015-2016 period also remains unchanged relative to the October April projections.



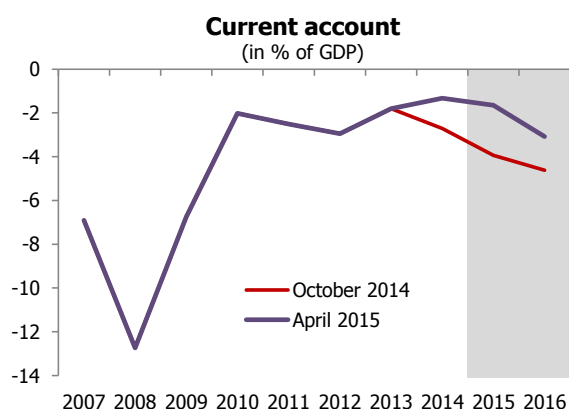
Given the economic growth in 2014, which is in line with the expectations in the October projection, as well as almost unchanged assumptions about the fundamental factors of GDP growth, **expectations for economic growth in 2015 and 2016 of 4.1% and 4.5% respectively, are unchanged compared with the October projection⁹⁶**. Regarding the expenditure approach to GDP, there were no major changes in the components that will drive growth. So, domestic demand is again expected to be the main driver of economic activity in the next two-year period, but with somewhat smaller positive contribution than expected in October. Moreover, as in October, growth is expected to be supported by the three components of domestic demand, with largest contribution of gross investments. However, the contribution of investments on a cumulative basis for the period of projections (2015-2016) is lower compared with the October projection, mainly due to the downward revision in 2015, while for 2016 a mild upward revision has been made. These revisions mainly reflect the comparative basis, i.e. the new revised data on GDP and expenditure components. A significant contribution is expected also from private consumption, which underwent a small downward revision in both years, mainly due to the slower growth achieved in the previous two years, according to new data. Furthermore, public consumption is almost unchanged, retaining the minimum positive contribution. Net exports are again expected to have a negative contribution to growth in the next two-year period, but less negative compared to October, mainly due to the lower negative contribution of the imports of goods and services. The slower growth of imports in 2015 and 2016 is explained by its fast growth in 2014 (faster than expected in the October projections) and the slower growth in domestic demand and exports, as its main determinants.

In the first quarter of 2015, inflation was lower than expected in the October projection,

⁹⁶ In October 2014, the SSO announced new revised data on GDP by year, for the period 2000 to 2013, while in December 2014 it published data by quarters. October projections were based on a series of data on GDP and its structure, published in June 2014, before the inclusion of the methodological changes. More information can be found at the link of the SSO regarding data revision: http://www.stat.gov.mk/ESS_revizija.aspx and the link to the Information on data revision for national accounts and implementation of the new methodology ESS 2010 at: http://www.stat.gov.mk/Dokumenti/ESA2010_mk.pdf.



with downward variations in all three components, especially in the energy component in accordance with the downward movement in oil prices. Lower performances so far, and the downward revision of foreign inflation and particularly the significant downward revision of the expected movement of energy, led to a moderate **downward revision of inflation in the domestic economy for 2015 relative to the October projections**. So, now the assessment of the inflation rate in 2015 is 0.5%, unlike the October estimate for inflation of 1%. **The assessment of inflation for 2016 has not undergone changes relative to the October projection, i.e. it is still expected that the inflation rate in the next year will amount to about 2%.**



According to recent estimates, the current account deficit is expected to improve relative to the October forecasting round. **By the end of 2015, it is expected that the deficit will be 1.6% of GDP, instead of the previously expected 3.9% of GDP.** The downward adjustment of the current account deficit is mainly due to the smaller deficit in goods and services amid significantly lower international prices of crude oil and import pressures weaker than expected. Better than expected performances of new export-oriented facilities have an additional effect. The position of secondary income is virtually unchanged, while the slightly higher negative gap in primary income acted in the opposite direction. **In 2016, the current account deficit is expected to reach 3.1% of GDP, compared with 4.6% of GDP according to the October projection.** The smaller current account deficit is again a consequence of the lower deficit in goods and services, primarily due to the more favorable energy balance, but also the lower non-energy deficit due to the improved performances of new export-oriented facilities. On the other hand, assumptions about the surplus in the secondary income and the position of the primary income deficit remained almost unchanged.

Regarding the financial flows, cumulatively in 2015 and 2016, significantly lower inflows compared to the October projection are expected. Downward revision of the financial account for both years is mainly due to the less favorable movements in short-term capital flows (currency and deposits) which given their volatility and uncertainty, are difficult to assess. Additionally, smaller financial flows are expected in direct investment, due to somewhat weaker performances. Despite the improved



expectations in the current account, the assessment for weaker financial account points to expected slightly larger decline in foreign reserves in the 2015-2016 period, in comparison with the decline assessed in the October projection.

Comparison of GDP and inflation forecasts for Macedonia from various organisations

Organisation	Month of publication	Real GDP growth, %		Inflation (average rate, %)	
		2015	2016	2015	2016
IMF	April 2015	3.8	3.9	0.1	1.3
World Bank	January 2015	3.5	3.8	-	-
European Commission	May 2015	3.8	3.9	1.2	1.7
EBRD	January 2015	3.5	-	-	-
Consensus Forecast	April 2015	3.5	3.9	0.7	2.0
National Bank of Greece	April 2015	3.8	3.5	0.5	1.0
Ministry of Finance of the Rep. of Macedonia	October 2014	4.0	4.2	2.0	2.2
National Bank of the Republic of Macedonia	April 2015	4.1	4.5	0.5	2.0

Source: IMF World Economic Outlook, April 2015; World Bank Global Economic Prospects, January 2015; European Commission European economic forecast - spring 2015; EBRD Regional Economic Prospects, January 2015; Consensus Forecast, April 2015; NBG Southeastern Europe and Mediterranean Emerging Market Economies, April 2015; Ministry of Finance of the Republic of Macedonia, 2015 Budget of the Republic of Macedonia and Fiscal Strategy 2015-2017, October 2014; and the National Bank of the Republic of Macedonia.

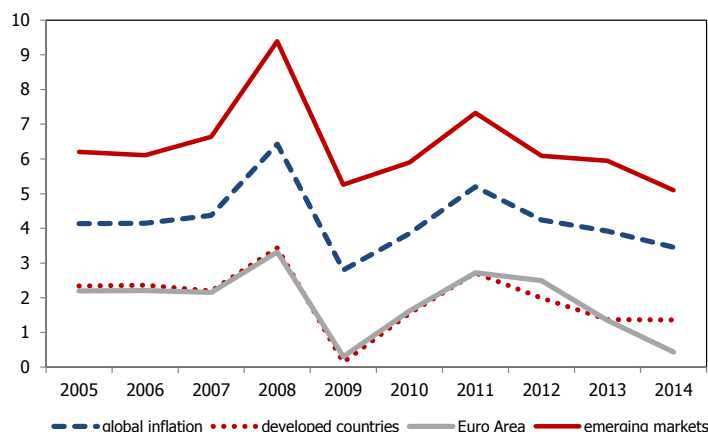
VI. Analytical appendices

Box 1: Analysis of the decline in prices in the case of the Republic of Macedonia

In the economic theory the decline in the general price level is defined as deflation. Deflation may be a result of factors on the demand side (decline in prices as a result of weak domestic demand) or factors on the supply side (increased supply, which amid unchanged demand, would cause a decline in the prices). When it comes to the effects of lower prices on the economic growth they are determined by the reasons and duration of the deflationary movements. For example, if the decline in prices is a result of expansion of aggregate supply due to various reasons (productivity growth, greater competitiveness or cheaper resources) lower prices, in the short run, would reflect positively on income, output and employment⁹⁷. However, if prices continue to decline and if this reduction is incorporated in the inflation expectations of economic agents, lower prices could have negative effects on economic growth⁹⁸ by further reduction in demand, increase in the real value of debt (due to the fall in prices and income) and broadening of the budget deficit (due to lower tax revenues). The role of monetary policy in such a situation, as one of the policies on the side of aggregate demand, would be to encourage demand by lowering interest rates.

Over the past year, there was a substantial slowdown in the growth of prices worldwide (global inflation slowed from 5.2% in 2011 to 3.5% in 2014), and in some developed economies, inflation entered the negative zone (for example in the Euro area). Factors explaining the downward global trend are the significant decline in the price of crude oil amid increased supply of this product worldwide, as well as the downward trend in food prices (mainly cereals). Additional pressure on prices comes from the economic situation in the Euro area where there are no significant signs of recovery of demand yet, given the relatively high unemployment, low propensity for consumption and commenced process of deleveraging of economic agents. Anemic demand, underpinned by the fall in prices of primary products, also caused a negative inflation rate in the Euro area at the end of the year, which continued in the first quarter of 2015.

Chart 1 Inflation rates in groups of economies (in%)



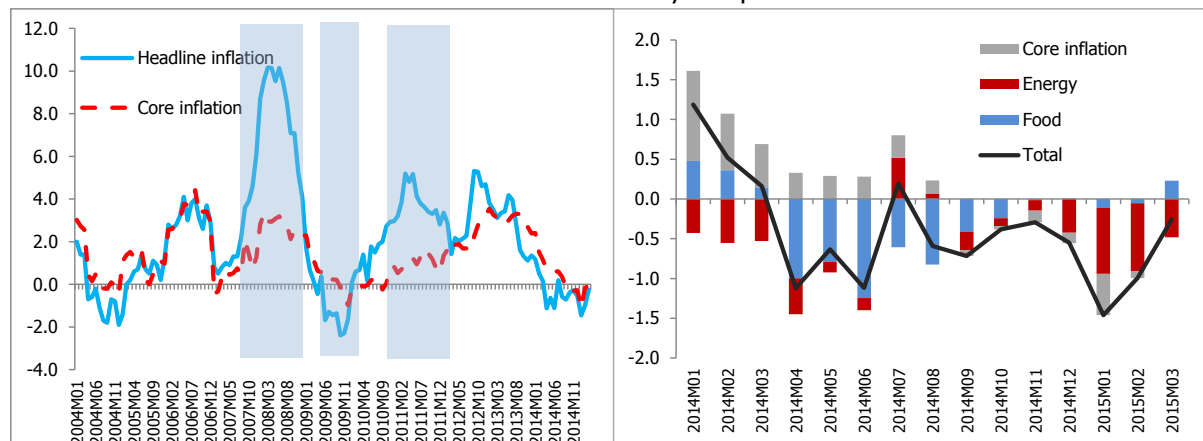
Source: World Economic Outlook database.

⁹⁷ Borio, C., Erdem, M., Filardo, A., Hofmann, B., "The costs of deflation: a historical perspective", BIS Quarterly Review, March 2015

⁹⁸ "The dangers of deflation - The pendulum swings to the pit", The Economist, <http://www.economist.com/news/briefing/21627625-politicians-and-central-bankers-are-not-providing-world-inflation-it-needs-some>

Slower growth of prices in 2014 was common also for Macedonia, where since April inflation has entered the negative zone. On average, for the whole 2014, the change in consumer prices was negative and amounted to 0.3%, and such movements in prices continued in the first three months of 2015. Taking into account the above mentioned potential adverse effects of long-term periods of deflationary movements, **this Appendix contains a brief analysis that aims to identify the factors that explain the decline in prices in the domestic economy during 2014, and on that basis it attempts to assess the likelihood of a negative impact on the growth of the domestic economy.**

Chart 2 Annual rate of total inflation and contributions by components



Source: State Statistical Office and NBRM calculations

* Highlighted periods refer to a shock (rise/fall) in world prices of food and energy at different periods (2007-08, 2009 and 2010-11).

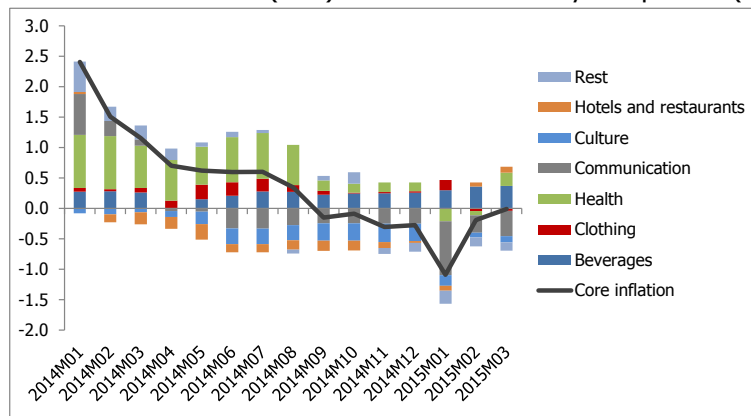
In terms of individual components within the index of consumer prices, the reduction in prices during 2014 is mainly explained by the lower energy and food prices (Chart 2). Similarly as in other economies, also in Macedonia such changes are generally associated with the movement in the prices of primary products on the world market which in the past year followed a downward trend. At the same time, there were no pressures from the import prices of consumer products, which is evident from foreign effective inflation, which after the growth in 2013, has stagnated in 2014. The downward adjustment of these prices took place in an environment of relatively solid economic growth in the domestic economy, which contributed to a significant narrowing of the negative output gap throughout the year. In such circumstances, throughout most of the year core inflation remained in the positive zone. However, observing the dynamics, starting from the second half of the year there was a significant slowdown in the rate of growth in core inflation, which in the last four months passed in the negative zone. Such movements in core inflation initiate the issue of the potential impact of these developments on economic growth. Moreover, **in assessing the likelihood of any adverse effects on economic growth, and as a result of the currently lower prices in the domestic economy, it is necessary to take into account several aspects.**

First, the decline in consumer prices, as already stated, is mostly explained by factors on the supply side, in circumstances of relatively solid growth of the domestic economy and favorable developments in the labor market.

Second, the ongoing reduction of core inflation is not a result of reduced aggregate demand. In circumstances of solid economic performance and growth of labor cost, negative core inflation is in a significant part associated with the fall of prices in the field of communications, a shift which is in part due to the growing competition in this sector (Chart 3). Also, the second-round effects of the fall

in prices of primary products affect core inflation to a certain extent. However, as evidenced within the econometric analysis of the "Indirect effects of oil prices on inflation"⁹⁹ the effect of these movements is relatively smaller compared to the effect they have on the overall rate of inflation.

Chart 3 Core inflation (in%) and contributions by component (in percentage points)



Source: State Statistical Office and NBRM calculations

Third, according to the latest macroeconomic projections of the NBRM the decline in the prices in 2014 is assessed as temporary. Namely, already in 2015 mild growth of consumer prices is expected, mainly due to food prices, but also because of the higher rate of core inflation. Namely, macroeconomic projections indicate further growth of domestic demand and improved conditions in the labor market and wage growth. Stabilization and growth of fuel prices in the coming period will make an additional contribution to the growth of domestic prices in 2016, when acceleration of the inflation rate of about 2% is expected¹⁰⁰.

Summed up, taking into account the nature of the decline in the prices in the past period (prices of food and energy) as well as the estimates for the temporary nature of this movement, it is not expected to have adverse effects on economic activity. In addition, taking into account the factors of the decline, it is likely that the decline in the prices stimulates economic activity, primarily through the favorable impact on the real income of economic agents.

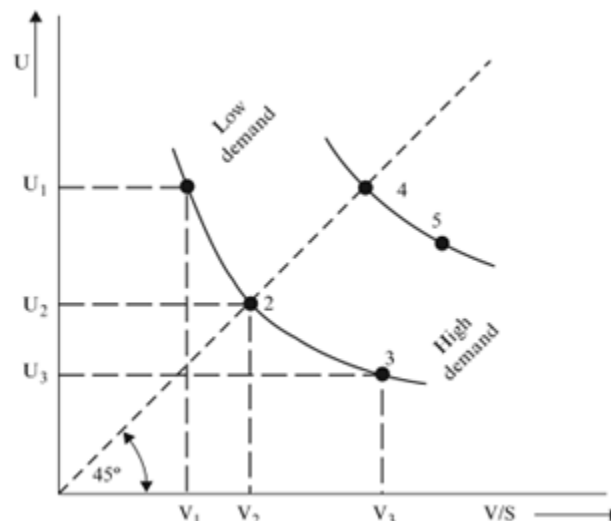
⁹⁹ For more details see the Appendix: "The indirect effects of oil prices on inflation", Quarterly Report, February 2015, NBRM.

¹⁰⁰ More details about the projected inflation for 2015 and 2016 are given in the section on the macroeconomic projections.

Box 2: Beveridge curve for Macedonia and comparative analysis with other European countries

Beveridge or UV curve is a well-known economic concept, which represents the inverse relationship between the unemployment rate and the job vacancy rate in the economy, so it has a declining trajectory. The dots along the Beveridge curve reflect the movements in unemployment in accordance with the business cycle of the economy, i.e. each dot represents the current state of the economy at different stages during the business cycle. This means that when the economy is in recession, demand for labor is low and employers are less motivated for new employment, so that the economy has a small number of vacancies and unemployment is high, and vice versa, in the case of expansion there is low unemployment and high vacancy rate.

Chart 1
Ideal Beveridge curve



Explanation: V represents the number of vacancies corrected by errors in the statements, U represents unemployment.

Source: J. C. R. Dow and L. A. Dicks-Mireaux (1958), „The Excess Demand for Labour. A Study of Conditions in Great Britain, 1946-56”, Oxford Economic Papers New Series, Vol. 10). 1 (Feb., 1958), pp. 1-33.

The concept of Beveridge curve is known since 1958 and originates from the work of two British economists Dow and Dicks-Mireaux (abbreviated: DDM), who sought to measure the excess demand on the product market in conditions of applying Keynesian fiscal policy. Given that the excess demand is an immeasurable category, they proposed to use the data on the vacancy rate and the unemployment rate as a proxy for measuring the excess demand. By linking data they derived the ideal curve in the form of hyperbole, assuming that unemployment above a certain level is becoming less sensitive to demand, i.e. amid further growth of demand, unemployment will decline disproportionately less than the growth in demand. An additional feature is that a dummy line with a slope of 45 degrees can be created, which is a zero excess demand and divides the sectors in the chart into weak (recession) and strong (expansion) demand. This concept allowed the economists to break down unemployment into: unemployment due to insufficient demand (or cyclical) and structural unemployment, and later on, in the first half of the 1970s, the method was revised, with the possibility to decompose unemployment into: frictional unemployment, structural unemployment and unemployment due to insufficient demand. Considering the fact that this concept enabled analysis of many problems that were previously set by Beveridge, in the 1980s this concept was called Beveridge curve.

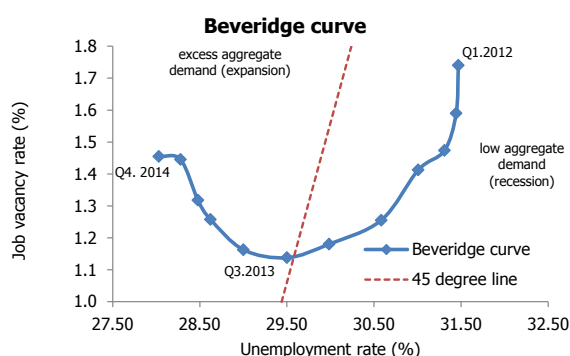
The varying degree of maladjustment corresponds with a different curve, closer or farther from the beginning, i.e. sometimes a deviation from the true ideal curve occurs. Namely, structural changes in the economy, the mismatch of supply and demand of skills of the labor force, long-term unemployment, frictional unemployment or other factors that affect the performance of the labor market can generate shifts in the curve. For example, when there is a simultaneous increase in the unemployment rate and the vacancy rate, it may result from the unequal growth between regions or

the activities, and the efficiency of the labor market in matching supply and demand decreases. In that case, Beveridge curve slopes to the right and presents declining efficiency of the labor market. On the other hand, sloping to the left means improved efficiency of the labor market, i.e. it functions smoothly. In the case of improving the efficiency of the labor market to match supply and demand of labor, there is a simultaneous reduction in the job vacancy and unemployment rates.

In this Appendix, we will try to construct the Beveridge curve for Macedonia and make a certain comparison with other European countries. The data source for Macedonia is taken from the State Statistical Office of the Republic of Macedonia, while the data on the European countries included in the analysis are from the Eurostat. The data are by quarters, with the data on Macedonia starting from Q1 2012, when the data on the number of vacancies were first published, while the initial data on the European countries are different and for most of the countries they start as of Q1 2008. The analysis of the Beveridge curve requires more observations, which is particularly important for the study in terms of the presence of some shifts of the curve before and after the crisis. However, this analysis may give some indication of the short-term changes in the labor market.

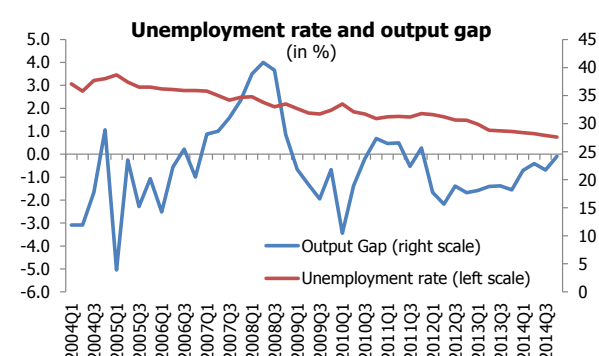
It is a common practice the data on the unemployment and job vacancy rates to be analyzed on a seasonally adjusted basis, but as the series of vacancy rate is short and doesn't have a regular seasonal component, for both series we analyze the moving average of the last four quarters for the corresponding period, according to the Eurostat approach. The rate of job vacancies is calculated as the ratio between the number of vacancies and the sum of the number of vacant and filled jobs¹⁰¹, while the unemployment rate is the ratio between the number of unemployed and the number of active population.

As can be seen from Chart 2, in 2012, the Beveridge curve for Macedonia shows simultaneously high unemployment and high vacancy rates. This divergence can be explained by a mismatch of the supply and demand of skills in the labor market. One part of this discrepancy stems from the high percentage of long-term unemployment (unemployed up to 4 years and more), which in 2012-2013 accounted for 61.1% of the total number of unemployed. Namely, the workforce with long-term unemployment is characterized by degradation of their working skills and knowledge so that for these people finding a job is more difficult. Additionally, this may be associated with the beginning of the production of a large number of facilities with foreign investment in the technological industrial development zones, especially in the automotive industry, when foreign investors are faced with an insufficient number of skilled workers.

Chart 2¹⁰²


Source: SSO and NBRM calculations.

Chart 3



¹⁰¹Usually in the literature, the vacancy rate is represented as a ratio between the number of vacancies and the number of active population.

However, the vacancy rate published by the State Statistical Office of the Republic of Macedonia and the Eurostat are calculated in the same way, hence we use the published rates of these two statistical institutions. In addition, the appearance and movements of the Beveridge curve are quite similar, only the level of the vacancy rate is different. Hence the conclusions arising from the analysis would be the same.

¹⁰²Due to lack of data and in order to present a longer series of data on the Beveridge curve for the period Q1-Q3 2012, the vacancy rates are given as a cumulative average for each period rather than four quarters moving average.

In 2013, a shift to the left was registered, i.e. a situation of a simultaneous reduction of the vacancy and unemployment rates, which leads to fast filling of jobs. This situation is most likely associated with the increased demand for labor in the new facilities from foreign investments that employed people without the necessary skills, but also undertook activities for retraining and training of the newly employed. Government's active employment measures also made a certain contribution¹⁰³. Already in 2014, the curve obtained for Macedonia shows that our economy is recovering and moving towards expansion (Chart 3) and is in line with the theoretically expected Beveridge curve, i.e. there is an increase in the rate of job vacancies and a decline in the unemployment rate, i.e. reducing unemployment is in line with the movements in the business cycle. This means that the positive changes in the economy and on the labor market are reflected also in the movement of the Beveridge curve. At the same time, the curve shows that in 2014, amid the same vacancy rate we have a lower rate of unemployment, which points to a reduction of structural unemployment and smaller effects of the factors that lead to a shift in the curve. The shifts of the curve, as previously mentioned, are usually associated with the efficiency of the labor market and reduction of the deviations in the supply and demand of skills of the labor force in the labor market, which is consistent with the conclusions derived from our previous analyses of the labor market, pointing to a trend of continuous reduction of the mismatch between the supply and demand of skills in the labor market¹⁰⁴.

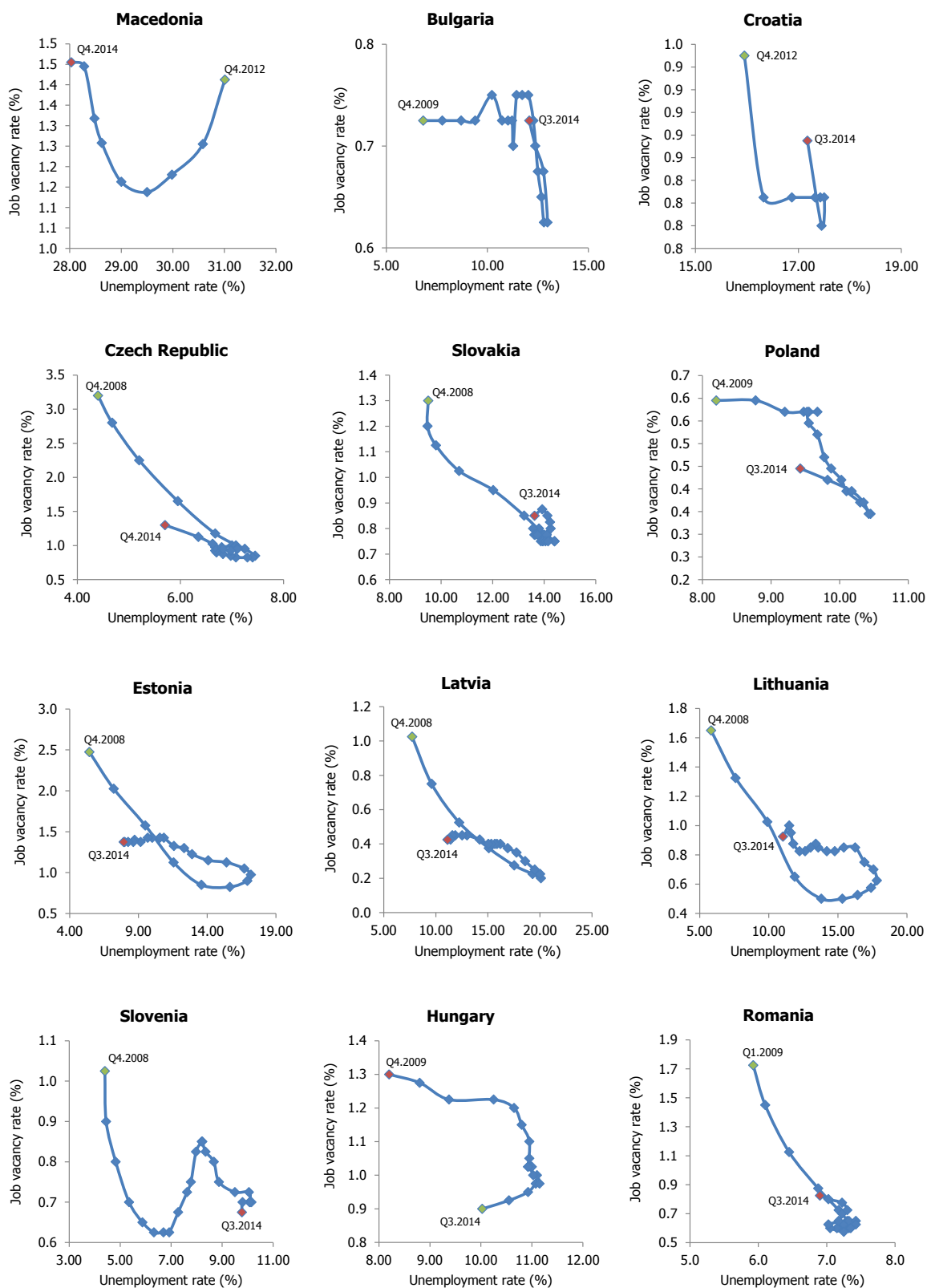
For the purpose of a comparative analysis with other countries, Beveridge curves for European countries are presented, in particular for the countries in transition, but also for some developed countries, according to the availability of data. From Chart 4 it is evident that in some countries the relationship between unemployment rate and the vacancy rate is relatively stable and there are no significant shifts of the curve to the left or right (the Baltic States, the Czech Republic, Slovakia, Poland, Romania). This means that unemployment changed in accordance with the business cycle, with all of them showing that their economies moved towards recession, and in the recent period some of them show improvement in the labor market and movement to the expansion phase. On the other hand, in some countries certain shifts were registered in the recent period. Thus, beside in Macedonia, positive shifts toward more efficient functioning of the market were observed also in Germany and Hungary, while Slovenia and Croatia have registered deterioration in the functioning of the labor market in comparison with the previous period, given that for the same vacancy rate, the unemployment rate is higher compared to the previous period. Bulgaria generally indicates deteriorating conditions in the labor market, but the data do not show an adequate slope of the Beveridge curve, which shows that Bulgaria faces significant obstacles in the functioning of the labor market. The Netherlands is the only country where the Beveridge curve before and after the crisis can be analyzed. Thus, before the crisis it moves toward expansion, i.e. growth in the vacancy rate and decline in unemployment, while after the crisis there is some shift toward the beginning indicating that after the crisis the labor market became more efficient, which is in line with other analyses which included the Netherlands. Moreover, this change is accompanied by a continuous decrease in the vacancy rate and increase in unemployment, which suggests that the economy is heading toward recession.

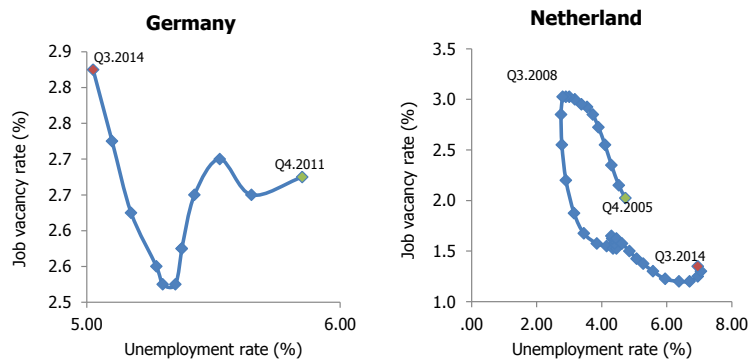
¹⁰³ For more details see the Appendix "Overview of active programs and employment measures in the Republic of Macedonia" in the Quarterly Report of the NBRM, January 2014

¹⁰⁴ For more details see the Appendix "Index of mismatch of supply of and demand for skills in the labor market" in the Quarterly Report of the NBRM, July 2013



Chart 4
Beveridge curves for individual countries

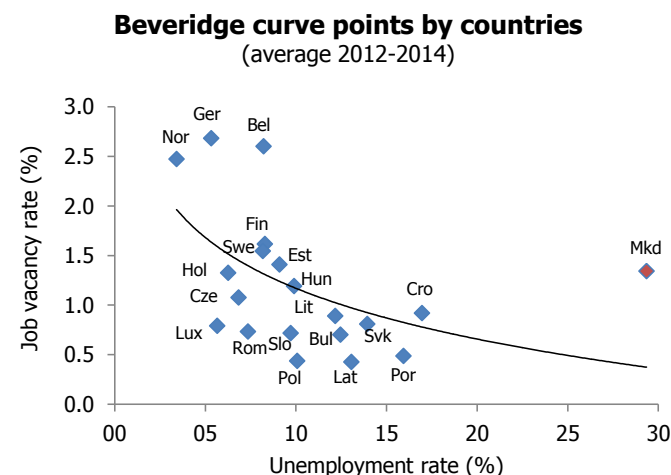




Source: State Statistical Office, Eurostat and NBRM calculations.

In order to assess the situation with the matching of supply and demand of skills in the labor market in these countries, we analyze dots of the Beveridge curve at some point in time on a chart, which in our case is an average for the period 2012-2014, depending on available data. Thus, as it can be seen from Chart 5, Belgium, Germany and Norway, are a group of countries that stand out and are characterized by low unemployment and a high vacancy rate. On the other hand, Macedonia also stands out from other countries and is characterized by high unemployment and a moderate vacancy rate, indicating that in Macedonia there are certain obstacles in the functioning of the labor market in comparison with other countries, which probably stems from the great structural unemployment.

Chart 5



Source: State Statistical Office, Eurostat and NBRM calculations.

As a conclusion, we can say that the situation on the labor market in Macedonia is improving, in circumstances of structural changes, with the entry of foreign direct investment, which opened many jobs, and Government's active employment measures probably also have some effect. Good economic performance is reflected in the current position of the Beveridge curve, which shows that the economy is moving towards expansion. However, given the short period of analysis, the conclusions of this analysis are primarily indicative.

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Box 3: Brief analysis of the sensitivity of the credit conditions of banks (Lending Survey) to changes in the key interest rate of the NBRM

This Appendix analyzes the link between the credit conditions of banks with the changes in the interest rate on CB bills. For this purpose, we use the data from the Bank Lending Survey¹⁰⁵, which offers information on credit conditions, as indicators of banks' credit supply. Beside on the overall credit conditions, we put a special focus on the analysis of individual credit conditions (presented in the form of interest, fees and other conditions for approval of a loan) in order to get a picture of which credit conditions showed the greatest link with changes in the key interest rate, and which are the conditions that may limit the credit supply. Thus, this Appendix presents the first analysis of the connection between the non-interest credit conditions and the changes in the key interest rate.

The need for this analysis resulted from the developments in the credit market in the period after the acute phase of the global crisis, when a slower recovery of the lending to the corporate sector was recorded, compared to that of the household sector (see Chart 1). Such movements occurred in conditions of continuous conduct of an accommodative monetary policy by the NBRM¹⁰⁶, which indicated a potentially weakened monetary transmission to the credit segment of companies in the period after the acute phase of the global crisis and an impact of other non-monetary factors on the decisions of banks for lending to the corporate sector. The purpose of this Appendix is to examine these theses by analyzing the connection between the credit conditions of companies as opposed to the connection between the credit conditions of the households with the changes in the key interest rate. We use a simple approach of a descriptive data analysis and evaluation of the link between the credit conditions and the key interest rate by analyzing the correlation coefficients. Since the method of analysis is quite simple, the results and conclusions obtained should be considered as an indication of the existence of certain stronger or weaker relationship, rather than as an evaluation of the responsiveness of credit conditions to the key interest rate. The analysis uses the net percentages¹⁰⁷ for the changes in credit conditions in the corporate sector as well as in the lending for house purchase and consumer loans to households. The analysis covers the period from Q2 2006 to Q4 2014, and the focus is put on the period of recovery from the global crisis compared to the pre-crisis period and the period during the acute phase of the crisis.

Chart 1 Total loans, annual change in%

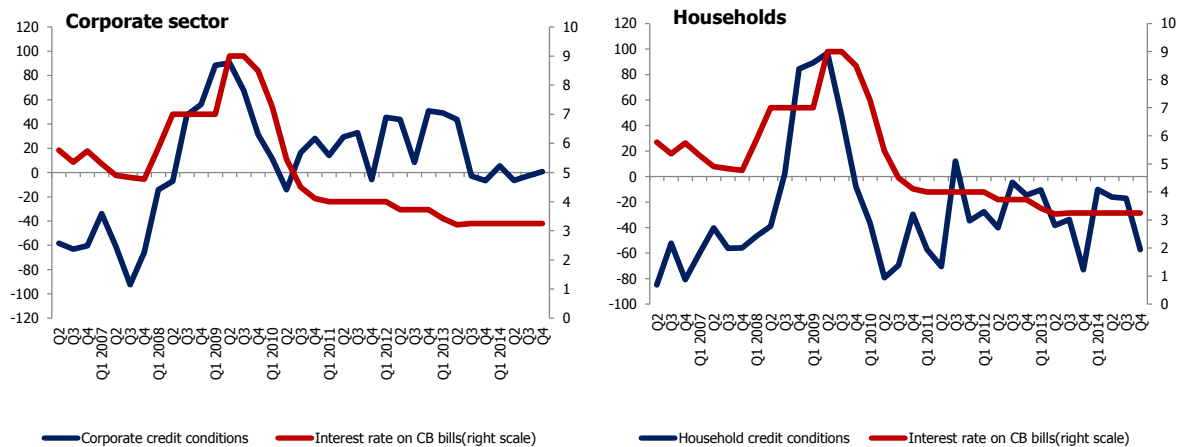


¹⁰⁵ Starting from July 2006, the NBRM has been conducting the Lending Survey in the domestic banking sector on a regular quarterly basis. The Survey contains information on the banks' assessment of changes in credit supply and credit demand within the relevant quarter, as well as the factors that moved these changes. Overall results for all the questions of the Survey are based on net percentages calculated as the difference of the optimistic and pessimistic assessments of banks.

¹⁰⁶ As of end-2009, the NBRM cut the key interest rate on several occasions. Also, it made changes in the other monetary instruments and macroprudential measures, which in part were targeted, aimed at supporting lending to the corporate sector. You can find more details on the changes in the monetary policy stance and the macroprudential policy in the period after the acute phase of the global crisis in the quarterly and annual reports of the NBRM.

¹⁰⁷ Positive net percentage denotes tightening of credit conditions, while a negative net percentage denotes easing of credit conditions.

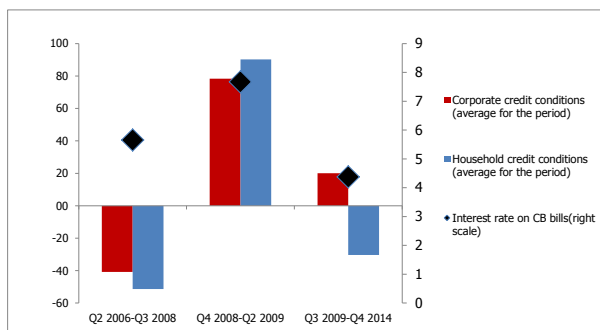
Chart 2 Credit conditions and key interest rate



Source: NBRM

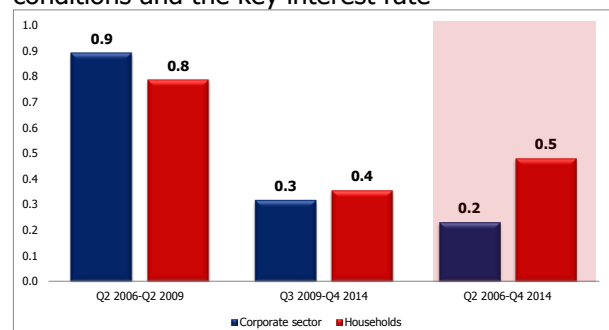
The analysis of data from the Lending Survey shows conformity between the changes in credit conditions with the changes in the key interest rate in the period before and during the acute phase of the global crisis. Thus, the period of reduction of the key interest in the pre-crisis period corresponds with the period of relaxation of the credit policy, followed by tightening of credit conditions in response to the increase of the key interest rate during the acute phase of the crisis. Such movements were typical for both the households and the corporate sector. In the years after the acute phase of the global crisis, which is the main subject of interest of our analysis, credit conditions are typically more volatile in both sectors and there is deviation from the monetary policy stance of the NBRM. These developments suggest a reduced synchronization of credit conditions with the interest rate during this period. This is especially emphasized in the corporate sector, whose credit conditions, despite the continued reduction of the key interest rate, remained in the zone of tighter conditions until the second half of 2013. The analysis of the correlation coefficients points to the same conclusions. Namely, in terms of the degree of correlation, the link between the key interest rate and credit conditions of enterprises and households weakened to 0.3 and 0.4, respectively, in the post-crisis period, as opposed to the previous period (Q2 2006 - Q2 2009) when almost complete correlation of movements was registered, of 0.9 and 0.8, respectively. As a result of these developments, over the period of analysis, companies show lower correlation coefficient compared with the households. So, based on the descriptive analysis and the analysis of correlation coefficients it can be concluded that the link between credit conditions and the key interest rate is weakening in the period after the acute phase of the global crisis in both sectors, with a little more intensity in the corporate sector.

Chart 3 Credit conditions and key interest rate



Source: NBRM

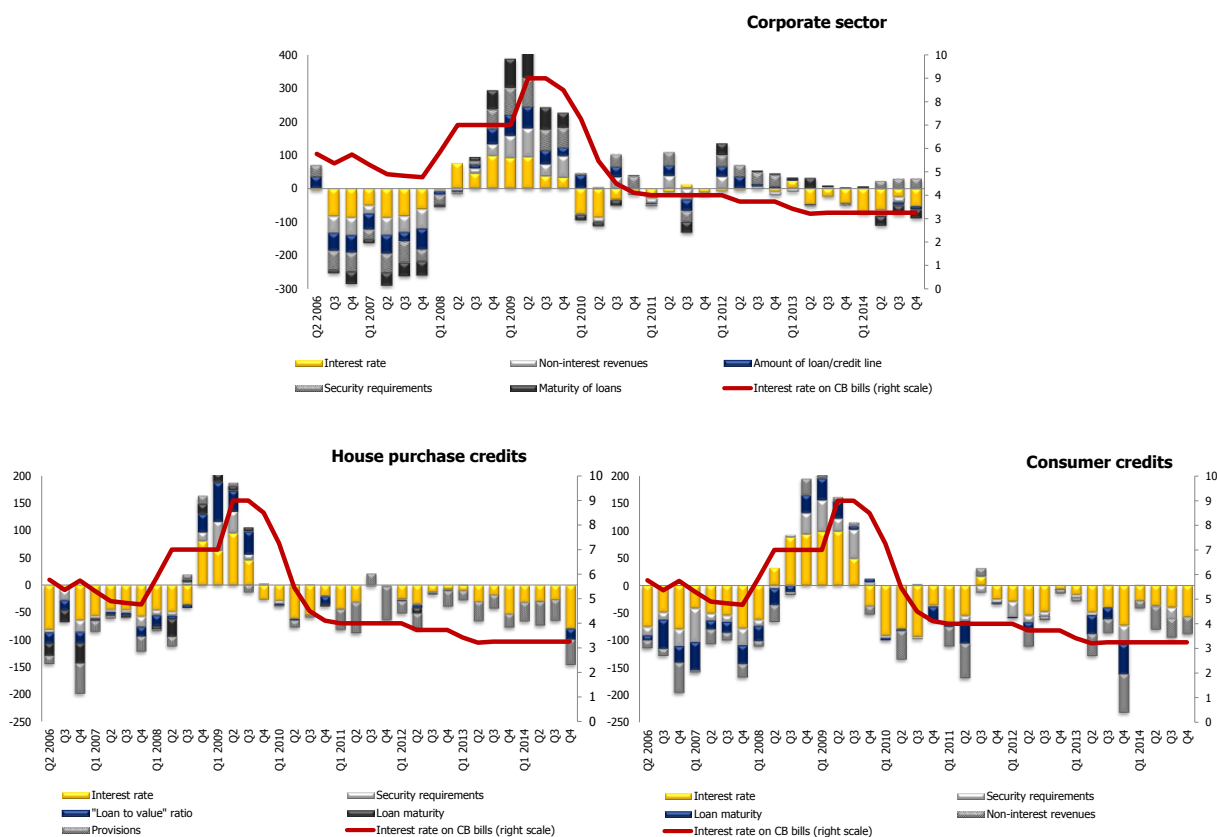
Chart 4 Correlation coefficients between credit conditions and the key interest rate



The analysis of individual credit conditions shows a similar picture as in the overall credit conditions. Thus, within the pre-crisis period and the period of the acute phase of the crisis, changes in almost all individual credit conditions, with both the households and the companies sectors are

quite consistent with the changes in the key interest rate. In the period of recovery from the global crisis weakening of the link was registered, which is especially evident in the corporate sector. Observed by individual credit conditions, the lending interest rate in both sectors shows generally synchronized movement with the key interest rate within the entire analyzed period. It means that this condition remains quite aligned with the key interest rate also in the period of recovery from the global crisis. Thus, in the corporate sector, the interest rate generally followed the continued trend of easing of monetary policy, which began in late 2009, but with present volatility in certain periods. Other credit conditions such as fees (non-interest income), the size of the loans, the collateral requirement and maturity of the loans, remained mainly in the area of tighter credit conditions. Their easing is registered towards the end of 2013, with the exception of the collateral requirement that remained within the tighter credit conditions. In terms of correlation, coefficients for individual corporate credit conditions reduced from the interval of 0.8-0.9 to 0.3-0.5 in the periods before and after the global crisis.

Chart 5 Individual credit conditions and key interest rate



Source: NBRM

In the household sector, in the period of recovery from the crisis, weakening of the correlation of part of the individual credit conditions with the key interest rate was noticed, but with lower intensity compared to the corporate sector. Thus, the correlation coefficients show reduced values moving in the ranges of 0.5-0.7 and 0.2-0.6 in the periods before and after the global crisis. The lending interest rate on lending for house purchase and consumer loans registered a downward trend, continuously following the downward movements in the interest rate of CB bills. Regarding the lending for house purchase, beside the interest rate, the fees also followed the downward trend of the key interest rate, stopping in the zone of relaxed credit conditions. The other credit conditions such as the collateral requirements, coverage of the loan with collateral, and maturity of loans, remained largely unchanged in this period, or there was very little change toward their relaxation. Consumer loans reported greater synchronization between individual credit conditions and signals of the central bank, so that all credit conditions (interest rate, collateral requirements, coverage of the loan and fees, i.e. non-interest income) were relaxed in the period after the acute phase of the crisis, although with varying intensity regarding different conditions and at different times.

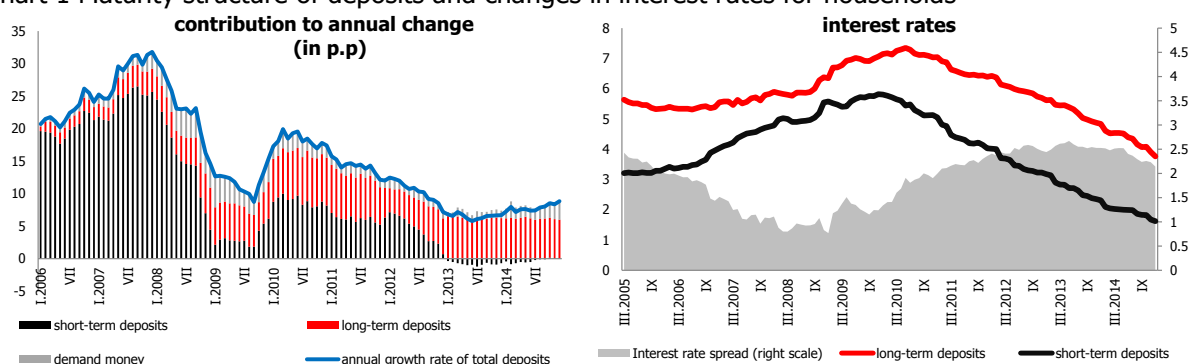
According to the analysis, we can conclude that in the period of recovery from the global financial crisis, weakening of the link between credit conditions and the key interest rate was registered, with this being somewhat more pronounced in the corporate sector. Analyzed by individual credit conditions, the greatest compliance with the changes in the key interest rate was registered in lending interest rates, while changes in the other lending conditions were less harmonized, particularly in the corporate sector. These findings suggest that the banks have duly transmitted the decline in the key interest rate of the NBRM in their interest rates and relaxed the interest conditions. Nevertheless, they restricted the supply of corporate loans by keeping other conditions tighter. However, starting from the end of 2013, positive changes and a gradual relaxation of the other conditions were made that could indicate a gradual strengthening of the link with the key interest rate and revival of the lending activity also of the corporate segment. In the household sector, in the period of recovery from the global crisis, beside in the interest rate, relaxation was registered also in part of the other credit conditions (fees for house purchasing loans and all credit conditions for consumer loans) suggesting further correlation of the credit conditions with key interest rate and smaller disruption of the link compared to the corporate sector.

Box 4: A brief analysis of the impact of changes in the interest rate spread on the decisions of households for saving in the short or long term

Maintaining the quality structure of the deposit base as a fundamental source of financing banking activities is an important prerequisite for efficient financial intermediation. One aspect of quality is the maturity structure of deposits. Namely, by extending the maturity of total deposits the stability of the deposit base is increased, and banks can finance long-term projects and support the investment cycle. In economies with stable economic and banking systems, one of the main factors that affects decisions on savings in the short or long run is the yield, i.e. the interest on these deposit products. Additionally, depositors decide on the maturity structure of their savings depending also on the risk associated with that yield, i.e. depending on their perception of the stability of the environment, the stability of the banking system and their personal preferences and liquidity needs. But if the perceptions of risk and liquidity preferences are stronger, the yield from saving in the short run is sufficient and in this case it is likely that short-term savings are predominant in their decisions. If perceptions are favorable and stable, and the yield in the short run is lower than the risk, then the preferences are likely to move towards longer terms. If perceptions of risk do not change significantly, i.e. they are stable, changes in the interest rate spread between savings in the short and in the long run can significantly affect the maturity structure of savings.

Within the analysis presented below, we try to assess the impact of the change in the interest rate spread of households' deposits on their propensity to save in the short or long term. The main motive for the analysis stems from the shifts that have been observed in the maturity structure of household savings in recent years, at the expense of the increased savings in the long run, while the interest rate spread between the yields of long-term and short-term savings has broadened. For this purpose, first we conduct a dynamic analysis of the changes in saving against the interest rate spread and analysis using the correlation coefficients. Then, we try to empirically assess the relationship by applying panel techniques of analysis. The analysis focuses on the household sector as a traditional "net-saver" in the economy. For the purposes of the first and second approach of the analysis we use weighted monthly interest rates on household deposits¹⁰⁸, according to the interest rates statistics, while for total household deposits we use official data on the total deposits with other depository institutions (banks and savings houses), according to the monetary statistics. The analysis refers to the period January 2006 to December 2014.

Chart 1 Maturity structure of deposits and changes in interest rates for households



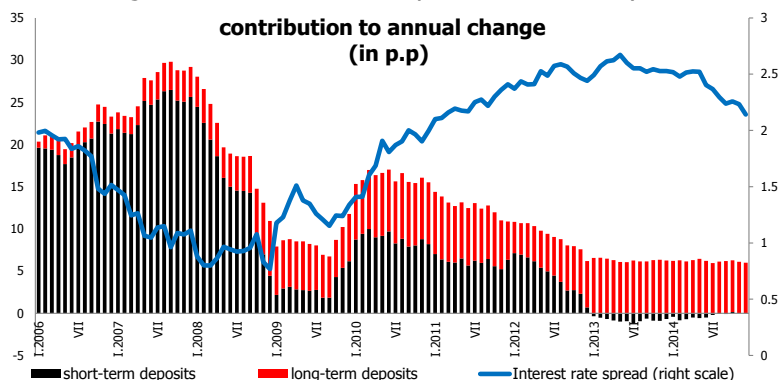
Source: NBRM

Regarding deposit interest rates, in the period since the beginning of our analysis until late 2008, there was a notable narrowing of the interest rate spread between long-term and short-term interest rates. This is achieved in circumstances when changes in both types of interest rates are in an upward direction, but with a slightly higher intensity in the short-term saving. **Already from the beginning, and especially starting from the second half of 2009,**

¹⁰⁸ Interest rates on short-term and long-term deposits that we use in the analysis are calculated on the basis of data from the interest rates statistics and are related to the total aggregate short-term and total aggregate long-term interest rate of the Denar and foreign currency household deposits. In the panel analysis of total deposits, data from the interest rates statistics are used.

trends changed. Thus, during this period, until mid-2013, there was a continuous broadening of the interest rate spread between the long-term and short-term returns on savings (in May 2013 the interest rate spread was 2.7 percentage points, which is the highest value of the interest rate spread for the entire period analyzed), followed by a period of generally more stable movements. The reasons for the broadening of the interest rate spread in 2009 can be located in the more intensive growth of long-term interest rates relative to the growth of short-term interest rates in this period. In the subsequent period, the broadening was led by the more substantial and more dynamic downward adjustment of yields from short-term savings relative to the reduction in the yields from long-term savings (a decline of 4.2 percentage points and 3.4 percentage points, respectively, compared to the end of 2009). Changes in deposit interest rates were basically consistent with the changes in the key interest rate of the NBRM. But in addition, in this period, the NBRM made changes also in the setup of other instruments, which probably influenced the dynamics of the banks' interest rates and may be one of the reasons for the more intensive lowering of short-term compared to the long-term interest rates in the recent period. These changes relate to changes in the reserve requirement (effective since January 2012¹⁰⁹), whereby the NBRM lifted the obligation for the banks to allocate reserve requirement on household deposits with maturity period exceeding two years. These changes meant lower costs for banks based on reserve requirement for long-term household deposits, opening room for smaller downward adjustment of long-term interest rates and keeping the attractiveness of savings as an option for investment of free assets.

Chart 2 Changes in the interest rate spread and maturity structure of deposits of households

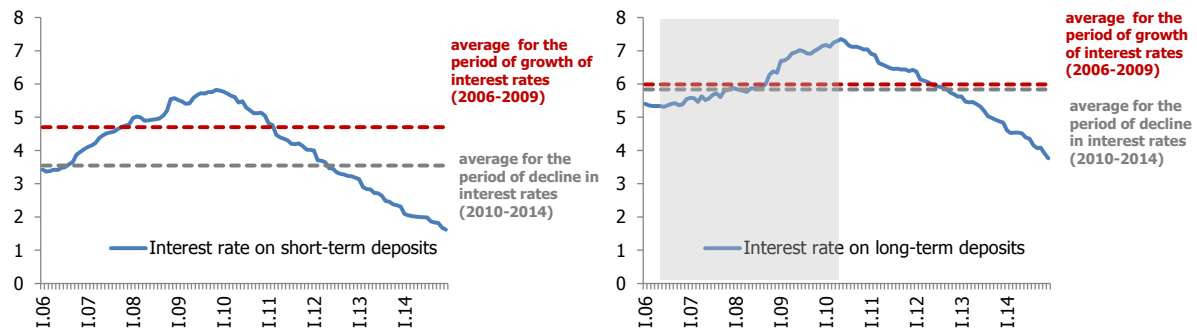


Source: NBRM

If we analyze the maturity structure of household deposits, similar to the interest rate spread, two different phases can be distinguished. Thus, for the first few years of the analysis, data show higher propensity of households to save in the short term, and in the period 2005-2008, short-term deposits accounted for about 79% in the realized deposit growth. Since the end of 2008 and beginning of 2009, the importance of long-term deposits has gradually started to rise, and in the last two years they have become a central category of total households' deposit growth. The positive restructuring of household deposits in the recent period is perceived through the contribution of long-term deposits in the total deposits growth, which for the period after 2008 is about 56%. From early 2013 onwards, the contribution of long-term deposits ranges from 70-90%.

¹⁰⁹ For more details see the Decision amending the Decision on reserve requirement "Official Gazette of R.Macedonia" 126/11.

Chart 3 Interest rates on of household deposits in%



Source: NBRM

In summary, what can be drawn as a conclusion based on the analysis of the dynamics is that changes in the maturity structure of household deposits, in circumstances where their perceptions of risk are probably unchanged, largely correspond to the changes in the interest rate spread. Thus, the period until 2009, which is characterized by faster growth of short-term interest rates and a narrowing of the interest rate spread between long-term and short-term savings is marked by faster growth of short-term deposits. The second period, which in the analysis coincides with the period after the "acute phase" of the crisis, is characterized by a broadening interest rate spread and more intensive lowering of interest rates on short-term deposits, which is followed by a gradual increase in the contribution of long-term savings to the growth of total household deposits. **Such indications derived from the dynamic analysis are underpinned by the analysis of the correlation coefficients between changes in the maturity structure of household deposits and movements in the interest rate spread¹¹⁰.** The results of the analysis indicate relatively high correlation of about -0.65 between the movements of short-term deposits and interest rate spread in the entire period analyzed, while the synchronization with long-term deposits is smaller and equals 0.38. The results of the correlation are intuitive and have a proper sign, but they should be interpreted only as an indication of the existence of a relationship between variables, rather than as causality or elasticity of changes in the maturity structure of household deposits to changes in the interest rate spread.

Considering the indications obtained from the analysis of the dynamics and the correlation coefficients, the next step in our analysis is to try to explore the degree of correlation between the changes in long-term household deposits and the movements of the interest rate spread, through advanced techniques. To this end, we use dynamic heterogeneous panel cointegration techniques, i.e. the PMG technique (Pooled Mean Group)¹¹¹. The analysis was made by using disaggregated monthly data on interest rates and deposits for individual commercial banks that operate within the Macedonian banking system. The data cover the period from 2005 - 2014. Some results of the econometric analysis are shown in Table 1.

Table 1 Results of the regression analysis

	Coefficient of the PMG estimation
D.lolg_vk_dep	0.60*** (0.000)
ec	-0.020*** (0.000)

*** Indicates significance of 1%.

*Note: The table presents the long-term response rate of long term deposits expressed in logarithms (D.lolg_vk_dep) of the interest rate spread.
ec denotes error correction term.

¹¹⁰ The change in the structure of deposits is covered by the contribution of short-term and long-term deposits to the total annual deposit growth while the interest rate spread is calculated as the difference in the returns on long-term savings relative to the returns on short-term savings of households.

¹¹¹ More details on this technique can be found in Pesaran and Smith (1995) and Pesaran, Shin and Smith (1999).

The results of the analysis indicate relatively high sensitivity of long-term deposits to changes in the interest rate spread in the analyzed period. Thus, the broadening of the interest rate spread by 0.1 percentage point indicates 6% growth in long-term deposits. The resulting relatively high and significant coefficient indicates the adjustment of households' decisions for saving depending on the return on deposits. Thus, given the low yields of short-term savings and limited supply of other financial instruments, the households are likely to seek to optimize the deposit portfolio by directing funds towards longer maturities, so as to achieve a higher rate of return.

In order to obtain indications of any differences in the relation of depositors' preferences with the interest rate spread depending on the direction of movement of the interest rates, further analysis is made, which is focused on two sub-periods of movement of interest rates. The first sub-period covers the phase of rise in interest rates, while the second sub-period covers the phase of their decline¹¹². This assessment is made by including an interactive dummy variable in the regression (interaction term) where the results obtained are given in Table 2.

Table 2 Results of the regression analysis

	Coefficient of SGP assessment with included interaction
D.lolg_vk_dep; I period	0.89*** (0.000)
D.lolg_vk_dep; II period	0.59*** (0.000)
interactive dummy variable	-0.29** (0.029)
ec	-0.017*** (0.001)

** and *** indicate significance of 5% and 1%, respectively.

*Note: The table presents the long-term response rate of long term deposits expressed in logarithms (D.lolg_vk_dep) of the interest rate spread. ec denotes error correction term.

As can be seen from Table 2, the coefficient of the statistical interactive dummy variable is significant at the level of 5% which means that the effect of the interaction should not be ignored. The results indicate higher sensitivity of the long-term savings of households to the change in the interest rate spread in the first sub-period of growth of interest rates relative to the period of general reduction of yields (coefficients of 0.89 and 0.59, respectively). The first sub-period corresponds to a period of generally improved perceptions of risk by banks and the private sector, given that the pre-crisis years were marked by strong economic growth and favorable domestic and global environment. For the second period, perceptions of risk are probably more volatile under the influence of the effects of the global crisis. However, comparing coefficients with the first approach by analyzing the whole period, suggests that differences in the results are not as pronounced, with both approaches indicating a relatively high response of long-term deposits to changes in the interest rate spread in the whole analyzed period.

In summary, the analysis of the degree of correlation between the change in the maturity structure of deposits and the movement of the interest rate spread suggests relatively high synchronization of their movements in the entire analyzed period. The descriptive analysis of these movements, and the formal evaluation by panel techniques suggest that the propensity of households to save in the long run is sensitive to the change in their yields, which applies to both the periods of rising and periods of falling interest rates.

¹¹² The first subperiod extends from the first quarter of 2005 through the fourth quarter of 2009, while the second subperiod covers the period from the first quarter of 2010 through the fourth quarter of 2014.