

**National Bank of the Republic of Macedonia**



**Quarterly Report  
May 2016**



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## Summary

**During the first quarter of 2016, the NBRM kept its policy rate unchanged at the level of 3.25%.** This decision was based on the latest data of key macroeconomic and financial indicators, which did not indicate significant deviations compared with the last macroeconomic projections of the NBRM from October 2015. Changes in the **headline domestic inflation** were again predominantly affected by the fall in world oil prices, leading to a decline in the domestic prices on an annual basis. The growth of **economic activity** in 2015 was generally within expectations, and recent short-term indicators pointed to further retention of positive trends in the first quarter of 2016, notwithstanding the further existence of risks in terms of the domestic political situation, which were also present in the previous year. Banks continued to support the economic growth through enhanced **lending**. However, credit flows in the first quarter were more moderate. **Foreign reserves** registered moderate growth, and all reserves adequacy indicators were maintained in the comfortable zone, with enough room for dealing with possible shocks. **Contrary to the absence of changes in the policy rate, in the first quarter of 2016, macroprudential measures adopted by the NBRM in December 2015 started to apply, in order to protect against any future risks for the financial stability and prevent future macroeconomic imbalances.**

**The latest cycle of macroeconomic forecasts for 2016 and 2017 was rounded at the beginning of April and did not indicate major changes in the macroeconomic environment, compared to the October projection. Within the projections, relatively rapid stabilization of the political situation was assumed, without its major effects on the domestic economy.** Available indicators for the domestic economy for the first quarter did not deviate significantly from the previous projections, which together with incorporated external and domestic assumptions for the next period resulted in a similar projected path of key indicators, as well as within the October projections. Overall, the baseline macroeconomic scenario shows solid economic and credit growth, absence of price pressures and balance of payment position that ensures further growth of foreign reserves.

**During April 2016, the political situation deteriorated, with more pronounced signals of its action on the confidence and expectations of the entities being noticed. For these reasons, within this forecasting round, alternative macroeconomic scenario was developed, which assumes continuation of the political crisis for a certain period of time.** The alternative scenario shows the main transmission channels of the domestic crisis on the economy and gives assessment of the possible effects on key indicators of the domestic economy. The macroeconomic landscape within this scenario shows significantly weaker economic and credit growth compared to the baseline scenario, retention of price changes in the negative zone, somewhat larger current account deficit of the balance of payments and smaller financial inflows. However, in this scenario, foreign reserves adequacy indicators remain within the safe zone.

**The assumptions for the external environment are common for both scenarios. Certain changes occurred in the expected movements of key indicators of the external environment in the period between both projections. Foreign effective inflation** in 2016 has been revised downwards and is estimated to be relatively low, and its moderate acceleration is expected in the following year. During this year, the recovery of the **foreign effective demand** will continue at a similar pace as previously expected, while growth in 2017 will be faster, mainly due to improved expectations for some of the countries in the region. As in previous assessments, dynamically speaking, it is expected that the external environment will be more favorable in the next period.

Despite the **moderate pace of external demand recovery**, estimates for growth of the domestic economy continue to point to **solid performance and expectations about the future.** The registered GDP growth of 3.7% in 2015 and the indicators for the first quarter show somewhat better performance compared to October cycle projections. *Within the baseline scenario*, these initial conditions, combined with the expected path of the key external and domestic factors, point to **economic growth of 3.5% in 2016 and accelerating growth of around 4% in 2017, which is in line with the October projection.** Assessments for faster growth of the domestic economy than the growth in trading partners reflect the specific structural factors of domestic growth, i.e. the activity of the new export-oriented facilities with foreign capital and public investments in road infrastructure. In such



conditions and with the assumptions for improving the global environment, exports and investments are expected to be leading growth factors in the next two years. These movements will be appropriately reflected on the growth of private consumption by further increasing wages and employment. Under such assumptions for relatively solid growth in all components of domestic demand, rapid growth of imports is also expected. **The growth in private consumption and investments will be supported by the banking sector**, whereby in terms of solid economic growth, further strengthening of the banks' deposit base is expected in the next two years, as a major source of funding the lending to the private sector. Annual credit growth of around 7% is estimated for 2016 and 2017, which is a moderate downward revision compared to the previous projection.

**Significantly lower growth rates are expected for 2016 compared to the October projection (0.5% instead of 1.5%).** These estimates reflect price movements in the previous period, as well as significant downward revisions of the projections of import prices of energy, food and foreign effective inflation. Positive effect on inflation is expected by domestic demand, i.e. it is estimated that the output gap will be positive during the entire period of projections. The continued growth of the domestic economy, and the expected increase in the prices of food, oil and foreign inflation will increase inflation to about 1.6% in 2017 (same as in the October projections).

**The latest estimations for the balance of payments indicate just smaller current account deficit for the period 2016-2017, compared to the October projections. Deficit of 1.2% of GDP is expected for 2016, compared to the current account deficit of 1.9% of GDP as projected in October.** This change mostly reflects changes in the balance of goods and services, primarily as a result of the improved energy deficit amid low level of the price of crude oil on world markets, as well as the improved primary income balance. Dynamically speaking, in 2016, the current account deficit is estimated to be slightly lower compared to 2015, with no significant changes in the main components. **In 2017, no major changes are expected, i.e. the current account deficit is expected to return to the level of 1.4% of GDP (2.4% of GDP according to the October projections).** Observing both years, the expected path of the current account deficit and its structure do not suggest major imbalances in the economy. Less favorable global environment and domestic political factors will condition somewhat lower financial flows in 2016 and 2017, primarily through direct investments and external borrowing by the private sector, compared with the October projection. In terms of the structure of capital inflows, as previously projected, current assessments also show that it will be a combination of debt and non-debt flows, mainly direct investments and borrowing. Cumulatively for 2016 and 2017, the current projection foresees a moderate rise in foreign reserves. Foreign reserves adequacy indicators remain in the safe zone, suggesting a sufficient level of foreign reserves to deal with any unforeseen shocks.

*The alternative macroeconomic scenario, which assumes continuation of the current political situation for a certain period shows the key transmission channels of the political crisis on the economy and possible effects.* The unstable political context will act on the confidence and expectations of the entities and thus the growth of the domestic economy. **The alternative scenario shows lower GDP growth in 2016 compared to the baseline scenario by about 2 percentage points (1.6% GDP growth, compared to 3.5% in the baseline scenario).** At this pace of economic activity, the output gap would remain in the negative zone and create downward pressures on prices in 2016, despite the expected moderate increase in inflation in the baseline scenario. In terms of individual components of demand, reduced confidence of the households will increase the restraint from greater consumption. Despite the general restraint from psychological causes, the slower growth in disposable income would also have an effect on the private consumption, given that in such a scenario, less favorable developments were assumed in the labor market and corresponding effects on disposable income. Thus, private consumption would have a neutral effect on growth, while in the baseline scenario this component is one of the sources of GDP growth. Increased distrust is expected among investors, as well, which presumably may come to restraint from new investments. Namely, there is a possibility foreign and domestic investors to postpone their investment decisions to invest in the country. On the other hand, although this scenario probably determines slowdown in infrastructure projects of the government, however some of these projects for which sources of funding are provided would continue to be implemented, especially in road infrastructure projects. Hence, investment growth is still expected in the alternative scenario, but significantly smaller compared to the baseline scenario. The alternative scenario



did not envisage major effects on overall export activity, which was largely driven by the new export-oriented facilities whose business plans would be implemented in accordance with the dynamics assumed in the baseline scenario. On the other hand, the weaker pace of domestic demand would reduce import pressures, whereby the growth in imports is slower compared to the baseline scenario.

**In terms of the balance of payments, the assumption of a prolonged political crisis indicates somewhat larger current account deficit compared to the baseline scenario.** Thus, the alternative scenario shows a larger current account deficit, which still remains moderate and is around 2% of GDP, compared to 1.2% in the baseline scenario. In circumstances where lower domestic demand creates smaller import pressures and improves the trade balance, the deterioration of the current account deficit is the result of private transfers. The increased propensity of the households for holding foreign currency is a common reaction in crisis and leads to a lower level of private transfers (smaller amount of net cash purchased on the currency exchange market). Larger effects were expected through the financial channel, in the form of smaller inflows of direct investments and hampered access of the government and the private sector to external borrowing. Increased preferences for liquid foreign assets in the alternative scenario are appropriately reflected on the higher net outflows in currency and deposits of other sectors. On the other hand, the alternative scenario envisages higher funding of the economy in 2016 through trade credits compared to the baseline scenario, which is a common feature of funding trade flows in such circumstances. The larger current account deficit, combined with weaker financial flows is transferred on foreign reserves, but their level in such a scenario remains adequate and sufficient to deal with shocks.

**The weaker economic growth and weaker foreign exchange flows in the alternative scenario resulted in weaker growth in the banks' deposit base compared to the baseline scenario.** In such conditions, amid concomitant assumption of lower propensity for borrowing by the private sector on the one hand and the restraint of the banks from greater risk, the alternative scenario in 2016 shows smaller credit growth than expected in the baseline scenario, i.e. 3% annual growth, compared to around 7% in the baseline scenario.

**The alternative scenario assumes resolving the political crisis by the end of this year and gradual reduction of the possible effects on the economy in 2017.** Hence, in view of the main points affected by the crisis, recovery of private consumption and investments is expected. There are similar expectations regarding the dynamics of private transfers and external and domestic financial flows, which dynamically speaking are expected to recover during 2017.

The risks regarding the projections are further associated with the external environment and the domestic political developments. The uncertainty of **the intensity of the recovery of the global economy, especially the European economy, remains present** and may affect the projected path of the indicators of the domestic economy. **Risks due to domestic factors, associated with the domestic political crisis remain present**, referring to the duration of the crisis which largely conditions the fulfillment of both scenarios. The NBRM, as before, will continue to closely monitor the developments in the period ahead, and if appropriate, will accommodate the monetary policy for successful achievement of the monetary policy objectives.

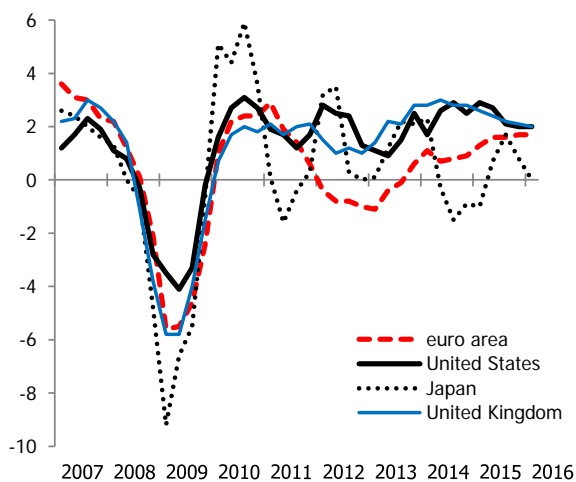


## I. Macroeconomic developments

### 1.1. International economic surrounding<sup>1</sup>

*In the last quarter of 2015, the global economy continued to recover, but at a slower pace, which is characteristic of developed and emerging economies. In the developed economies, growth is further supported by the fall in oil prices, relaxed monetary policy, improved labor market and alleviation of the adverse effects of the private sector deleveraging and the government. However, the present uncertainty, as well as instability in global financial markets contributed to slower growth than expected. According to the IMF April projections, in 2016, global growth was revised downwards in both developed and emerging economies. The expected growth of the euro zone for the next period has also been corrected downwards, and the ECB further increased the extent of monetary easing. There are similar expectations about the US economy, whose slowdown towards the end of the year led to market expectations for delaying the further increase in the interest rate of the Fed. In terms of emerging economies, the economic outlook varies by country, but in general the estimates for the whole group show further slowdown of the growth pace as a result of the weak performance of countries exporting primary commodities, slower growth of the Chinese economy, and generally the slow growth of some economies after the phase of high credit and investment growth. Global inflation has still been maintained at a low level, whereby in a number of countries, inflation rates are below target rates of the central banks. No significant inflationary pressures are expected, given the still weak global demand. However, at the beginning of 2016, the growth of prices of some primary commodities indicates possible upward movements of global inflation.*

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

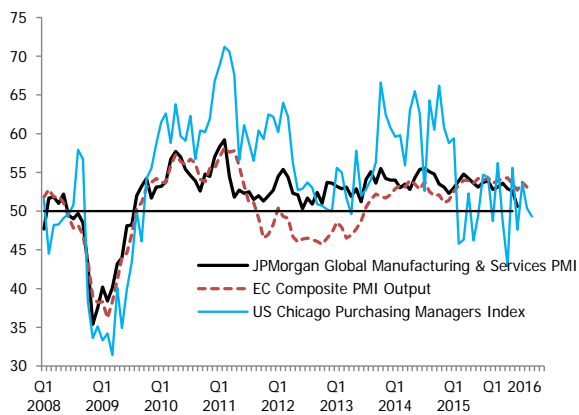


Source: OECD.

**Global economic activity has been recovering, with the indicators pointing to a moderate and uneven growth at the end of 2015.** In the fourth quarter of 2015, growth in some developed countries slowed down. Thus, GDP growth in the US was 0.3% on a quarterly basis (compared to 0.5% in the third quarter), with an annual growth rate of 2.4%. Private consumption remains a major driver of growth in the US economy, supported by rising of employment, nominal wages and real disposable income amid lower oil prices and slower inflation, as well as improved credit conditions. The unemployment rate further declined and in January it reduced to 4.9% on average. On the other hand, somewhat weaker performance has been seen in investments as well as net exports caused by the appreciation of the US dollar, but also reduced global demand. After the quarterly growth in the third quarter, Japan experienced a drop in economic activity in the fourth quarter, mainly as a result of the slowdown in private consumption. On the other hand, in the fourth quarter, the British economy continued to realize positive results and increased by 0.5% compared to the previous quarter, similar to the growth pace since the beginning of the year. The

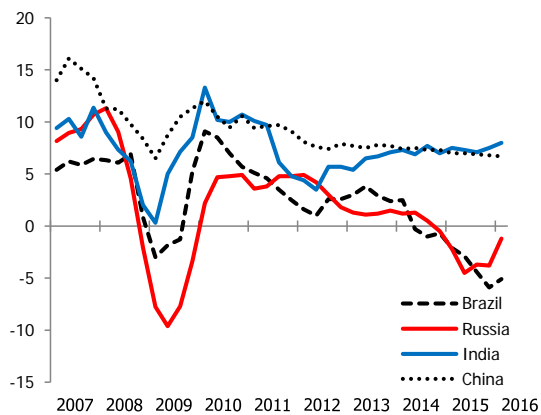
<sup>1</sup> The analysis is based on the ECB's Economic Bulletin; the monthly reports of Deutsche Bundesbank; the announcements of "Markit Economics"; "Economic Prospects" of the OECD; "Roubini Global Economics" and "Capital Economics" reports and the weekly reports of the Bank of Greece.





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

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



Source: OECD and IMF.

increased private consumption had the largest contribution to the economic recovery, fueled by real disposable income, and to a lesser extent investments, while net exports had a negative contribution to growth. The unemployment rate continued to decline and in the last quarter it was 5.1%. The performance of emerging and developing economies is heterogeneous, partly reflecting the divergent impact of downward correction in world prices of primary commodities on the exporting and importing countries.

The high-frequency survey indicators of economic activity - PMI<sup>2</sup> point to a moderate growth of the world economy at the end of 2015 and further slowdown of growth at the beginning of 2016, and especially in the US and Great Britain. Namely, in the period January - March 2016, the global composite PMI averaged 51.5 index points (six consecutive months was lower than the long-term average), amid weaker performance in both manufacturing industry and services sector.

According to the IMF April projections, the risks around the outlook for the global economy remain unfavorable, and are also more pronounced compared to the previous period. Adverse risks were mostly associated with the tightening of financing conditions and volatility in financial markets, whose prolongation can have effects on the confidence and expectations of economic agents. The possibility of sudden capital outflows from emerging economies and disturbance to the financial stability in these countries is also assessed as potential adverse risk for the global economy. The deceleration of growth in the Chinese economy remains downward risk, which through direct and indirect channels can have global economic effects. The scheduled referendum in the UK to leave the European Union is already a risk for investors and a threat for disturbance to the established trade relations. Also, risk factors in the next period include geopolitical risks associated with the developments in the Middle East.

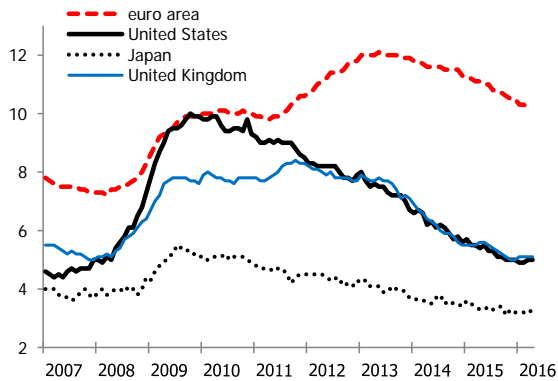
**Available data show a moderate acceleration of global inflation at the beginning of 2016.** After the growth of 2.5% in the last quarter of 2015, in January 2016, global inflation reached 3.1%. Among developed countries, the US registered an accelerated inflation of 0.6 percentage points in the first quarter of 2016, in the UK there were no major changes, while in Japan and the euro zone inflation slowed down. Within the emerging countries,

<sup>2</sup> PMI (Purchasing Manager's Index) is based on surveys of a representative sample of companies from the manufacturing and service sectors, and are often used as high frequency indicators for the current and future economic activity.



China registered an accelerated inflation, a sharper slowdown in inflation was recorded in Russia, while in the other emerging economies there were no major changes. According to latest estimates, no major inflationary pressures are expected in the period ahead.

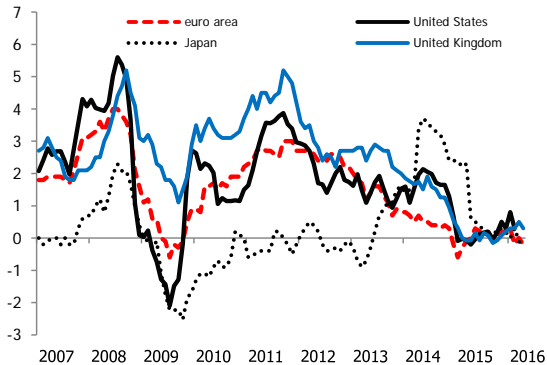
### Unemployment in advanced economies (in percent; seasonally adjusted monthly data)



Source: Eurostat.

**In the fourth quarter, economic activity in the euro area continued to recover.** Real quarterly GDP growth was 0.3% (same as in the previous quarter), which caused the annual growth to amount to 1.6%, which is the highest growth since 2011. Observed by individual components, gross investments are the main driver of the positive economic performance in the fourth quarter (unlike the second and third quarter when their contribution was minimal). Private consumption acted in the same direction (although with a smaller contribution compared to the third quarter) stimulated by the higher purchasing power of households, primarily as a result of the favorable labor market developments, low oil prices as well as easing of the monetary policy by the ECB. The unemployment rate in January further reduced to 10.3%, the lowest level since mid-2011. Yet, the unemployment rate has been declining slowly, so it is estimated that it requires a longer period before it reinstates to the pre-crisis levels. The deceleration of growth in the emerging economies had its repercussions on the demand for European products that had a negative contribution of net exports to growth. Analyzing individual economies, Spain has registered continuous trend of gradual economic recovery with solid quarterly GDP growth (0.8%), fueled by increased domestic demand. Other major economies of the euro area such as Germany, France and Italy have seen more moderate quarterly GDP growth (0.3%, 0.3% and 0.1%, respectively).

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

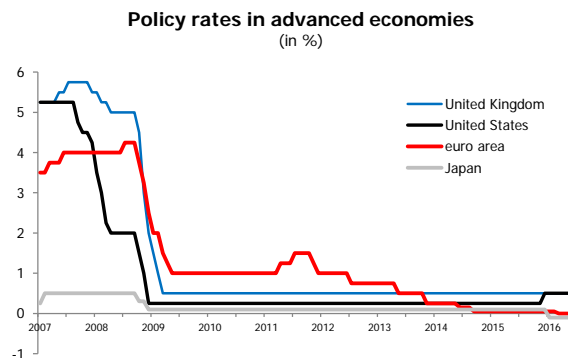


Source: Eurostat and national statistical offices.

**During the first quarter of 2016, inflation in the euro area remained low and well below the targeted rate of 2%.** Namely, in this period, the average annual inflation rate amounted to 0.0%, and is lower compared with the annual growth in the previous quarter. Such performance results from the energy and food components of the index, while core inflation remained at the same level as in the previous quarter.

**In the fourth quarter of 2015 and at the beginning of 2016, the central banks of developed countries continued to conduct accommodative monetary policy.** At the regular meetings in January and March 2016, Fed maintained its key interest rate unchanged amid steady economic growth, improved conditions in the labor market and expectations for reinstatement of inflation to the inflation target by the end of 2017. However, the





Source: Central banks.

growth of the US economy is slower than expected, whereby market expectations are aimed at delaying the further increase in the key interest rate. Unlike Fed, the European Central Bank adopted several decisions in March 2016 aimed at further easing of the monetary policy, in order to encourage economic growth and bring the inflation closer to the target of 2%. The package of measures of the ECB includes reduction in the interest rate on the main refinancing operations by 5 basis points to 0%, but additional monetary measures, as well.<sup>3</sup>

The Bank of England has not made significant adjustments in the monetary policy, i.e. it kept the level of 0.5% of the key interest rate, whereby there was no change in the asset purchase program. At the meeting in January 2016, the Bank of Japan took additional measures aimed at easing of the monetary policy through "Quantitative and Qualitative Monetary Easing with a Negative Interest Rate" in order to achieve the target of 2% inflation<sup>4</sup>.

**Box 1: New package of measures of the European Central Bank and the Bank of Japan in the first quarter of 2016**

In order to further ease the financial conditions in the euro area, at the meeting in March 2016, **the European Central Bank** adopted a new package of measures which includes several changes.

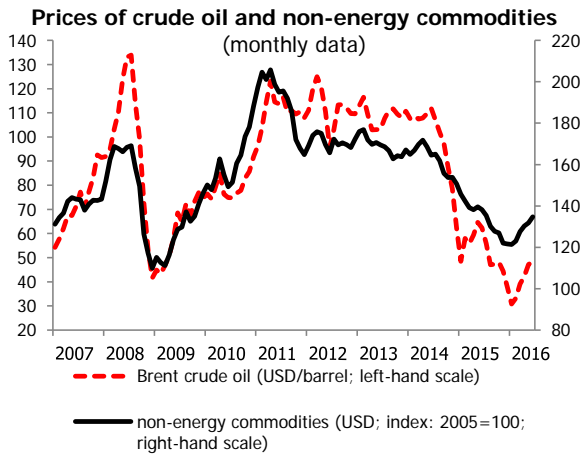
- 1) Reduction in interest rates, i.e. the interest rate on the main refinancing operations from 0.05% to 0.00%, the interest rate on the deposit facility from -0.30% to -0.40% and the interest rate on the marginal lending facility from 0.30% to 0.25%.
- 2) Increase of the monthly purchase of bonds under the quantitative easing program (from Euro 60 to Euro 80 billion) starting from April 2016, involving the purchase of non-financial corporate debt securities from the euro area with an appropriate investment grade rating;
- 3) A decision to implement additional 4 Targeted Longer-Term Refinancing Operations (TLTRO II) with maturity of 4 years was adopted, starting from June 2016, with an interest rate at the level of the policy rate of the ECB. Moreover, for banks that will increase their lending activity to a larger extent than the set target, a lower interest rate will be applied to the amount above the target, but most up to the level of deposit facility interest rate.

**In January 2016, the Bank of Japan** introduced a three-tier system of reimbursement of funds of financial institutions with the central bank, whereby for part of the funds negative interest rate will be applied (-0.1%). At the same time, it continued to conduct expansive monetary policy through the purchase of assets from financial institutions. In order to mitigate the effect of the introduced negative interest rates and to ease financial conditions, in March, the Bank of Japan made changes in the operations for temporary purchase of securities (increased the amount for purchase of Japanese government bonds) and made additional changes in the newly introduced system of reimbursement of funds of financial institutions with the central bank.

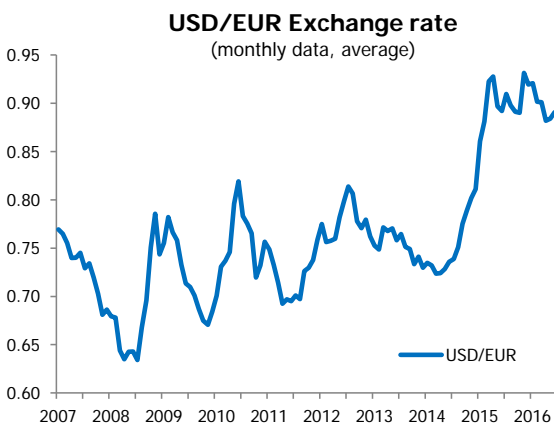
**Volatile movements of the nominal exchange rate of the US dollar against the euro continued in the first quarter of 2016. Unlike the fourth quarter**

<sup>3</sup> For more details about the measures see Box 1 of this Report.

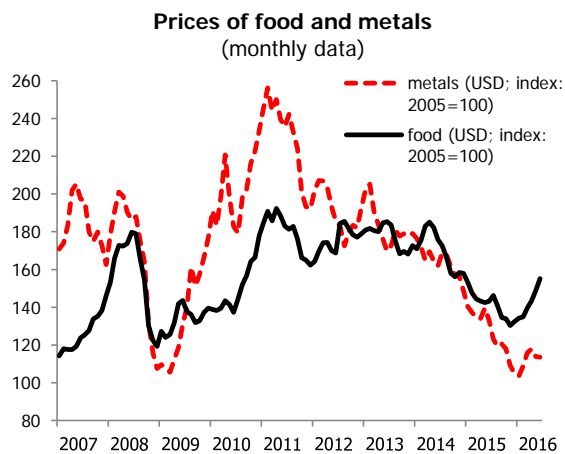
<sup>4</sup> For more details about the measures see Box 1 of this Report.



Source: IMF monthly database.



Source: Eurostat.



Source: IMF monthly database.

of 2015, when the US dollar appreciated by 1.6% against the euro, in the first three months of 2016, the US dollar slightly depreciated by 0.6%. Such movements of the US dollar in the period under observation are not in line with the expectations for further normalization of the Fed monetary policy. On annual basis, the US dollar against the euro depreciated by 2.4%, and in March 2016, one US dollar was exchanged for 0.9015 euros.

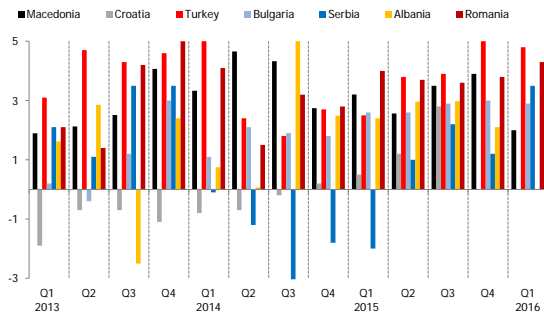
**The oil price continued to decline during the first quarter of 2016, when it averaged 31.2 euros per barrel, which is a decrease of 21.4% compared to the previous quarter, i.e. of 35.2% on an annual basis.** Volatile movements were registered during this period. Thus, in January, the oil price reached the lowest level in the past 12 years, while in February and March, there was an increase in the price level. The rise in oil prices in February and March is actually a result of the agreement of the OPEC countries to freeze production at the January level, the problems that arose with oil production in Iraq and Nigeria, as well as the significant reduction in the production of shale oil in the US. However, the oil supply on the global market remains high, as a result of the disunity of the OPEC countries that most likely will not reach an agreement on significant production cuts, as well as the removal of sanctions on Iran by the United Nations. On the demand side, the weaker performance of the Chinese economy and the moderate recovery of European economies have created downward pressure on the oil price. **The downtrend in prices of non-energy primary products<sup>5</sup> in euros continued in the first quarter of 2016 (down by 0.4%).** However, analyzed by groups, there were divergent performances, i.e. a quarterly decline of 1.7% in metal prices and an increase of 2.2% in food prices. The fall in metal prices is mainly due to the weaker performance of the Chinese economy, and the high level of supply in world markets. In terms of metal prices, in February 2016, there was a certain change in the trend, particularly in March when prices grew by 6.4% on a monthly basis.

**The economic recovery of the countries in the region continued in the fourth quarter of 2015, but in some countries at a slower pace.** The Serbian economy registered an annual growth of 1.2%, which is a slowdown of 1 p.p. compared to the previous quarter, mostly due to the slowdown in gross investments. In the fourth quarter of 2015, similar to the Serbian economy, the Croatian economy recorded

<sup>5</sup> The price index of non-energy primary products includes: prices of food, beverages, agricultural raw materials and metals.



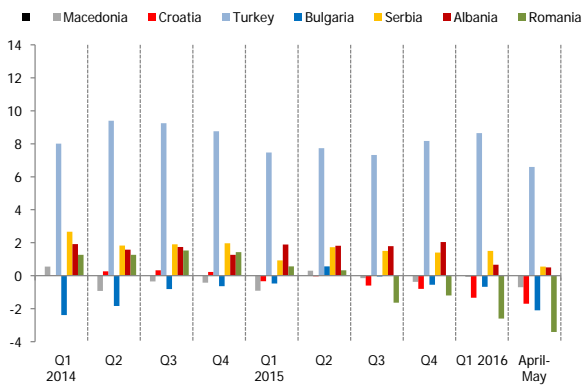
**Real GDP growth in countries from the region**  
(annual percentage changes, quarterly data)



Source: Eurostat and national statistical offices.

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

**Inflation in countries from the region**  
(annual percentage changes)



Source: Eurostat and national statistical offices.

a slowdown of the economic growth. The annual GDP growth in Croatia amounted to 1.9%, or slower growth by 0.9 p.p. compared to growth in the previous quarter. The slowdown was mostly a result of the deeper negative contribution of net exports. Same as in the preceding quarter, solid economic growth of 3.0% was also recorded in the fourth quarter of 2015 in Bulgaria, whereby, unlike the previous quarter, when gross investments had a negative contribution, in the last quarter, their contribution was positive. The Romanian economy continued reporting solid performance (growth of 3.8%), among the highest in Europe.

### **The downward trend of inflation started in 2015 continued in the beginning of 2016.**

Measured by consumer prices, most countries reported negative inflation rates or rates close to 0%. Downward changes in the energy component are the underlying factor for deflation movements, but unlike the last quarter of 2015, when it was recorded a slight increase in food prices, at the beginning of 2016, there was a slight decline in this component. The fall in oil price has also had an adverse effect on the Turkish inflation, but the depreciation of the Turkish Lira contributed the inflation rate in Turkey to amount to 8.5% in the first quarter of 2016. In Romania, food prices continued to decline significantly (down by 6.7% in March 2016) due to the reduction in the VAT rate. In Serbia, the rate of inflation in this period was 1.5% and is higher than other countries in the region because of the slight depreciation of the Serbian dinar. In Albania, the inflation rate was 0.7%, the lowest level in the past five years.

## **1.2. Domestic supply**

*The domestic economy continued growing in the fourth quarter of 2015, when GDP rose by 3.9% annually (quarterly growth of 1.1%). Analyzed by sectors, similar to the previous quarter, construction sector was the driving force in the fourth quarter, whose value added growth registered acceleration attributable to the intense activity in civil engineering, which is partly explained by public investments in several large infrastructure projects. Trade, transport and communication sector, catering sector, as well as the financial intermediation have made significant contribution to the growth. Higher added value is also typical for the industrial sector, but again, the contribution has been relatively modest.*

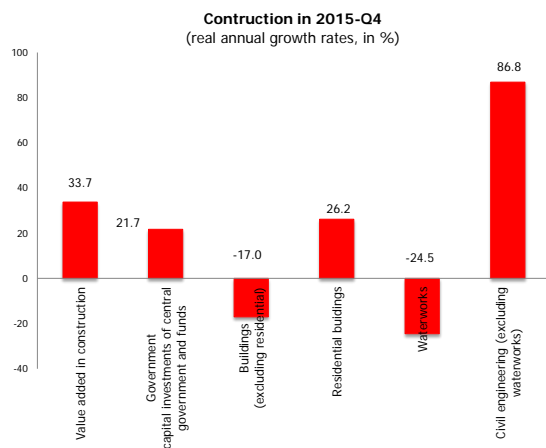
**In the fourth quarter of 2015, the GDP quarterly growth amounted to 1.1% (seasonally adjusted), while on annual basis, GDP rose by 3.9%, which is slightly faster compared to the previous quarter.** Construction, and trade, transport and communications, catering



services, as well as the financial intermediation<sup>6</sup> are generators of the annual growth, and higher added value was recorded by other services (excluding public administration and defense, and arts). In agriculture, despite the decline in activity in the previous quarter, during the fourth quarter, there were favorable developments.

	2013	2014	2015	Q1 2015	Q2 2015	Q3 2015	Q4 2015	2013	2014	2015	Q1 2015	Q2 2015	Q3 2015	Q4 2015
Agriculture	8.6	2.2	-0.7	0.6	1.0	-4.7	1.2	0.8	0.2	-0.1	0.0	0.1	-0.5	0.2
Industry	3.7	20.1	1.4	1.8	0.8	1.1	1.9	0.6	3.0	0.2	0.3	0.2	0.0	0.3
Manufacturing	9.6	28.0	-2.0	-9.4	-2.6	1.5	1.2	1.0	2.8	-0.2	-0.9	-0.2	0.0	0.2
Construction	12.8	1.8	16.8	5.4	2.8	29.4	33.7	0.7	0.1	1.1	0.3	0.2	1.7	2.0
Trade and transport	11.1	1.8	7.3	6.9	6.0	7.8	8.5	1.9	0.3	1.4	1.2	1.2	1.4	1.5
Information and communication	4.8	14.6	4.6	8.7	3.2	3.3	3.6	0.2	0.5	0.2	0.3	0.1	0.1	0.1
Financial and insurance activities	-1.4	11.3	11.8	8.3	12.2	11.7	14.9	0.0	0.3	0.4	0.2	0.4	0.3	0.5
Real estate activities	-1.3	2.8	1.9	1.1	2.8	1.9	1.9	-0.2	0.3	0.2	0.1	0.3	0.2	0.2
Professional, scientific and technical activities	9.6	9.9	12.7	8.6	12.1	15.9	14.3	0.3	0.3	0.4	0.3	0.4	0.5	0.5
Public administration	-7.5	2.1	-2.0	-0.4	-1.0	-3.1	-3.7	-1.1	0.3	-0.3	-0.1	-0.1	-0.4	-0.4
Other service activities	12.7	12.4	-8.7	4.8	-3.1	-13.6	-22.1	0.3	0.3	-0.2	0.1	-0.1	-0.3	-0.6
<b>Gross Domestic Product</b>	<b>2.9</b>	<b>3.5</b>	<b>3.7</b>	<b>3.8</b>	<b>3.4</b>	<b>3.6</b>	<b>3.9</b>							

Source: State Statistical Office and NBRM calculations.



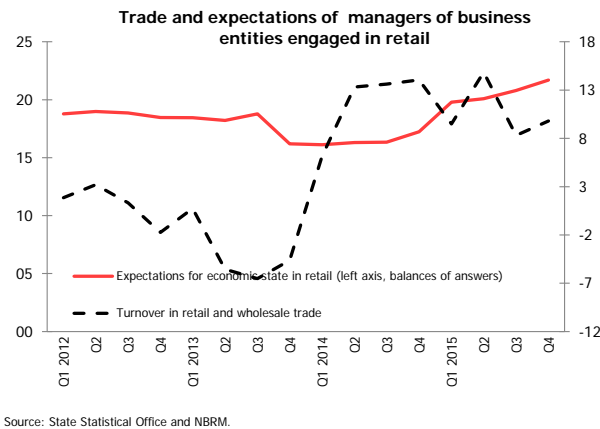
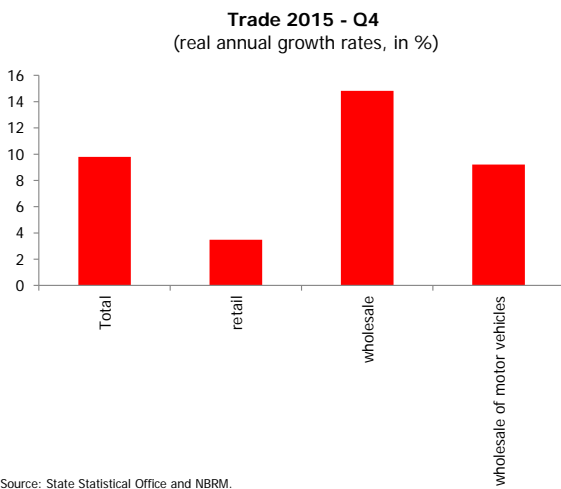
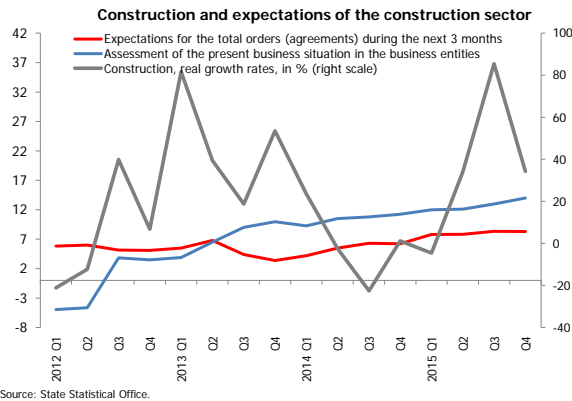
Source: State Statistical Office and Ministry of finance.

**Construction was the driving force of economic growth for two consecutive quarters, whereby, in the fourth quarter, an additional acceleration in the annual growth of added value was registered.** Solid growth was also registered on a quarterly basis, although more moderate compared to the previous quarter<sup>7</sup>. Favorable movements have been observed in all areas of the construction sector, with most of the growth being explained by the increased activity in the field of civil engineering given the realization of some phases of several larger public infrastructural projects. The results of the Business Tendency Survey in construction<sup>8</sup> also point to accelerated activity in this sector amid more favorable assessments of the current economic and financial situation in corporations (compared to the same period last year), and as limitation factors whose effect is significantly reduced, managers highlight the factors on the demand side and weather conditions. On the other hand, factors whose limiting impact increased in the fourth quarter are the lack of skilled labor and higher production costs (labor costs, materials and financial costs). **Favorable developments in this sector are expected to continue in the first quarter of 2016,** taking into account the continuation of double-digit growth in the value of completed construction works. Additionally, according to data from the survey conducted in the fourth quarter of 2015, company managers had more favorable expectations regarding the volume of orders for the next three-month period,

<sup>6</sup> Within the published GDP data, the three activities: trade, transport and communications, and hotels and restaurants are published aggregately, i.e. it is impossible to isolate the individual growth of each of them.

<sup>7</sup> Seasonally-adjusted.

<sup>8</sup> Refers to surveys conducted in the fourth quarter of 2015.



which also suggests continuation of growth of construction activity.

**The growth of activity in trade, which was typical for the first three quarters of the year continued in the last quarter<sup>9</sup>.** Analyzing data on the total trade turnover, the annual growth accelerated moderately in the fourth quarter. Most of the growth was again explained by the increased turnover in the field of wholesale trade, whose growth accelerated further in the fourth quarter. Retail trade has also registered moderate acceleration of growth. Favorable developments in this field are confirmed also by the results of the Survey of managers in retail trade<sup>10</sup> conducted in the fourth quarter. The results point to more favorable managers' assessments of the current business and financial situation of companies. In terms of the factors that influenced the activity in this sector, the managers emphasized the significant improvement in the field of demand, while as factors whose limiting effect was more pronounced in the fourth quarter, they indicated the shortage of sales area and increased labor costs (compared to the same period last year). **Favorable trends in trade are expected to continue in the first quarter of the year.** The data on the trade turnover in the period January-February 2016 indicate continuing growth in the total turnover, given the significant intensification of growth in the value of the turnover in retail trade. These developments are in line with the results of the Survey of managers in retail trade in the fourth quarter, where the managers expressed more favorable expectations for the number of employees and the business situation of companies for the next three to six months.

**Observing the trends in the transport and communication sector,** the indicators for the last quarter of the year gave different signals. The rail road traffic registered high growth (partly due to greater demand for this type of service because of the refugee crisis). Air traffic and passenger road traffic registered increased activity. On the other hand, freight traffic continued the downward trend in the volume of all types of freight traffic. **The small number of high frequency indicators hinders any precise assessment of the developments in the transport and communications sector in the first quarter,** although the currently available data

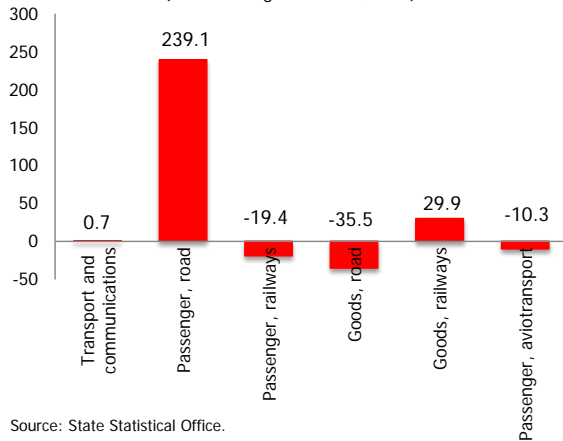
<sup>9</sup> The analysis of trends in trade is based on data on the trade turnover.

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

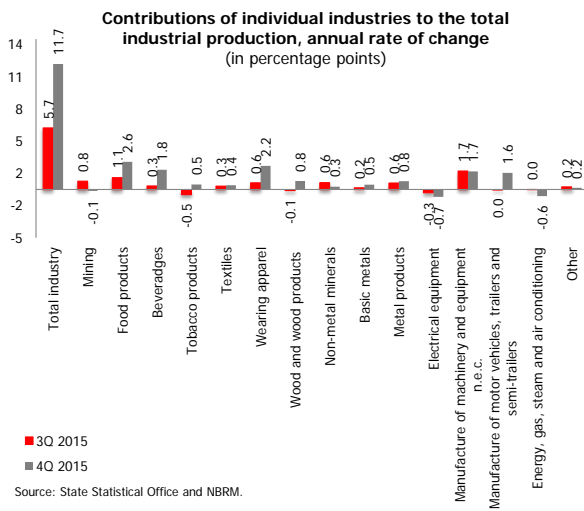


### Transports and communications in 2015 - Q4

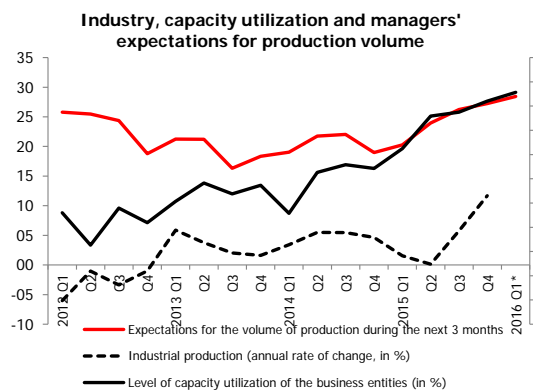
(real annual growth rates, in %)



Source: State Statistical Office.



Source: State Statistical Office and NBRM.



Source: State Statistical Office.  
\* average of expectations for January and February of 2016

suggest growth of this activity given the high annual growth of passenger rail traffic.

During the fourth quarter, there were favorable developments in the industrial sector, where moderate annual growth in the added value was registered. On the other hand, on a quarterly basis, following the high increase in the previous quarter, the added value in this sector in the fourth quarter of 2015 is lower. The main generator of the annual growth in industry is the manufacturing industry<sup>11</sup>. In terms of individual activities within the manufacturing industry, the production of machines and equipment and motor vehicles had a significant contribution to growth in the fourth quarter, i.e. activities where export facilities with foreign capital are present. Additionally, a high contribution to growth comes from traditional economic sectors such as food industry, beverages and clothing. The improved performance of manufacturing industry has also been confirmed by the results of the **Business Tendency Survey in the manufacturing industry**<sup>12</sup>, where managers assess the economic standing of their businesses as more favorable, amid better assessment of the output volume in the preceding three months and the higher average capacity utilization in the fourth quarter of the year. Observing the limiting factors, company managers assess that the financial problems and uncertain economic environment are factors whose limiting effect declined in the fourth quarter, while the lack of skilled labor and insufficient domestic demand are highlighted as factors with more pronounced negative impact (compared to the same period last year). Contrary to the favorable trends in manufacturing industry, there was fall in production in **mining and electricity, gas, steam and air conditioning** sectors.

The available data on the industrial sector for the period January - February 2016 suggest continuation of favorable trends during the first quarter. Namely, in the first two months of the first quarter, industrial output recorded an average annual increase of 11.7%, reaching high growth rates in the both months. The growth stems mainly from manufacturing, with a small production growth being observed in both mining and electricity production. The favorable trends in manufacturing industry are also supported by surveys conducted in January and February that indicate further increase of the capacity utilization level, as well as more optimistic perceptions regarding the output volume and the number of employees in the next three months.

<sup>11</sup> The analysis by activity is based on data on industrial production.

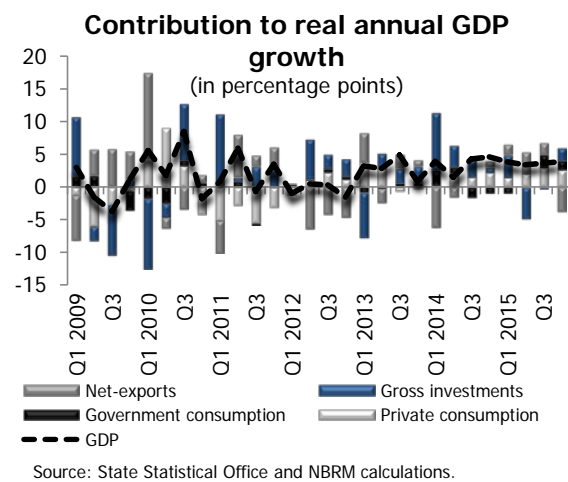
<sup>12</sup> Refers to surveys conducted during the fourth quarter of 2015.



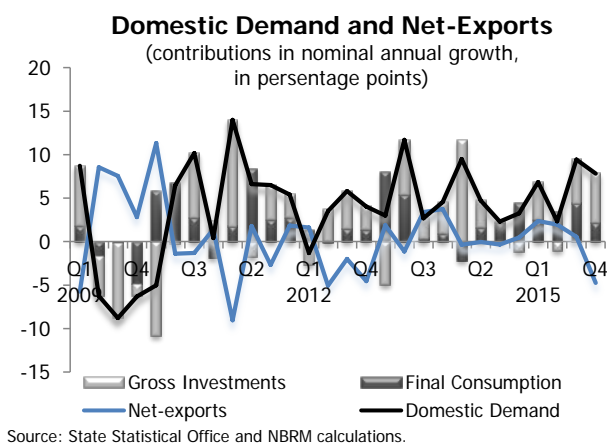


### 1.3. Aggregate demand

In the last quarter of 2015, the gross domestic product continued to grow at an annual rate of 3.9%, a slightly higher growth than that of the previous quarter. The solid growth in economic activity suggests so far limited impact of uncertainty associated with the domestic political developments and the global environment. The structure analysis shows that growth in the last quarter entirely stems from domestic demand, while net exports had a negative contribution, unlike the previous few quarters, when affected positively. In terms of individual components, household consumption is the component with the highest individual contribution to growth in the last quarter, underpinned by favorable labor market developments, lower consumer prices which positively reflected on the real disposable income and further credit support to households. The gross investments registered growth, which most probably reflects the implementation of public projects of strategic interest, and public consumption had a positive contribution to growth in the fourth quarter. Export demand continued to grow, but slower compared to the previous quarter, largely driven by export activity of the new facilities. The growth of domestic and export demand acted on imports, which continued to grow in the last quarter at a faster pace.



In the last quarter of 2015, the gross domestic product (GDP) grew by 1.1% compared to the previous quarter (seasonally adjusted) and by 3.9% compared to the same period last year, which is slightly faster growth compared to the previous quarter. The growth was due to domestic demand, and exports also made solid positive contribution. Household consumption, coupled by the favorable labor market trends and the lending to this segment, was the main generator of growth. Alongside with this, after falling in the previous quarter, gross capital formation in the fourth quarter has returned to the zone of positive annual growth, which most probably stems from the realization of public infrastructure projects, taking into account the high increase in the value of completed construction works. In the same period, growth was also registered in the field of public consumption. There was also growth of exports in the fourth quarter, but with more moderate intensity compared to the average recorded in the preceding two-year period, when this component was continually the main generator of growth. Such shifts on the domestic and export demand led to an increase in imports, whereby the contribution of net exports in the fourth quarter was negative.

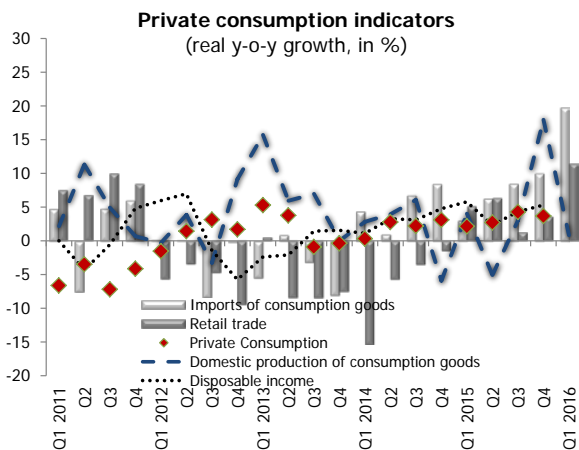




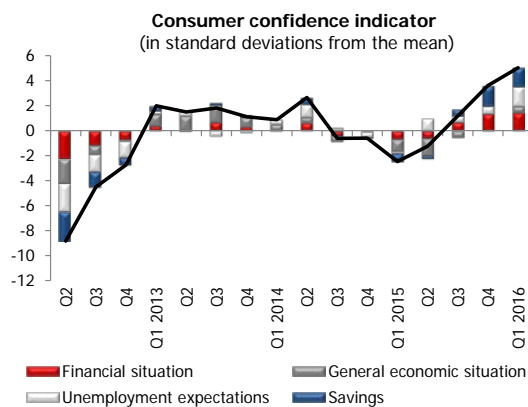
	Real annual growth rates (%)							Contributions to real annual growth (in p.p.)						
	2013	2014	2015	2015-Q1	2015-Q2	2015-Q3	2015-Q4	2013	2014	2015	2015-Q1	2015-Q2	2015-Q3	2015-Q4
Private consumption	1.9	2.1	3.2	2.1	2.7	4.3	3.6	1.4	1.5	2.2	1.5	2.0	2.9	2.5
Government consumption	0.5	1.0	4.6	-5.6	0.7	15.4	9.7	0.1	0.2	0.8	-1.1	0.1	2.3	1.6
Exports of goods and services	6.1	18.2	4.6	2.7	6.8	4.6	4.1	2.8	7.9	2.2	1.3	3.3	2.2	2.0
Imports of goods and services	2.2	16.0	2.4	-0.5	0.4	0.9	8.3	-1.4	-9.8	-1.6	0.2	-0.1	-0.8	-5.5
Gross capital formation	0.5	13.1	0.1	11.0	-14.9	-1.1	5.5	0.1	3.8	0.0	3.3	-4.6	-0.2	1.8
Domestic demand	1.3	4.7	2.5	3.4	-2.2	4.1	4.9	1.6	5.5	3.0	3.7	-2.5	4.9	5.9
Net exports*	-6.9	10.1	-3.9	-8.2	-14.9	-14.9	20.4	1.3	-1.9	0.6	1.5	3.1	1.5	-3.5
Statistical discrepancy											-1.4	2.7	-2.8	1.5
<b>GDP</b>	<b>2.9</b>	<b>3.5</b>	<b>3.7</b>	<b>3.8</b>	<b>3.4</b>	<b>3.6</b>	<b>3.9</b>	<b>2.9</b>	<b>3.5</b>	<b>3.7</b>	<b>3.8</b>	<b>3.4</b>	<b>3.6</b>	<b>3.9</b>

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

### 1.3.1. Private consumption



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



Source: European Commission and NBRM's calculations.

In the fourth quarter of 2015, household consumption registered a quarterly increase of 0.6% (seasonally adjusted) and real annual growth of 3.6%, which is slightly slower than the growth in the previous quarter. Moreover, as in the previous quarter, household consumption was the main generator of growth supported by favorable labor market developments, and additional support was provided by lower consumer prices, which most likely had a positive effect on the consumer sentiment of households. With the favorable movements of the disposable income components, the real growth of retail lending continued in the fourth quarter, mainly in the form of consumer loans.

Most of the latest high-frequency data pointed to continuing growth of private consumption in the first quarter of 2016<sup>13</sup>. This is suggested by the growth of real wages and pensions, as components of disposable income and the stable growth of household lending, which according to the Bank Lending Survey<sup>14</sup>, corresponds to the banks' assessments to moderately ease the overall credit conditions to households and a small increase in demand for loans in this period. As for the remaining high-frequency data on private consumption, additional positive signals also come from the retail trade, as well as from the imports of consumer goods. The signals from the surveys of consumer confidence<sup>15</sup>, conducted in the first quarter, indicating favorable expectations in terms of the unemployment and the financial situation of consumers, were in the same direction with short-term indicators.

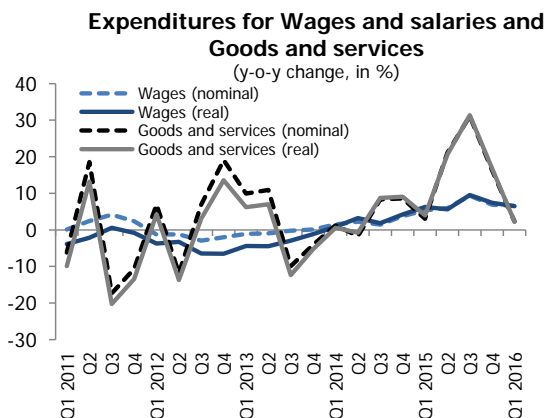
<sup>13</sup> The analysis of net private transfers was made using January data. Other factors have been analyzed as of February.

<sup>14</sup> NBRM's Lending Survey, April 2016.

<sup>15</sup> European Commission's Consumer Survey as of February 2016.



### 1.3.2. Public consumption

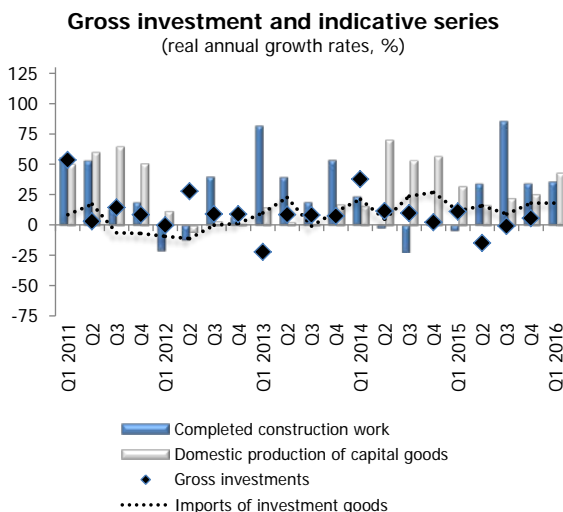


Source: Ministry of Finance and NBRM calculations.  
The calculations include expenditures of Consolidated Budget of Central Government and Funds, deflated by CPI.

In the last quarter of 2015, public consumption recorded a quarterly growth of 1.0% (seasonally adjusted) and relatively high real annual growth of 9.7%. However, the real annual growth dynamics was slower compared to the exceptionally high growth of the previous quarter. Real annual growth mainly stems from the high increase in expenditures for goods and services and the higher expenditures for wages.

Data for January-February 2016 indicate an annual increase of public spending in the first quarter, given the increased expenditures for wages of public sector employees, health care transfers<sup>16</sup>, as well as increase in expenditures for goods and services.

### 1.3.3. Investment consumption



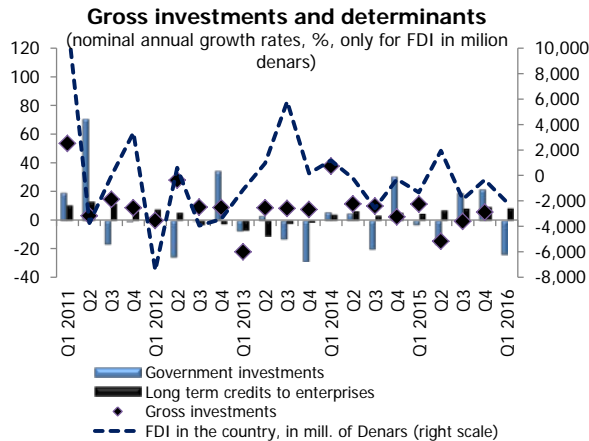
Source: State Statistical Office, Ministry of Finance and NBRM calculations.

In the last quarter of 2015, the gross capital formation registered a quarterly growth of 9.3% (seasonally adjusted) and an annual growth of 5.5%, following the minimal decline in the previous quarter. The increased investment activity in this period is in line with the positive developments of the two most important indicative categories of investment in fixed assets - completed construction works, as well as imports of machinery and equipment. The rise in construction activity is a result of growth in the field of civil engineering, which is mainly associated with investments in road infrastructure. Import of capital goods, which is an indicator of investment in machinery and equipment continued to grow in the fourth quarter at an accelerated pace. Most other short-term investment indicators also experienced positive shifts. In the last quarter of 2015, faster increase has been registered in the domestic production of capital goods, corporate loans of banks, as well as government expenditures for capital investments.

Most of the signals coming from the available high-frequency data point to continuing growth<sup>17</sup> of gross capital formation in the first quarter of 2016. The support of the construction sector to overall investment demand is expected to continue in the next period, considering the optimistic expectations of construction sector

<sup>16</sup> Most of these assets relate to expenditures on goods and services.

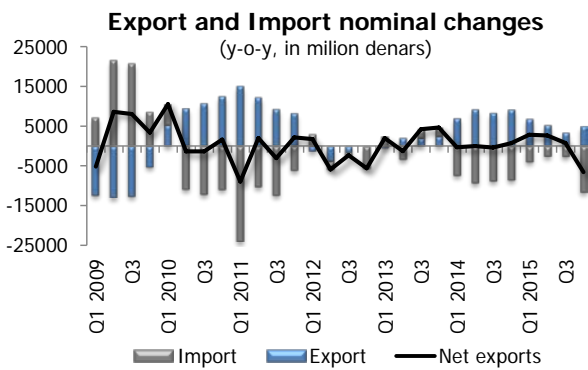
<sup>17</sup> Data on completed construction works and foreign direct investments have been analyzed as of January, while for the other indicative categories, the cut off date is February.



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

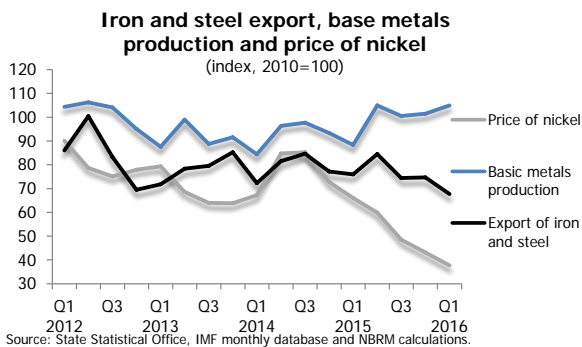
managers in terms of total orders, selling prices and number of employees<sup>18</sup>. In January 2016, the realized high growth of completed construction works was in this direction. Growth is expected in investment in fixed assets of the corporate sector, which is suggested by the increased capacity utilization in the manufacturing industry, coupled with solid long-term corporate lending by banks, as a result of the banks' assessments for a further easing of the overall credit conditions for granting corporate loans, amid unchanged credit demand in this period<sup>19</sup>. Also, in January-February 2016, favorable movements were observed in the import of investment goods and in the domestic production of capital goods.

### 1.3.4. Net external demand



Source: State Statistical Office.

**Developments in the external sector during the last quarter varied compared to the shifts that characterized the previous quarters.** Namely, amid slower growth of exports than imports, the deficit in foreign trade increased, so that net exports in the last quarter of 2015 made a negative contribution to GDP growth, as opposed to the previous four quarters, when the effect was positive. **Real exports of goods and services** recorded an annual growth of 4.1% (a slight deceleration of the annual growth pace) and a quarterly increase (quarterly growth of 4.8%, seasonally adjusted). The annual growth is mainly a result of the increased exports of new production facilities. On the other hand, unfavorable conditions in the metal market had a negative impact on the export activity of the metal industry. **Import of goods and services** in real terms increased in the fourth quarter by 8.3% annually, which is a significant acceleration compared to the dynamics observed in the previous quarter. Also, imports registered a quarterly increase of 9.1% (seasonally adjusted).



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

**The widening of the trade deficit is expected to continue in the first quarter of 2016.** The nominal data on foreign trade for January-February 2016 indicate a widening of the deficit in the first quarter of 2016. The increased trade deficit is a result of higher imports than exports of goods.

## 1.4. Employment and wages

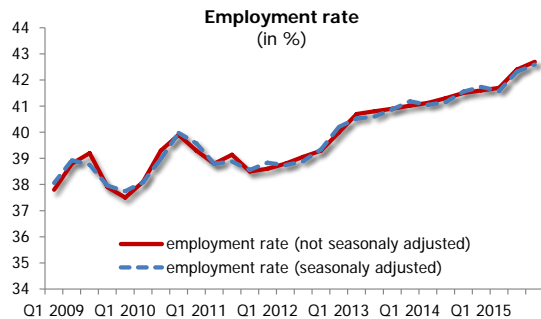
*The positive trends in key indicators in the labor market continued in the last quarter of 2015, a tendency present for a long period continuously. The number of employees increased by 2.8%, which is the second highest annual growth rate since 2014. Additionally,*

<sup>18</sup> Refers to surveys conducted in the fourth quarter of 2015.

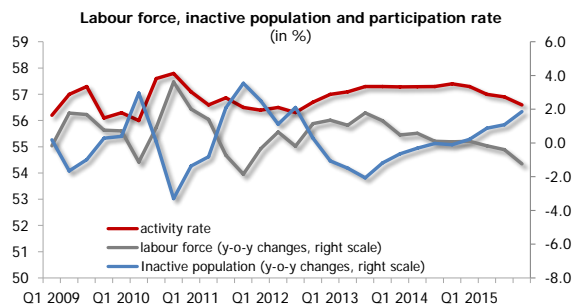
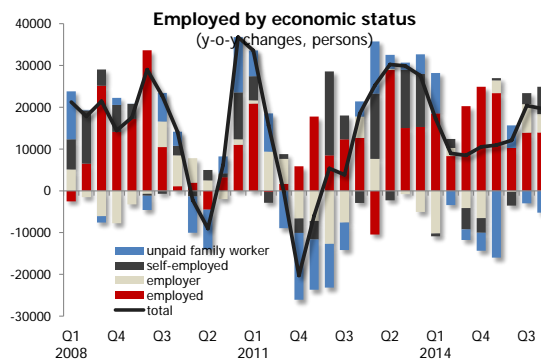
<sup>19</sup> NBRM's Bank Lending Survey, April 2016.



*a significant downward adjustment was observed in the unemployment rate. Competitiveness indicators registered an annual improvement in the fourth quarter. Thus, labor productivity continued to increase, with simultaneous downward adjustment of labor costs. The aggregated signals from business tendency surveys point to stronger optimism about employment for the next three months.*



Source: State Statistical Office, Labour Force Survey.



Source: State Statistical Office, Labor Force Survey.

In the fourth quarter, the number of employees increased by 2.8% on an annual basis, which is the second strongest growth since 2014. Employment recorded a quarterly growth (of 0.6%<sup>20</sup>), which is a certain slowdown compared to the pace in the previous quarter. The annual growth in the number of employees is fully associated with the services sector. Analyzed by sectors of activity, most of the growth reflects trends in the "trade", followed by the other community, social and personal services, as well as shifts in broadly defined public administration<sup>21</sup>. In terms of the economic status<sup>22</sup>, the growth mostly results from the category of employed persons. These developments have increased the employment rate by 1.2 percentage points annually, to 42.7%. The results of the Job Vacancy Survey confirm the positive developments in the employment<sup>23</sup>. Namely, the number of vacancies, as an additional indicator of the movement of labor demand registered an annual growth of 14% in the last quarter. Growth was registered also in the rate of vacancies<sup>24</sup>, positioning itself at 1.50%. The mining, accommodation and food services, as well as health and social care services stand out according to the intensity of the annual growth of the rate of vacancies.

In terms of employment prospects in the short run, the cumulative signals from the business tendency surveys<sup>25</sup> indicate stronger optimism among company managers.

In the fourth quarter, labor supply decreased by 1.2%, which is an increase of the negative annual pace from the previous two

<sup>20</sup> The analysis of quarterly dynamics of employment, unemployment and total active population was made using seasonally adjusted data.

<sup>21</sup> More precisely, public administration, defense and compulsory social insurance; education, as well as health and social work.

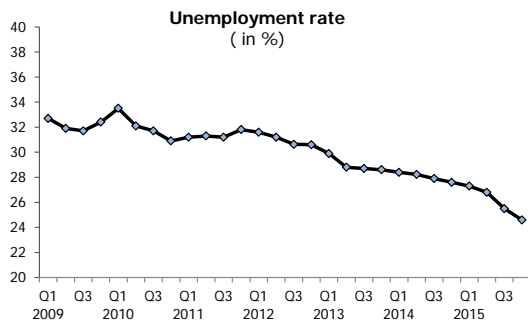
<sup>22</sup> The classification by economic status applies to the following groups: **employers** - persons who operate their own business entity or engages independently in their own shop, or farm owners who hire other employees; **employees** - persons who work in government institutions, business 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).

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

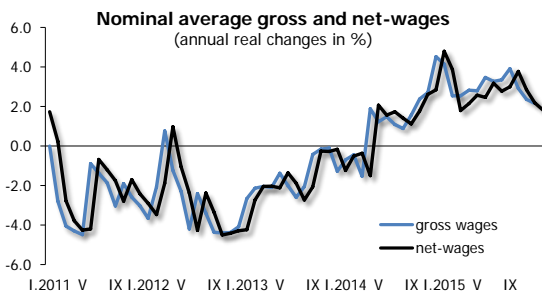
<sup>24</sup> The rate of vacancies is defined as the ratio between the number of job vacancies and the total number of jobs, i.e. both vacant and occupied jobs.

<sup>25</sup> Source: State Statistical Office, business tendency surveys in manufacturing industry (December 2015), construction (fourth quarter of 2015) and trade (fourth quarter of 2015).

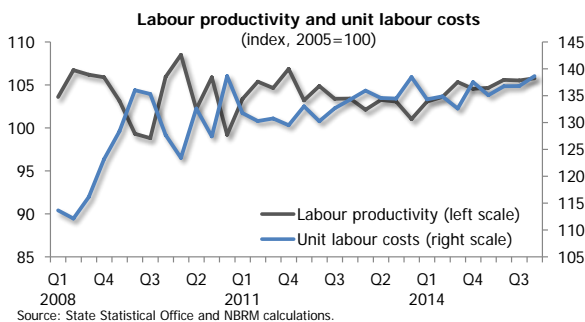




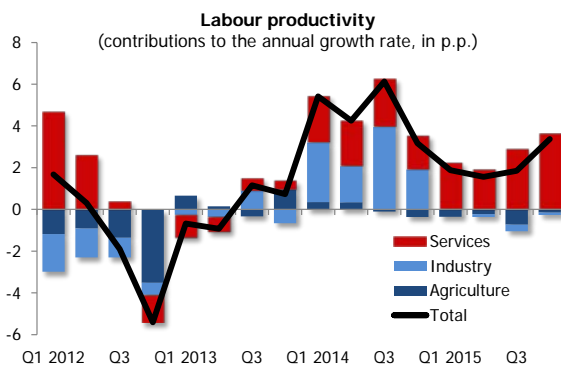
Source: State Statistical Office, Labor Force Survey.



Source: State Statistical Office.



Source: State Statistical Office and NBRM calculations.



Source: State Statistical Office and NBRM calculations

quarters. The decline of the number of economically active population, amid faster growth of the number of inactive job-seekers led to a downward adjustment of the activity rate from 57.4% in the same period of 2014 to 56.6%, which is a record low in the last three years.

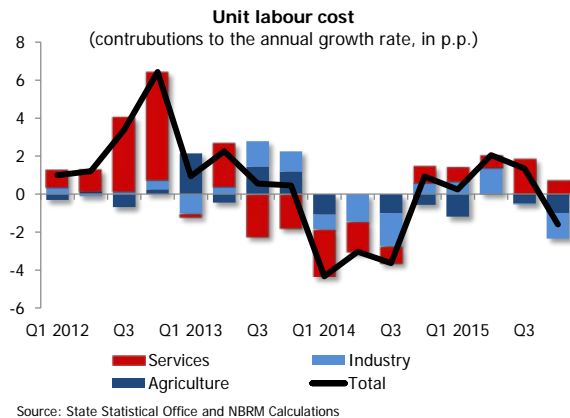
**In the fourth quarter, the considerably strengthened demand amid reduced labor supply resulted in accelerated pace of decline in unemployment.** Namely, the number of unemployed in the last quarter decreased by 11.9% on an annual basis, whereby the unemployment rate registered a decline of 3 percentage points, reducing to a record low (24.6%).

**The average wages paid in the fourth quarter have increased annually, but at a slower pace compared to the previous quarter.** In the last quarter, the nominal net and gross wages increased by 1.8% and 2%, respectively. The upward adjustment of wages was registered in all three major sectors. Regarding the individual sub-sectors of activity, most remarkable according to the intensity of the positive change are the segments of arts, entertainment and recreation, followed by administrative and support services, and other services. After the stagnation recorded in the previous quarter, the nominal net and gross wages increased on a quarterly basis. **In the last quarter, given the further reduction in the general price level, the real net and gross wages registered an annual growth of 2.3% and 2.5%, respectively, which is a slight deceleration of the pace compared to that of the previous quarter, which is fully associated with the slowdown in nominal wages.** Also, the nominal wage growth, given the further reduction in the general price level, resulted in a quarterly increase in real net and gross wages of 1.9% and 1.8%, respectively.

**Labor productivity in the fourth quarter registered an annual growth of 3.4%<sup>26</sup>, which is an acceleration of growth compared to the same in the previous quarter.** Moreover, with such performance, this indicator has been in the zone of positive changes for ten consecutive quarters. Productivity has increased as a result of the faster annual growth of economic activity compared to the employment growth. Observed by sector, the annual

<sup>26</sup> Total productivity is calculated as the ratio between the sum of added values of individual sectors included in the calculation and the number of employees in these sectors. The total GDP in the fourth quarter of 2015 recorded an annual growth of 3.9%, while the sum of added values of individual sectors increased by 6.1%. Employment has increased by 2.8%, and hence productivity has increased by 3.4%.

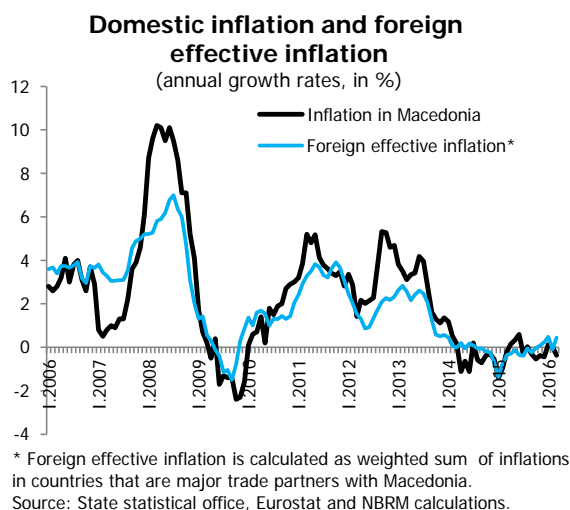




productivity growth is fully associated with the services sector. Productivity grew also on a quarterly basis, amid faster growth of the economic activity compared to the employment growth. **Unit labor costs, for the first time after four quarters of growth or stagnation, decreased by 1.6% on an annual basis.** The downward adjustment results from the faster growth of productivity compared to the growth of gross wages. The annual fall in unit labor costs is solely driven by the developments in industry and agriculture. After the stagnation in the previous quarter, labor costs registered a quarterly increase amid more intense growth of gross wages compared to productivity growth.

## 1.5. Inflation

*In the first quarter of 2016, the global environment was generally marked by low prices of primary commodities. World prices of energy and food continued to decline, affecting domestic consumer prices of these categories. As a result, these price components also declined in the first quarter, maintaining the headline inflation in the negative zone for the third consecutive quarter. In the first quarter of 2016, annual prices declined by 0.1%, on average. Despite these developments in the energy component and food, core inflation continued increasing. As for producer prices in the domestic market, in the first two months of the quarter, they continued to decline, mainly due to the low prices of imported raw materials, although at significantly slower rate. In terms of future expectations, the Inflation Expectations Survey conducted in March indicates unchanged inflation expectations relative to the previous quarter. Dynamically speaking, same as in the previous quarter, the respondents expect moderate acceleration of inflation in 2016 and 2017.*



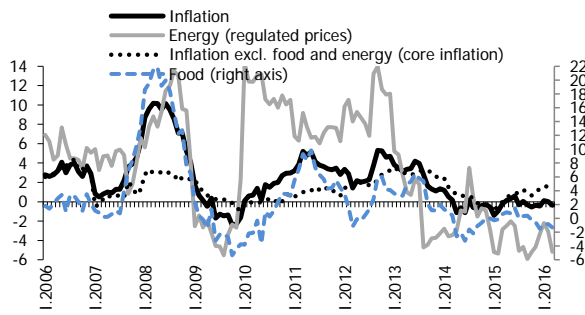
**Domestic consumer prices continued to decrease in the first quarter of 2016, when prices reduced by 0.1%, annually.** Analyzed by components, the decline in prices in the first quarter was mostly driven by the energy component, primarily due to the lower prices of liquid fuels and lubricants, in line with the falling oil prices on world markets, as well as falling food prices, mainly reflecting lower prices of vegetables. On the other hand, core inflation increased in the first quarter, amid higher prices of several categories within the index, with the largest contribution made by the higher tobacco prices<sup>27</sup> and prices of home maintenance products.

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



### Inflation and volatility of food and energy

(annual growth rates, in %)



Source: State statistical office and NBRM calculations.

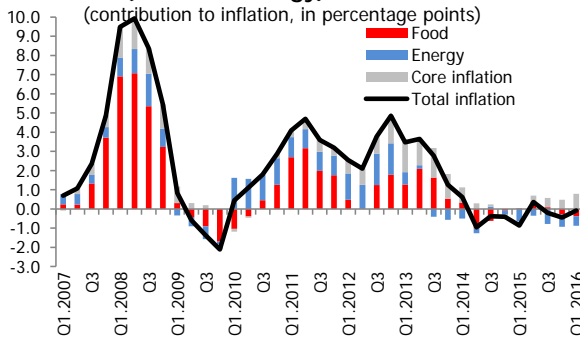
Unlike domestic inflation, **foreign effective inflation<sup>28</sup> followed an upward trajectory, and reached 0.3% in the first quarter compared to 0.1% in the previous quarter.**

	annual changes (in %)						contributions to GDP growth (in p.p.)							
	2014	2015			2016		2014	2015			2016			
		Q1	Q2	Q3	Q4	Q1	Q1	Q2	Q3	Q4	Q1	Q2		
<b>Consumer price index - all items</b>	<b>-0.3</b>	<b>-0.9</b>	<b>0.3</b>	<b>-0.2</b>	<b>-0.4</b>	<b>-0.3</b>	<b>-0.1</b>	<b>-0.3</b>	<b>-0.9</b>	<b>0.3</b>	<b>-0.2</b>	<b>-0.4</b>	<b>-0.3</b>	
Food	-0.9	0.1	1.0	0.6	-0.7	0.2	-1.0	-0.3	0.0	0.4	0.2	-0.3	0.1	
Energy	-1.4	-4.9	-2.7	-4.9	-3.9	-4.1	-3.5	-0.2	-0.7	-0.4	-0.7	-0.6	-0.6	
Electricity	0.4	3.6	3.6	-0.3	-0.4	1.6	-0.4	0.0	0.3	0.3	0.0	0.0	0.1	
Heat energy	-8.7	-11.0	-11.0	-4.0	-0.2	-6.8	-18.3	-0.1	-0.1	-0.1	0.0	0.0	-0.1	
Fuels and lubricants	-3.9	-20.1	-13.3	-17.2	-15.3	-16.5	-10.2	-0.2	-0.9	-0.6	-0.8	-0.6	-0.7	
Food and energy (volatile prices)	-1.1	-1.3	0.0	-1.0	-1.6	-1.0	-1.7	-0.6	-0.7	0.0	-0.5	-0.8	-0.5	
Core inflation (inflation excl. food and energy)	0.6	-0.4	0.7	0.7	1.0	0.5	1.7	0.3	-0.2	0.3	0.4	0.5	0.2	

Source: State Statistical Office and NBRM calculations.

### Volatile (food and energy) and core inflation

(contribution to inflation, in percentage points)

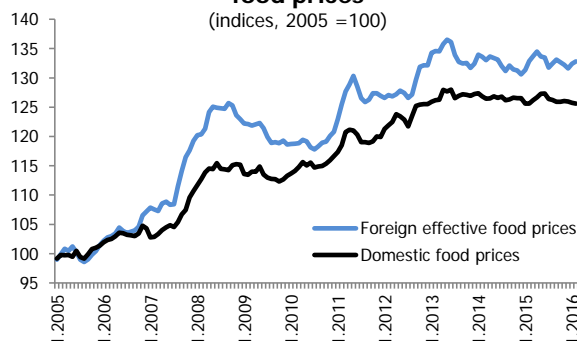


Source: State statistical office and NBRM calculations.

**Analyzed dynamically, the annual decline in consumer prices slowed down in the first quarter of the year, compared to the previous quarter, which for the most part reflects the rapid growth of core inflation, with certain influence of the slower decline in prices of energy component. Food prices, whose decline in the first quarter increased, acted in the opposite direction. In the first quarter, core inflation equaled 1.7% on annual basis (compared to 1% in the fourth quarter), and the shift mainly reflects the accelerated growth of prices of footwear, transport equipment, home maintenance products, as well as the slower decline in communication prices.**

### Foreign effective food prices\* and domestic food prices

(indices, 2005 = 100)



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

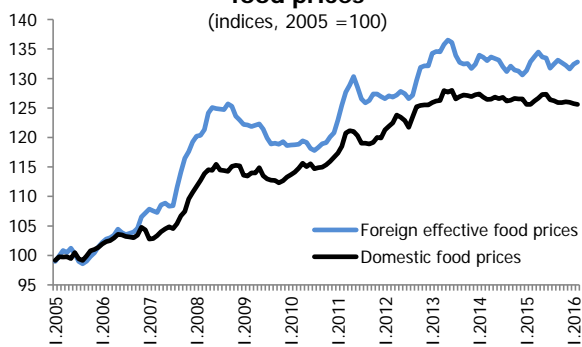
**On a quarterly basis, in the first quarter of 2016, consumer prices were lower by 0.2% (seasonally adjusted rate of 0%), fully reflecting the lower energy prices, with a small increase in commodity prices within the core inflation and unchanged food prices.**

**In the first quarter of 2016, the change in producer prices in the domestic market remained in the negative zone for the tenth consecutive quarter. However, in the first two months of the first quarter, the annual decline in producer prices significantly slowed down to 0.5% (versus 3.2% in the previous quarter). The lower production costs in the manufacturing industry made**

<sup>28</sup> The calculation of foreign effective inflation derives from the weighted sum of consumer price indices of the countries that are major partners of the Republic of Macedonia in the field of import of consumer goods. The weight structure is based on the normalized shares of nominal imports 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.

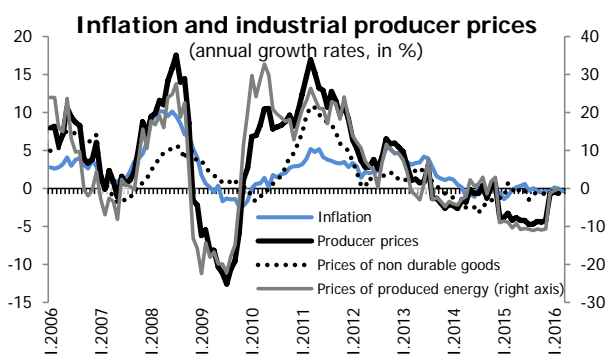


### Foreign effective food prices\* and domestic food prices



\* 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.

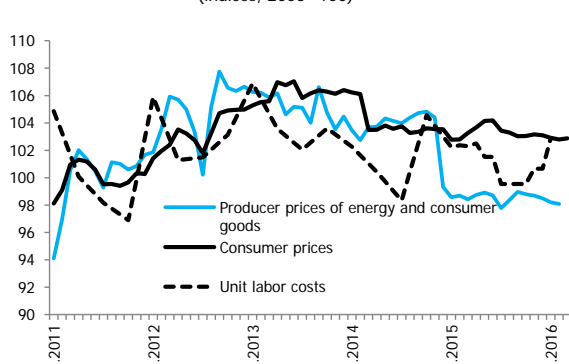
the largest contribution to the annual decline, with fall also being registered in producer prices of mining and electricity supply. **Producer prices registered a small quarterly decrease of 0.5%** (seasonally adjusted rate of 0.3%). **The movement of producer prices that affect the domestic component of inflation<sup>29</sup> suggests further downward pressure on inflation**, however, with significant slowdown of the decline in the first two months of the first quarter (annual fall of 0.5%, vis-a-vis the decline of 4.1% in the previous quarter). These prices slightly increased (by 0.6%), on a quarterly basis<sup>30</sup>. Keeping these prices in the negative zone on an annual basis indicates absence of inflationary pressures in the coming period.



Source: State statistical office and NBRM calculations.

**In the fourth quarter of 2015, unit labor costs decreased by 1.6%, annually.** Moreover, the estimates for the output gap still do not point to significant pressures from the demand side<sup>31</sup>, and for the time being, no inflationary pressures on prices of final products through this channel have been expected.

### Factors affecting consumer prices



Source: State statistical office and NBRM calculations.

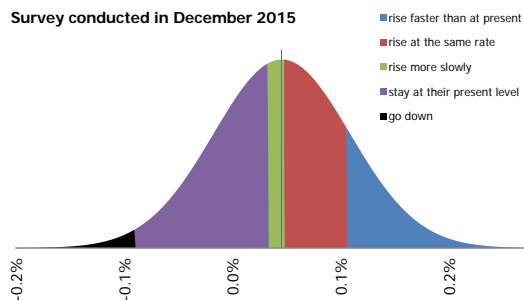
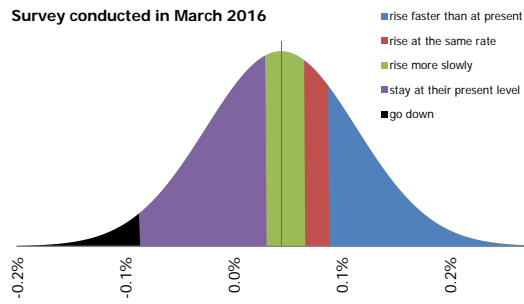
<sup>29</sup> Consumer goods (durable and non-durable) and energy.

<sup>30</sup> The quarterly change has been calculated using seasonally adjusted data.

<sup>31</sup> The NBRM estimates show that at the beginning of 2016, the output gap ranged around zero.

**Box 2: Inflation Expectations Survey<sup>32</sup>**

**Inflation Expectations Survey** includes three groups of respondents: economic analysts, companies, and financial institutions. The questionnaire contains two questions to measure inflation expectations, one qualitative and one quantitative in nature. For the first question on inflation expectations, the respondents indicate the direction and extent of price changes compared with the change in the previous 12 months<sup>33</sup>. Carlson and Parkin (1975) probability approach has been used for quantification of qualitative answers, which assumes that amid a sufficiently large number of



respondents, the expected change in prices is normally distributed among the population. The second question requires from the respondent to quantify precisely the expected average rate of change of prices in the next two years<sup>34</sup>. 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 2016<sup>35</sup>. Same as in the previous survey cycle, **the average inflation rate for the previous 12-month period<sup>36</sup> remained in the negative zone<sup>37</sup>. The results of the survey indicate unchanged inflation expectations relative to the previous survey**, i.e. as in December, respondents expect inflation to be around 0% in the next 12 months.

Expectations for the inflation rate of around 0% are common for all three groups of respondents (economic analysts, companies, and financial institutions).

**In terms of the quantitative question on the expected rate of inflation for 2016 and 2017, the respondents' inflation expectations remained unchanged compared to the previous survey.**

<sup>32</sup> 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.

<sup>33</sup> 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"

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

<sup>35</sup> The percentage of responsiveness to the Survey conducted in December was 24.9%, which compared to the previous quarter, represents a decrease of responsiveness. Analyzed by groups of respondents, the financial institutions' responsiveness is 33.3%, followed by economic analysts with 30.9% and companies with 19.4%.

<sup>36</sup> Refers to the period March 2015 to February 2016.

<sup>37</sup> In circumstances of a negative price growth, the interpretation of the results of the survey can be blurred, and therefore, it is necessary to change the method of calculation of the indicator for inflation expectations. Thus, in the procedure for quantification, the negative rate is replaced with the last positive growth rate. This is the way to avoid the contradictory responses from the survey that assume a positive price growth. Taking into account that changes in the method are of a purely technical nature, the quantification of qualitative answers for the expected rate of inflation in periods of negative inflation should be taken with caution, while the indicator for inflation expectations as approximate.



## 1.6. Balance of Payments<sup>38</sup>

After the surplus in the third quarter, the current account balance in the last quarter of 2015 recorded a deficit, which is less favorable compared to the same period last year. This shift was driven by all current account components. Cumulatively, for the entire 2015, the current account recorded a deficit of 1.4% of GDP, or expansion of 0.6 percentage points of GDP compared to the previous year. The annual change in the current account is the result of the secondary and primary income balance, while the balance of goods and services improved. In the fourth quarter, the financial account registered net inflows, mostly in the form of trade credits, net borrowing of the public sector and direct investment, while currency and deposits acted in the reverse direction. However, cumulatively, in 2015, the financial account was marked by net outflows, driven by the performance in currency and deposits, as well as the deleveraging based on long-term financial loans. In the course of 2015, foreign investments were the source of financial flows in the economy. Given these developments in the balance of payments, the fourth quarter witnessed higher accumulation of foreign reserves, while for the whole of 2015, their level decreased. All foreign reserves adequacy indicators were kept within comfortable zone.

	2014					2015					2014					2015				
	Q1	Q2	Q3	Q4	I-XII	Q1	Q2	Q3	Q4	I-XII	Q1	Q2	Q3	Q4	I-XII	Q1	Q2	Q3	Q4	I-XII
	во милиони евра										% од БДП									
<b>I. Current account</b>	-111	-89	127	4	-69	-46	-82	131	-130	-127	-1.3	-1.0	1.5	0.0	-0.8	-0.5	-0.9	1.4	-1.4	-1.4
<b>Goods and services</b>	-367	-441	-297	-393	-1,497	-318	-388	-279	-499	-1,483	-4.3	-5.2	-3.5	-4.6	-17.6	-3.5	-4.3	-3.1	-5.5	-16.3
Credit	871	999	1,101	1,086	4,057	988	1,095	1,160	1,168	4,411	10.2	11.7	12.9	12.7	47.6	10.9	12.0	12.8	12.8	48.5
Debit	1,238	1,440	1,398	1,479	5,554	1,306	1,482	1,439	1,667	5,894	14.5	16.9	16.4	17.3	65.1	14.4	16.3	15.8	18.3	64.8
Goods	-471	-448	-453	-483	-1,855	-426	-440	-419	-540	-1,825	-5.5	-5.2	-5.3	-5.7	-21.8	-4.7	-4.8	-4.6	-5.9	-20.1
Services	105	7	156	91	358	108	53	140	42	342	1.2	0.1	1.8	1.1	4.2	1.2	0.6	1.5	0.5	3.8
<b>Primary income</b>	-40	-40	-44	-38	-161	-54	-57	-53	-58	-222	-0.5	-0.5	-0.5	-0.4	-1.9	-0.6	-0.6	-0.6	-0.6	-2.4
<b>Secondary income</b>	295	391	468	434	1,589	325	362	463	427	1,577	3.5	4.6	5.5	5.1	18.6	3.6	4.0	5.1	4.7	17.3
<b>II. Capital account</b>	1	0	-2	4	3	2	1	2	1	6	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.1
Net lending (+) / net borrowing (-) (balance from current and capital account)	-110	-89	126	8	-65	-45	-81	133	-129	-122	-1.3	-1.0	1.5	0.1	-0.8	-0.5	-0.9	1.5	-1.4	-1.3
<b>III. Financial account</b>	-43	-7	-413	22	-441	146	-20	177	-213	89	-0.5	-0.1	-4.8	0.3	-5.2	1.6	-0.2	1.9	-2.3	1.0
Direct investment	-90	-15	-36	-57	-197	-68	-47	-5	-51	-171	-1.1	-0.2	-0.4	-0.7	-2.3	-0.7	-0.5	-0.1	-0.6	-1.9
Portfolio investment	0	8	-496	6	-482	-12	9	30	-94	-67	0.0	0.1	-5.8	0.1	-5.7	-0.1	0.1	0.3	-1.0	-0.7
Currency and deposits	44	55	114	129	342	65	71	88	64	289	0.5	0.6	1.3	1.5	4.0	0.7	0.8	1.0	0.7	3.2
Loans	-13	-58	4	1	-67	134	-6	-42	-30	57	-0.2	-0.7	0.1	0.0	-0.8	1.5	-0.1	-0.5	-0.3	0.6
Trade credit and advances	16	3	1	-57	-37	26	-48	107	-103	-19	0.2	0.0	0.0	-0.7	-0.4	0.3	-0.5	1.2	-1.1	-0.2
Other accounts receivable/payable	0	0	0	0	0	0	0	0	0	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Special drawing rights (Net incurrence of liabilities)	0	0	0	0	0	0	0	0	0	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>IV. Net errors and omissions</b>	9	12	11	2	33	24	-1	12	-7	28	0.1	0.1	0.1	0.0	0.4	0.3	0.0	0.1	-0.1	0.3
<b>V. Reserve assets</b>	-59	-70	549	-12	409	-167	-62	-32	77	-183	-0.7	-0.8	6.4	-0.1	4.8	-1.8	-0.7	-0.4	0.9	-2.0

Source: NBRM.

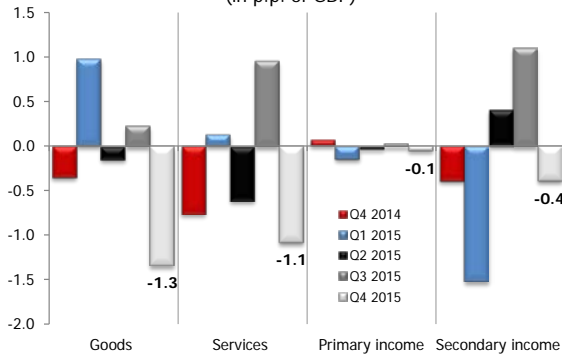
### 1.6.1. Current account

The current account of the balance of payments in the last quarter of 2015 recorded a deficit of Euro 129.6 million, or 1.4% of GDP. Compared to the previous quarter, the current account balance has deteriorated by 2.9 percentage points of GDP. Adverse changes in the

<sup>38</sup> 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 information on the methodological changes, visit the NBRM website at [http://nbrm.mk/WBStorage/Files/Statistika/Informacija\\_za\\_promenite\\_vo\\_platniot\\_bilans\\_megunarodnata\\_investiciska\\_pozicija\\_i\\_nadvoresniot\\_dolg\\_koisto\\_proizleguvaat\\_od\\_primenata\\_na\\_novite\\_megunarodni\\_statisticki\\_standardi.pdf](http://nbrm.mk/WBStorage/Files/Statistika/Informacija_za_promenite_vo_platniot_bilans_megunarodnata_investiciska_pozicija_i_nadvoresniot_dolg_koisto_proizleguvaat_od_primenata_na_novite_megunarodni_statisticki_standardi.pdf).

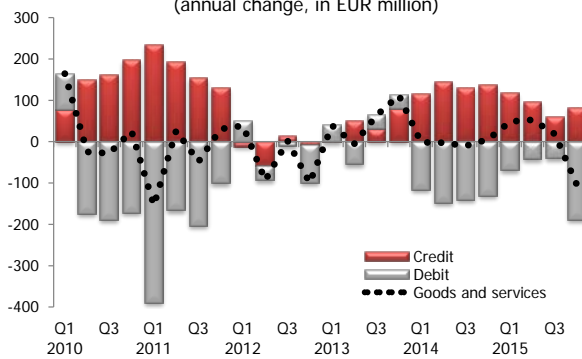


**Contribution of current account components in its quarterly change**  
(in p.p. of GDP)



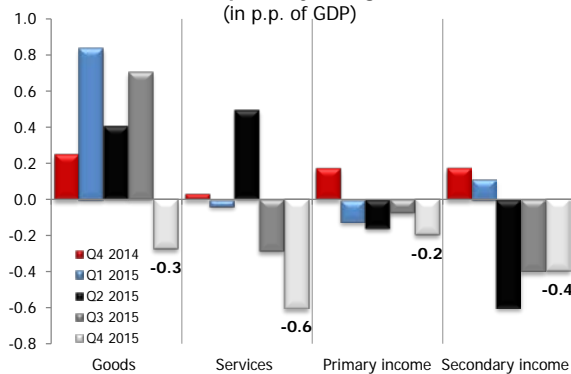
Source: NBRM.

**Balance of goods and services**  
(annual change, in EUR million)



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

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



Source: NBRM.

balance of trade in goods and services, coupled with the seasonally lower inflows in secondary income, are the main generators of the quarterly change. The intensification of import pressures in the fourth quarter, amid small positive change in exports, widened the trade deficit by 1.4 percentage points of GDP. In addition, the surplus in services has significantly narrowed (by 1.1 percentage points of GDP), dispersed between the individual categories. The quarterly changes in the secondary income have been driven by lower net inflows from private transfers, i.e. lower purchase of foreign cash on the foreign exchange market. On the other hand, net inflows in the government sector have increased due to the transfers from the IPA funds. Unfavorable quarterly shifts have been observed in the primary income, but with moderate intensity.

**Analyzed on annual basis, changes in the current account indicate deterioration of 1.5 percentage points of GDP.** The deficit in current transactions, despite the small surplus in the last quarter of 2014, was mostly due to the unfavorable changes in the balance of goods and services, although there have been deterioration in other categories. The decrease in the surplus in services, as a driving factor of annual growth, was mostly due to the higher import of construction services from overseas, amid continuous favorable developments in transport services. At the same time, the increase of trade deficit in goods was driven by the import component, whose growth was predominantly generated by the import of raw materials for intermediate products, amid continuous reduction in energy imports. Exports have registered an annual growth, although less intensive, driven by effective export performance of the new facilities in the economy. The sector-by-sector analysis of the change in secondary income suggests more pronounced negative contribution of the government sector, i.e. lower net inflows from official transfers due to the lower inflows from the EU pre-accession funds. On the other hand, the annual change in other sectors of the economy is negligible. The primary income deficit has slightly increased, driven by the investment income balance.

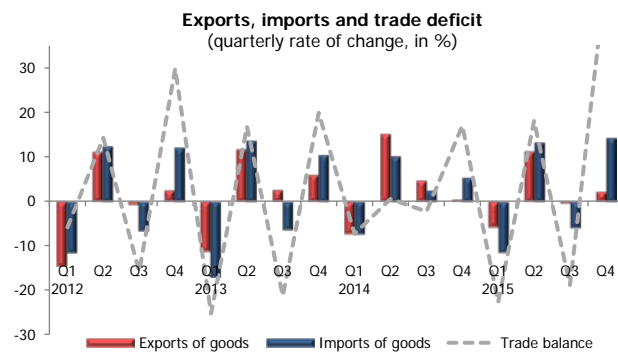
**The recent balance of payments data show that in January 2016, the current account recorded a surplus of Euro 24.9 million.** Compared to the same period last year, the surplus has slightly decreased, driven by lower net inflows in secondary income and deteriorating performance in services. The annual change in secondary income was determined by the lower amount of purchased foreign cash on the foreign exchange market, while the surplus in services has declined mostly due to





production services for customization and construction services. On the other hand, the improvement of sub-balance of goods, driven by the reduction in the import component, mitigated any adverse trends in other categories, annually.

**Box 3: Foreign trade of goods and movement of the Nominal and the Real Effective Exchange Rate (NEER and REER)<sup>39</sup>**



Source: SSO and NBRM.

\* Negative change in the trade balance indicates contraction of the deficit.

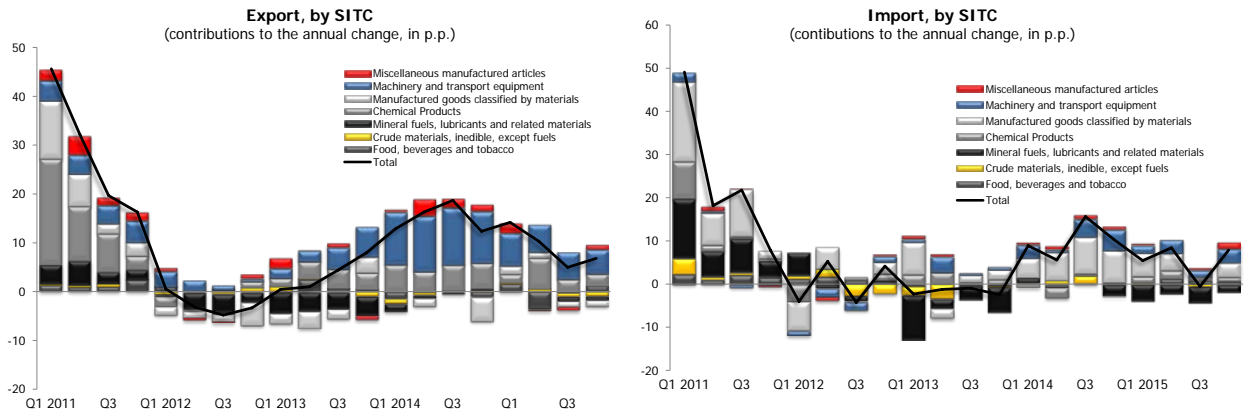
**In the last three months of 2015, the foreign trade of goods amounted to Euro 2,632.7 million (29% of GDP), which is an increase of 8.5% compared to the previous quarter. Such trends result from the faster growth of imports compared to the growth of export of goods. The import of goods has grown by 14.3% on a quarterly basis, mainly reflecting higher import of raw materials for the new facilities in the economy, increased investment imports, and higher import of raw materials for the textile industry, which is a typical seasonal pattern for this time of year. At the same time, export**

of goods have registered moderate quarterly growth of 2.2%, reflecting the intensified exports of the new export-oriented production facilities, and to a lesser extent, the higher exports of food, as opposed to the quarterly decline in exports of iron and steel. Consequently, **the foreign trade deficit in goods has expanded by 48.7% compared to the previous quarter**, given the higher non-energy deficit, amid further narrowing of the negative gap in energy balance.

The annual analysis shows an enhancement of foreign trade in the last quarter of 2015 (of 6.9%), driven by the growth in both of its components. **Export of goods continued to grow solidly in the fourth quarter of the year, reaching an annual growth rate of 6.8%**. The export activity of the new foreign facilities remains a key driver of positive export performance in the form of increased export of machinery and equipment and chemical products. Within traditional export sectors, increased export of food has provided a small positive spur to the annual growth. On the other hand, given the unfavorable conjuncture on the world metals market, metal manufacturing sector reported significantly poorer results, reducing export of iron and steel. **Export performance have had an effect on the country's imports, which after falling in the previous quarter, again increased and recorded an annual growth of 7.9%**. With the higher exports of foreign companies, the import of raw materials used during the manufacturing process has increased, accordingly, on annual basis. Higher imports of miscellaneous finished products and food have also made positive contribution to import growth. On the other hand, lower energy imports were aimed at alleviating import pressures. Namely, given the further decline in world stock prices of oil, imports of oil derivatives continue reporting negative growth rates<sup>40</sup>. **Such trends of the foreign trade components expanded the trade deficit by 10.1% on an annual basis**. Observing the individual balances, the main driver of these changes is the deteriorated non-energy balance, vis-a-vis the narrowing energy deficit.

<sup>39</sup> According to the Foreign Trade Methodology, data on the export of goods are published on an f.o.b. basis, and on the import of goods, on a c.i.f. basis.

<sup>40</sup> The falling value of the import of oil derivatives reflects solely the price effect, amid increased quantitative imports.

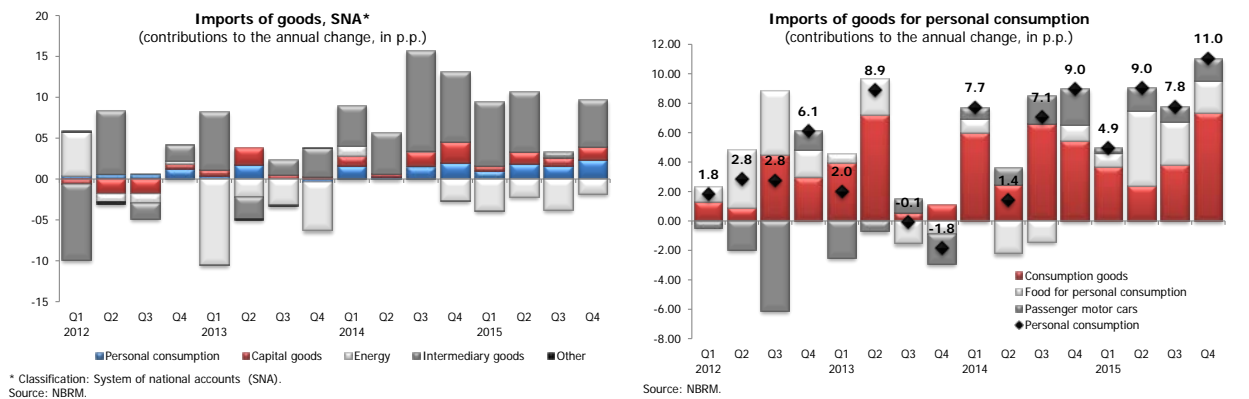


Source: SSO and NBRM.

Source: SSO and NBRM.

The analysis of the import of goods under the System of National Accounts (SNA) indicates dominant contribution of intermediate products to the annual growth of imports in the fourth quarter. Imports of capital goods and private consumption goods have slightly increased, compared to the negative contribution of the energy imports. The structural analysis of import of private consumer goods indicates that the increase is primarily due to the import of consumer goods, coupled with imports of passenger vehicles, and the private consumption food. In general, the annual growth of imports for private consumption remains moderate, indicating the absence of significant pressures on private consumption through this channel.

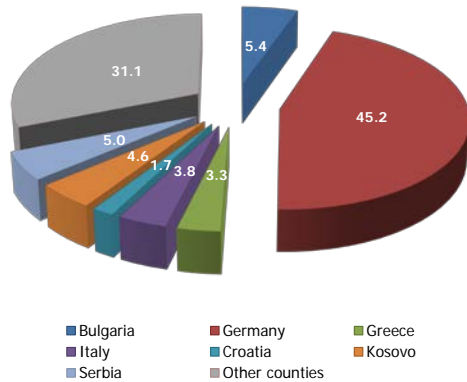
The latest available data on foreign trade indicate continuation of trends in the trade components during January and February. Export of goods has been increasing on an annual basis (at a rate of 7.2%), prompted by the efficient export performance of the new foreign capacities, amid significant annual fall of the export of the traditional metal manufacturing industry. Imports have also registered an annual growth (of 7.1%), as a result of the increased import of the new facilities, as opposed to the lower energy imports.



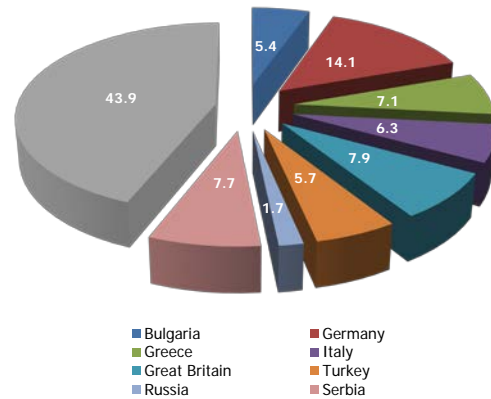
\* Classification: System of national accounts (SNA).  
Source: NBRM.

Source: NBRM.

The foreign trade analysis by country shows that in the fourth quarter of 2015, the European Union was our major trading partner (making up 67.9% of total trade). Observing the export side, by country, the exports to Germany, as a market to which the export activity of the new facilities in the domestic economy is largely targeted, remain the main driver of the annual growth. Belgium and Romania are among the European countries that have reported increased sale of products from the new foreign companies. On the other hand, the lower export of iron and steel to China, and the lower export of ores to Bulgaria have caused downward pressure on exports. Analyzing imports, the annual increase primarily reflects the intensive import of investment and raw materials from Germany. Imports have also increased due to the annual growth of import of goods from Turkey, China, Bulgaria, and Romania. Higher import of non-ferrous metals in South Africa has largely offset the lower imports of this raw material from the UK. Weaker manufacturing activity in the metal industry has caused the annual decline in the import of iron and steel from Ukraine. In terms of balances, the annual widening of the trade deficit is due to the increasing negative trade balance with South Africa, as well as the higher deficit with China, Bulgaria, and Turkey. On the other hand, the highest annual narrowing was seen in the total trade deficit with the EU member states (primarily due to reduced trade deficit with the Great Britain and increased surplus with Belgium), with lower deficit reported for the trade with Ukraine, and Russia.

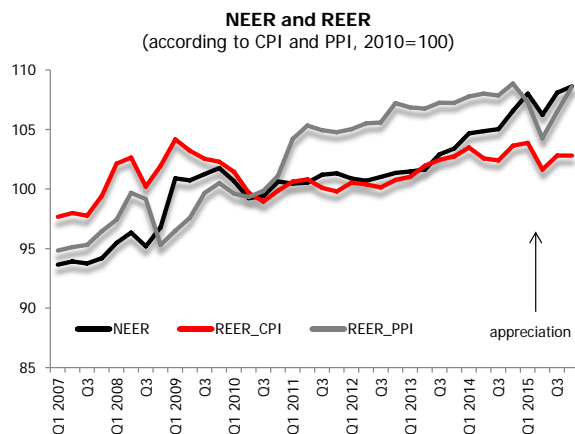
**Export of goods, by countries in the fourth quarter of 2015 (share, in %)**


Source: SSO.

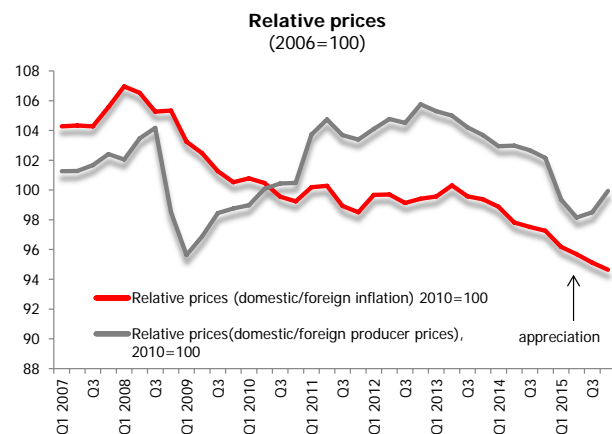
**Import of goods, by countries in the fourth quarter of 2015 (share, in %)**


Source: SSO.

The movement of some price competitiveness indicators in the fourth quarter indicates a deterioration of the competitiveness of the national economy, compared with the previous quarter. The REER index deflated by producer prices appreciated by 1.9%, quarterly, while the REER index deflated by consumer prices remained at the level of the previous quarter. The nominal effective exchange rate registered a quarterly growth of 0.5%, due to the depreciation of the Russian ruble against the denar. Analyzing relative prices, in this period, there was a quarterly growth in the relative producer prices (1.5%) and a quarterly decline in the relative consumer prices (0.5%). The annual analysis points to favorable changes in price competitiveness, given the depreciation of REER deflated by consumer prices, and REER deflated by producer prices, by 0.8% and 0.3%, respectively. These developments arise from the annual decline in relative prices, given the annual appreciation of the NEER.



Source: NBRM.



Source: NBRM.

The analysis of REER indices, as measured using weights based on the foreign trade without primary products<sup>41</sup> provides different indications of the price competitiveness<sup>42</sup>. Amid small appreciation of NEER (of 0.1%), the REER deflated by producer prices, has appreciated on a quarterly basis (1.7%), and the REER deflated by producer prices has registered a slight depreciation

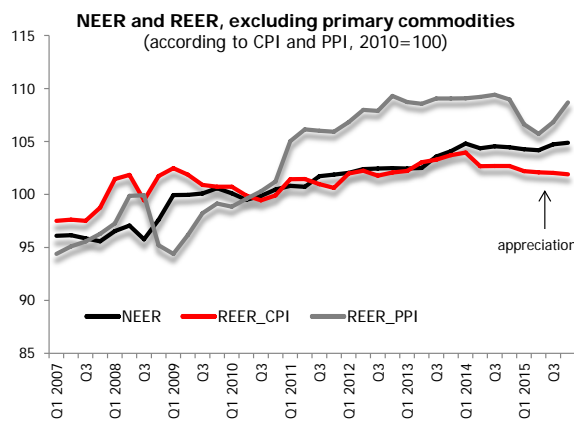
<sup>41</sup> Primary products not included in the calculation are: oil and oil derivatives, iron and steel, ores and imported raw materials for the new industrial facilities in the free economic zones. For more information on the methodology for calculating the real effective exchange rate visit:

[http://nbrm.mk/WBStorage/Files/Statistika\\_REDK\\_Informacija\\_za\\_promenite\\_na\\_metodologijata\\_za\\_presmetuvanje\\_na\\_realniot\\_ef\\_aktivnen\\_devizen\\_kurs\\_na\\_denarot\\_mak.pdf](http://nbrm.mk/WBStorage/Files/Statistika_REDK_Informacija_za_promenite_na_metodologijata_za_presmetuvanje_na_realniot_ef_aktivnen_devizen_kurs_na_denarot_mak.pdf)

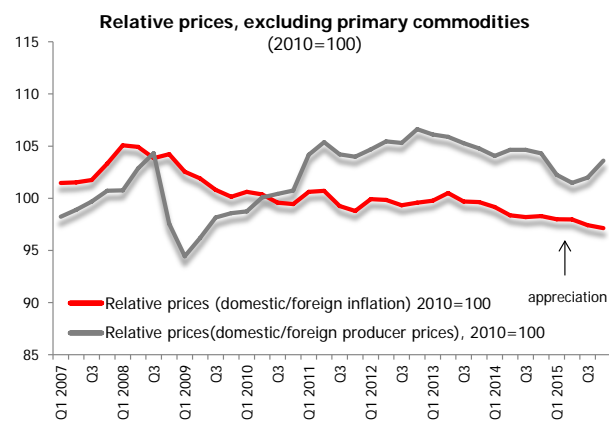
<sup>42</sup> Pronounced depreciation of the Russian ruble in 2014, caused by not only economic factors, points to problems in analyzing the indicators of price competitiveness of the domestic economy that include volatile currencies such as the ruble. Therefore, it is more appropriate to analyze the price competitiveness indicators through the real effective exchange rate indices calculated by using weights based on the foreign trade without primary products. This is to eliminate some volatilities related to changes in currencies sensitive to trends in world stock prices, and to put appropriate emphasis on structural factors that encourage competitiveness of the economy.



(0.1%). Divergent movements in REER results from the growth of relative producer prices, with a simultaneous decline in relative consumer prices. Year-on-year, both REER indices have depreciated given the fall in relative prices, compared to the annual appreciation of the NEER<sup>43</sup>.



Source: NBRM.

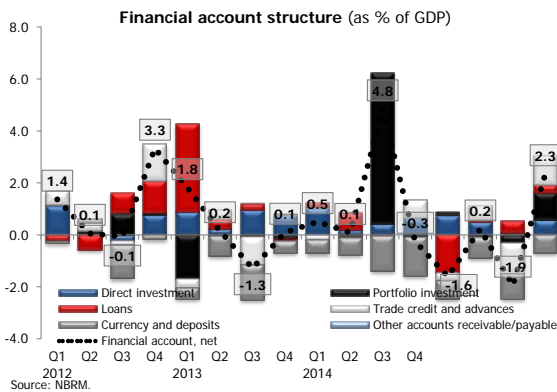


Source: NBRM.

According to the latest data of price competitiveness, in the period from January to February, the REER, as measured using weights of the total trade of goods, and weights based on foreign trade without primary commodities, has appreciated compared to the same period in 2015. The shift took place amid annual appreciation of the nominal effective exchange rate and divergent changes in relative prices. Within the REER measured using weights based on the total foreign trade, the index deflated by consumer prices has appreciated by 0.4%, and the index deflated by producer prices has appreciated by 3.5%. Similar trends have been registered in the REER measured using weights based on foreign trade excluding primary commodities, when the CPI-deflated index and the PPI-deflated index have appreciated by 0.1% and 3.1%, respectively.

### 1.6.2. Financial account

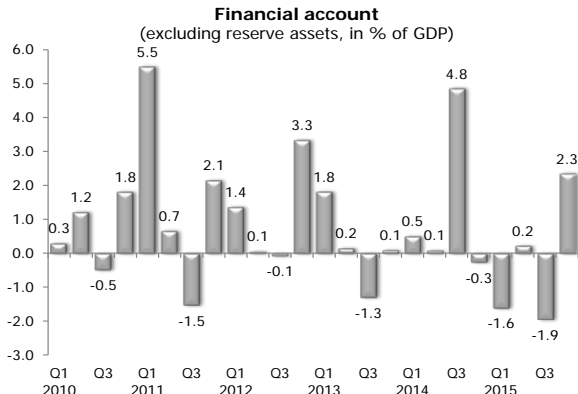
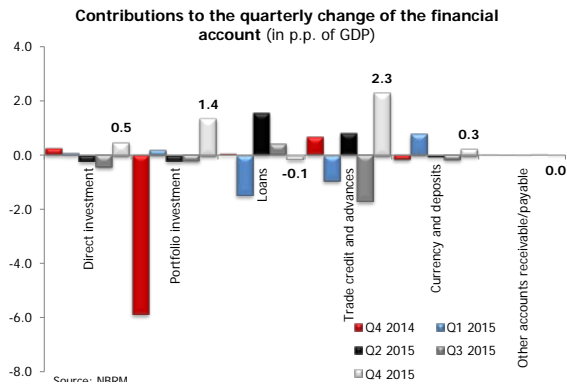
The financial account of the balance of payments recorded high net inflows of Euro 213.3 million, or 2.3% of GDP, in the fourth quarter. Funding was mostly made through trade credits and portfolio investments, as well as net inflows of foreign direct investment and financial loans. The category of currency and deposits has continued registering net outflows. The performances of trade credits and advances have been attributed to changes in the balance of goods and services, and its expansion was also accompanied by greater funding of ongoing activities in trade credits. On the other hand, the performance of portfolio investments has been entirely driven by net external government borrowing. More precisely, in December, the government borrowed from the international markets by issuing the fourth Eurobond<sup>44</sup>, at the same time servicing the due Eurobond of Euro 150 million issued in 2005. Positive flows have also been registered in



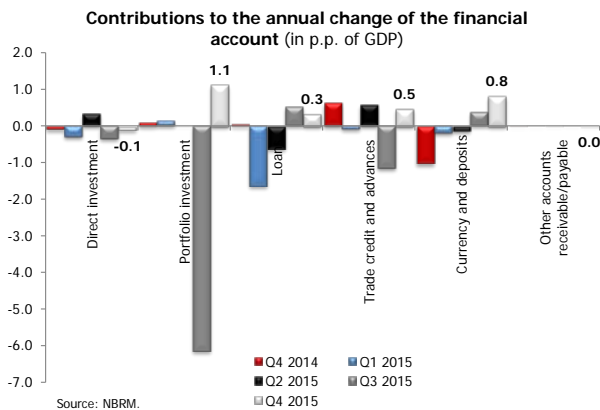
Source: NBRM.

<sup>43</sup> Annually, REER deflated by consumer prices has depreciated by 0.8%, the REER deflated by producer prices has depreciated by 0.3%, and NEER has appreciated by 0.4%.

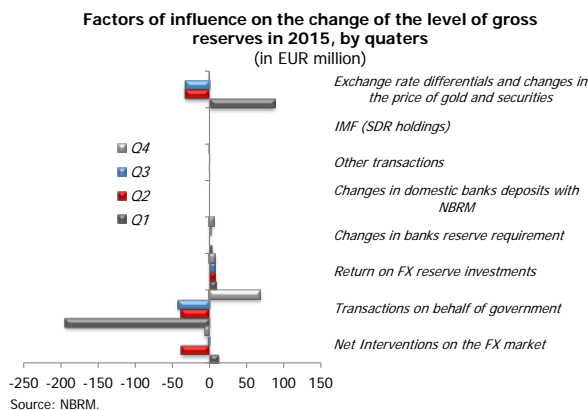
<sup>44</sup> The fourth Eurobond is Euro 270 million worth, with an annual interest rate of 4.875%, and maturity of 5 years.



Source: NBRM.



Source: NBRM.



Source: NBRM.

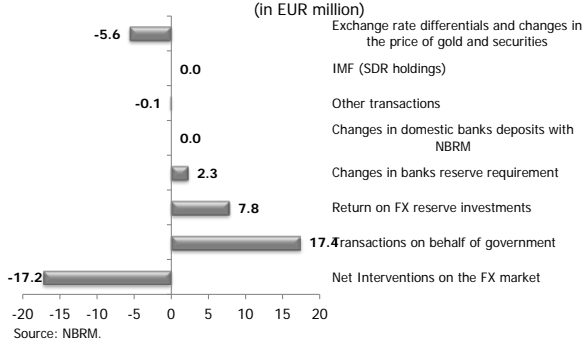
direct investments, driven by the debt component<sup>45</sup>, as well as in financial loans from abroad. The public sector that includes public companies and banks, and the government borrowed in the form of financial loans. On the other hand, the negative flows in currency and deposits continued in the fourth quarter, driven by net outflows in other sectors. *The quarterly analysis shows net inflows in the fourth quarter, despite the negative financial flows in the third quarter of the year.* The favorable trends compared to the previous quarter are mainly due to the higher net inflows in trade credits and portfolio investment, compared to the net outflows in the third quarter. Higher net financial inflows have been reported in direct investment, while the improvement in currencies was driven by reduced net outflows. Only the more moderate borrowing abroad in the form of long-term financial loans acted in the opposite direction.

*The annually analysis of financial account indicates significant improvement compared to the last quarter of the previous year, which registered small net outflows.* This change was predominantly driven by the performance of portfolio investments, fueled by the positive effect of currency and deposits, trade credits and advances, and to a lesser extent, financial loans. Net outflows in currency and deposits have decreased mainly due to the depository institutions as a result of lower accumulation of foreign assets in foreign banks. Only the foreign direct investment has slightly deteriorated on an annual basis. **The latest balance of payments data as of January 2016, suggests net outflows of Euro 42.6 million in the financial account.** These developments are due to the net outflows in trade loans and advances, as well as long-term loans, amid small net inflows of currency and deposits, and foreign direct investment. Deleveraging based on long-term financial loans abroad is mostly driven by the deleveraging of the banking sector.

**As of 30 September 2014, the gross foreign reserves were valued at Euro 2261.7 million, which is a quarterly increase of Euro 74.4 million.** Net inflows from transactions on behalf of the government are drivers of the change, amid insignificant changes in other categories. *According to the latest available data, at the end of the first quarter of 2016, the foreign reserves amounted to Euro 2266.3 million, which is by Euro 4.6 million more compared to the end of 2015.* The increase in foreign reserves was mostly due to transactions on behalf of

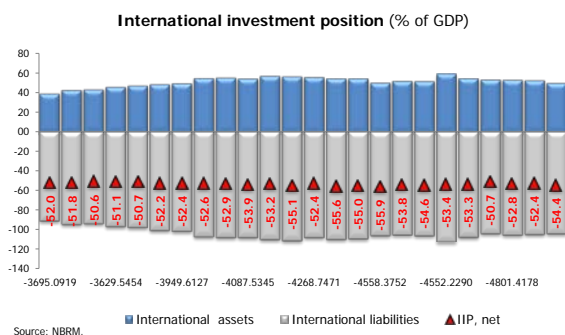
<sup>45</sup> In the fourth quarter, the ownership of a major foreign-owned company underwent certain changes. Thus the transformation reduced the share capital, while increasing direct investment in the form of liabilities to the parent entity.



**Factors of influence on the change of the level of gross reserves in 2016**

the government, contrary to the NBRM interventions, i.e. net sale of foreign currency on the foreign exchange market during this period, which acted in the opposite direction.

### 1.6.3. International investment position<sup>46</sup> and gross external debt



At the end of 2015, the **negative IIP<sup>47</sup> of the Republic of Macedonia equaled Euro 4,945.3 million, or 54.4% of GDP**. On a quarterly basis, the IPI has increased by 2 percentage points of GDP, amid greater decline in international assets compared to the fall in international liabilities. The sector-by-sector analysis shows that the quarterly change was mostly due to higher net liabilities in other sectors in the economy (higher liabilities on direct investment and short-term trade credits), as well as higher net government liabilities (mainly due to the increased liabilities on debt securities<sup>48</sup>). On the other hand, there was a quarterly improvement in net assets of the central bank, as well as a slight decrease in net liabilities of depository institutions.

On an annual basis, the net debt position of the country has moderately increased by 1.1 percentage points of GDP. The international assets have decreased by 4.6 percentage points of GDP, while the reduction of international liabilities was 3.5 percentage points. *The sector-by-sector analysis* indicates a decrease in net assets of the central bank (mainly resulted from reduced foreign reserves), amid improvement in all other institutional sectors, i.e.

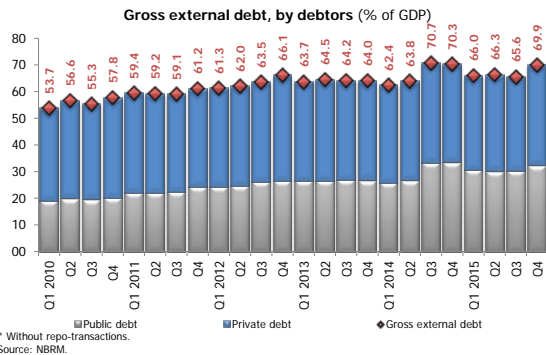
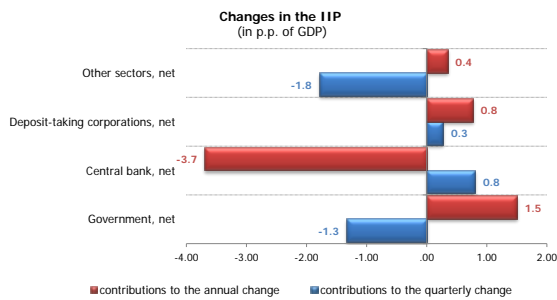
<sup>46</sup> The analysis in this section relies solely on IIP data compiled under the new methodology. Namely, in July 2014, the NBRM started disseminating data on the international investment position (IIP) and gross external debt of the Republic of Macedonia, according to the new international statistical standards defined by the Balance of Payments and International Investment Position Manual (BPM6) and the External Debt Statistics (2013). For more information on the methodological changes, visit the NBRM website

([http://nbrm.mk/WBStorage/Files/Statistika\\_Informacija\\_za\\_promenite\\_vo\\_platniot\\_bilans\\_megunarodnata\\_investiciska\\_pozicija\\_i\\_nadvoresniot\\_dolg\\_koisto\\_proizleguvaat\\_od\\_primenata\\_na\\_novite\\_megunarodni\\_statisticki\\_standardi.pdf](http://nbrm.mk/WBStorage/Files/Statistika_Informacija_za_promenite_vo_platniot_bilans_megunarodnata_investiciska_pozicija_i_nadvoresniot_dolg_koisto_proizleguvaat_od_primenata_na_novite_megunarodni_statisticki_standardi.pdf)).

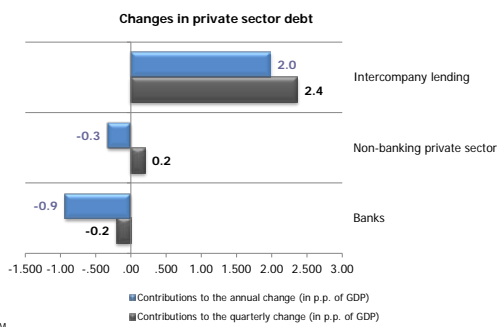
<sup>47</sup> In the second quarter of 2011, the NBRM began concluding repo and reverse repo transactions. These transactions represent an investment opportunity to use portfolio securities to provide additional income. Conclusion of repo transactions incurs liabilities. At the same time, claims created from entering into reverse repo agreements tend to 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, 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.

<sup>48</sup> In December, the government borrowed from the international markets by issuing the fourth Eurobond in the amount of Euro 270 million, at the same time servicing the due Eurobond of Euro 150 million issued in 2005.





\* Without repo-transactions.  
Source: NBRM.



Source: NBRM.

reduction of net government liabilities<sup>49</sup>, depository institutions (reduced net liabilities on long-term loans) and minor improvement in other sectors. In absolute terms, the annual growth (8.7%) of the negative IIP is due to the higher net liabilities in other sectors, and reduced net assets with the central bank, given the unchanged position in the government and reduced net liabilities of banks.

*At the end of 2015, the gross external debt stood at Euro 6,353.7 million, or 69.9% of GDP, which is a quarterly increase of 1.2 percentage points of GDP. If the effect of the repo transactions is excluded, the growth is larger and equals 4.3 p.p. of GDP<sup>50</sup>.* The higher gross external debt mainly arises from the increased private sector debt and public debt. The quarterly increase in the private sector debt is due to the higher liabilities to foreign direct investors, and to the slight increase in the debt of non-banking corporate sector. At the same time, the banking sector debt has been moderately decreasing. The growth of public debt is mostly due to the increase in the central government debt, with moderate increase in the debt of public companies and public banks.

*Annually, the gross external debt went down by 0.4 percentage points of GDP<sup>51</sup>.* The annual decrease in gross debt is due to the public debt that decreased by 1.1 percentage points of GDP, amid higher private sector debt of 0.7 percentage points of GDP. The decrease in the public debt is mostly due to the decrease in the central government debt. At the same time, the debt of public companies has increased due to the long-term debt to support road infrastructure. The annual increase in private sector debt is due to the higher liabilities to foreign direct investors amid moderate reduction in the debt of the banking and non-banking private sector.

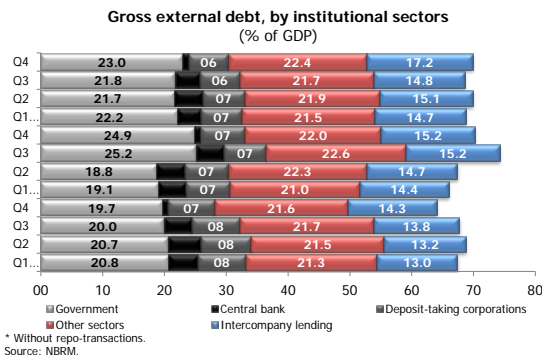
*Generally, the external indebtedness indicators of the national economy still show that the gross external debt is in the safe zone.* The only indicator that classifies the economy in the group of highly indebted countries is the gross external debt to GDP ratio. Dynamically speaking, the external debt analysis<sup>52</sup> indicates favorable movements in almost all

<sup>49</sup> In 2015, the government serviced two major repayments - the PCL to the IMF and the principal on the first issued Eurobond. The servicing of these repayments was made using part of the assets of the government borrowing in 2014, which was intended to finance the budgetary needs for 2014 and 2015, and part of the new Eurobond issued in late 2015.

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

<sup>51</sup> The analysis in absolute terms shows an increase in gross external debt of Euro 361.4 million compared to the end of 2014, as a result of the rising debt of the private and the public sector.

<sup>52</sup> 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



solvency indicators annually, with the exception of the ratio of debt servicing to export of goods and services and other inflows which has been deteriorating. Liquidity ratios show further coverage of short-term debt liabilities and short-term debt with residual maturity, with foreign reserves.

At the end of 2015, net external debt, as an additional indicator of external position of the economy, amounted to Euro 2,363.7 million or 26% of GDP, which is a quarterly growth of 4.0 percentage points of GDP, which is slightly slower growth of the gross external debt.

Indicators for external indebtedness	Solvency				Liquidity		
	Interest payments/ Export of goods and services and other inflows	Gross debt/ Export of goods and services and other inflows	Gross debt/ GDP	Debt servicing/ Export of goods and services and other inflows	Foreign reserves/ Short-term debt	Foreign reserves/ Short-term debt, with residual maturity	Short-term debt/ Overall debt
	in %				ratio	ratio	in %
31.12.2004	2.41	129.3	47.3	12.4	1.14	0.89	30.3
31.12.2005	2.66	147.0	54.2	11.06	1.67	1.04	26.7
31.12.2006	3.44	131.3	49.8	21.7	1.95	1.34	29.0
31.12.2007	2.78	119.3	51.3	19.4	1.35	1.08	39.8
31.12.2008	2.66	116.9	54.1	10.2	1.29	0.95	35.2
31.12.2009	2.43	131.0	57.8	11.8	1.29	0.94	32.9
31.12.2010	3.22	140.4	59.7	13.9	1.49	0.99	27.9
31.12.2011	3.12	148.4	64.6	16.8	1.78	1.18	25.2
31.12.2012	2.92	141.9	67.6	13.1	1.64	1.03	26.7
31.12.2013	2.51	137.3	67.4	15.8	1.64	1.08	23.3
31.03.2014	3.02	132.8	69.6	17.3	1.41	0.95	25.9
30.06.2014	3.02	135.7	71.1	17.3	1.33	0.90	25.8
30.09.2014	3.02	150.5	78.4	17.3	1.74	1.16	23.2
31.12.2014	3.02	149.4	74.1	17.3	1.82	1.13	22.3
31.03.2015	2.68	143.7	72.8	20.1	1.48	1.13	25.5
30.06.2015	2.68	146.2	74.0	20.1	1.32	1.07	26.9
30.09.2015	2.68	143.4	72.6	20.1	1.38	1.08	25.4
31.12.2015	2.68	146.1	74.0	20.1	1.62	1.10	22.0
<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.

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

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

Source: NBRM.

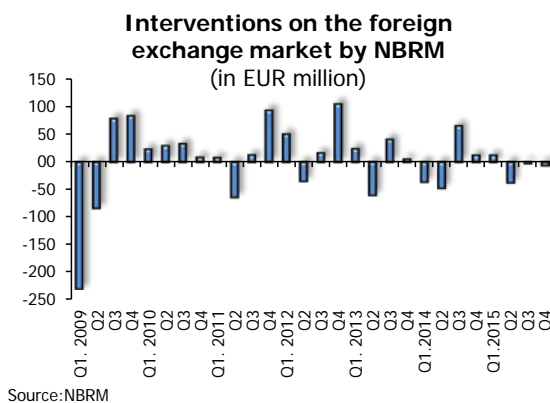
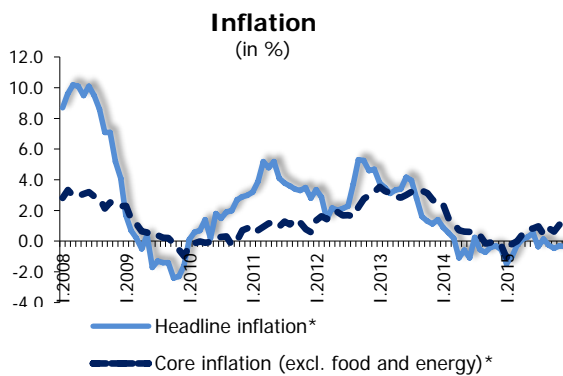
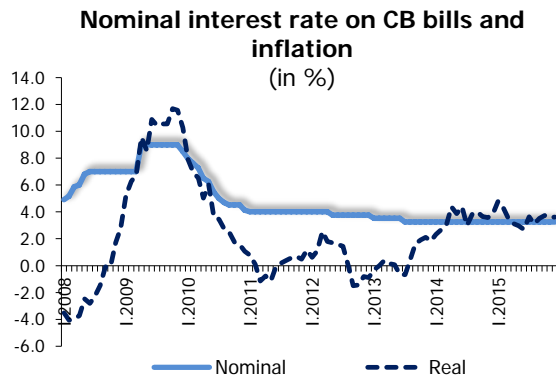
## II. Monetary policy

***During the first quarter of 2016, the NBRM kept its policy rate unchanged at 3.25%. This decision was based on the performance of key macroeconomic and financial indicators, compared with the macroeconomic projections of October. The***

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. they have improved relative to the analyses based on data from the previous methodological framework. On the other hand, the methodological changes in the export of goods and services and other inflows caused deterioration of the indicators for the share of export of goods and services and other inflows in the gross external debt and debt service in relation to export of goods and services and other inflows, compared with the indicators relevant prior to the methodological changes.

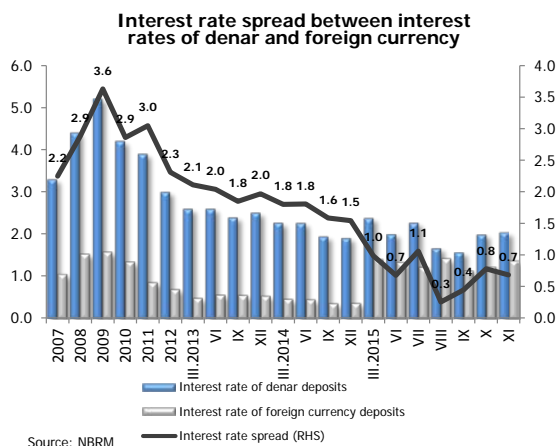
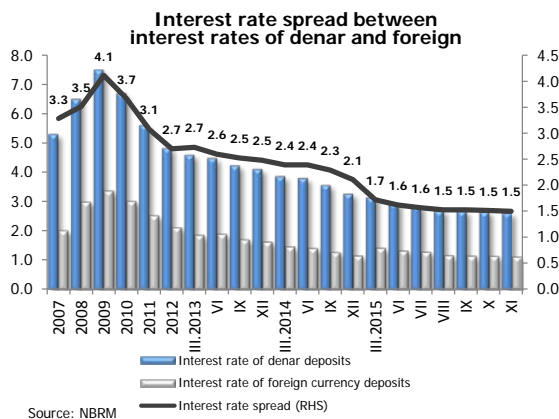
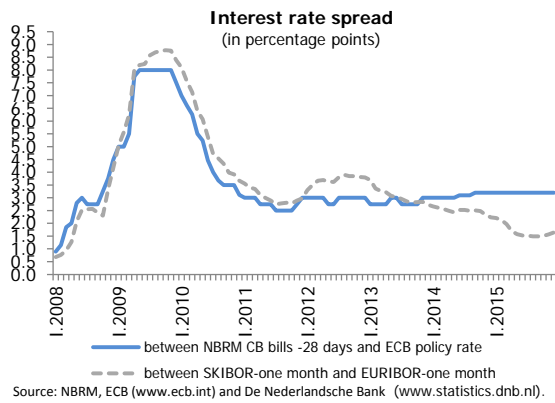


*analyses point to solid rate of recovery of the economy, without price pressures and with adequate level of foreign reserves. In terms of risks, it was assessed that the domestic political upheavals, as well as the economic and political developments in Greece continue to create uncertainty, mainly through the expectations channel, yet with limited effects on the domestic economy. Risks from the external environment have intensified compared to the previous quarter, changing the expected dynamics of recovery of global economic growth and increasing uncertainty in global financial markets as well as primary commodity markets. In the period ahead, the NBRM will continue to monitor closely the situation for the timely and appropriate adjustment of monetary policy.*



Based on the regular assessment of the recent macroeconomic and financial developments, at the meeting held during the first quarter<sup>53</sup> of 2016, the NBRM Operational Monetary Policy Committee decided to keep CB bill interest rate at 3.25%. A comparison of performance with the NBRM's macroeconomic projections in October did not indicate any significant changes in the environment for conducting monetary policy. Movements in key macroeconomic indicators available during the quarter do not deviate much from the projected dynamics. Thus, foreign reserves surged in the first quarter, at a slightly better rate than expected for this period. As for the change factors, government transactions acted towards increasing foreign reserves, while the NBRM foreign currency interventions acted in the opposite direction. In the first two months of the year, the NBRM intervened in the foreign exchange market by selling foreign currency to market makers, thus maintaining the exchange rate stable. Reserve adequacy indicators remained at the appropriate level, sufficient for managing shocks. In the first two months of the year, the average annual inflation rate was low (0.1%), amid lower energy and food prices, while core inflation continued to move in the zone of positive annual growth. In the first two months, the annual core inflation grew by 1.6%, on average. In this period, the inflation performance was weaker than forecasted in October, reflecting the factors on the supply side. Real sector remained robust. Available high frequency data have showed increasing economic activity in the fourth quarter, as confirmed by the GDP official data, given the favorable developments noticed in the major economic sectors. As for the credit market, in the first quarter of 2016, lending activity continued to grow at a solid rate of about 8%, which is moderately higher than estimated for the first quarter of 2016. In terms of risks, recent performance has indicated somewhat less favorable

<sup>53</sup> During the quarter, the NBRM's Operational Monetary Policy Committee held three sessions on 12 January, 9 February, and 8 March 2016, and reassessed the monetary policy setup.



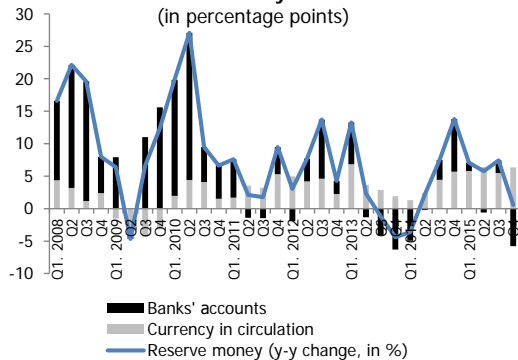
global environment, with lower growth in the emerging economies (China in particular) and developing countries, increased uncertainty in global financial markets and in primary commodity markets and pronounced geopolitical risks. In such a setting, the pace of economic recovery in the euro area for the coming period was revised downward. In terms of domestic risks arising from the political developments in the country, it was estimated that their effects on the economy are still limited and mainly spread through the expectations channel. In circumstances where key indicators move within the expected range, amid continued adverse risks, exiting the zone of accommodative monetary policy in the coming period will depend on the materialization of identified risks and their effects on the external position and on foreign reserves.

In the first quarter of 2016 (March 2016), the ECB adopted a set of measures aimed at further easing of financial conditions in the euro area, which includes reduction of interest rate on the main refinancing operations from 0.05% to 0%, and additional easing measures. With the changes introduced in March, the interest rate spread between the CB bill interest rate and the ECB policy rate has moderately increased from 3.20 to 3.25 percentage points. During the first quarter, the movements of short-term market interest rates on the European and domestic financial markets were relatively stable, and the interest rate spread between the one-month SKIBOR and one-month EURIBOR expanded marginally by 1.7 percentage points, compared to 1.6 percentage points on average in the previous quarter. Within the banking sector in the domestic economy, analyzing the newly accepted deposits, the interest rate on Denar deposits in the first month of 2016 has increased, which amid a simultaneous drop in the interest rate on foreign currency deposits, has expanded the interest rate spread from 0.5 percentage points in December to 0.9 percentage points in January. However, it should be born in mind that the interest rates on newly received deposits are volatile, which can result in frequent and temporary adjustments of the interest spread. Interest rate spread between interest rates on total Denar and total foreign currency deposits is stable, and in January it was 1.4 percentage points, remaining at the same level as in the previous month, since in December it moderately declined by 0.1 percentage points.



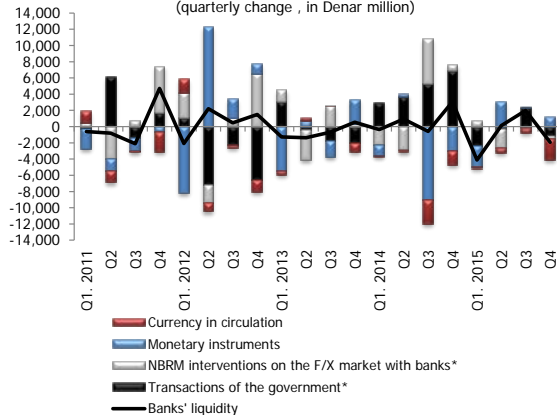
## 2.1. Banks' liquidity and interbank money market developments

Contribution to annual change in reserve money  
(in percentage points)



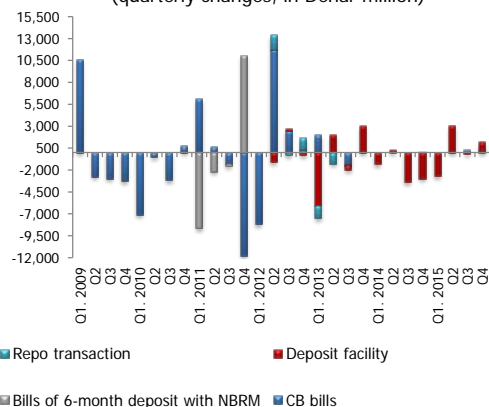
Source: NBRM.

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



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

Monetary policy instruments  
(quarterly changes, in Denar million)\*



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

During the first quarter<sup>54</sup> of 2016, bank liquidity<sup>55</sup> increased by Denar 3,312 million, compared to the end of 2015. In February 2016, reserve money<sup>56</sup> increased by 3.3% annually, compared to December 2015, when they registered an annual growth of 0.6%.

Within the analyzed period, autonomous factors affected the growth of bank net liquidity (by Denar 1,450 million). Analyzed individually, government transactions, given the payment of subsidies, have increased the liquidity by Denar 1,745 million. The decline in currency in circulation (by Denar 400 million), acted in the same direction, while the effect of foreign exchange interventions of the NBRM (selling foreign currency to market makers) has decreased bank liquidity.

During the analyzed period, the stock of the NBRM monetary instruments decreased on a net basis, creating liquidity in the banking system of Denar 1,228 million. Three volume tender (limited amount) CB bill auctions with fixed interest rate of 3.25% were held in this period. At the auctions, CB bills in the amount of Denar 25,500 million were offered, while the demand from banks was lower than both the supply and the amount due. Thus, the stock of CB bills has decreased to Denar 24,606 million, thus creating liquidity of Denar 469 million<sup>57</sup> in the banking system. The lower interest of banks to place excess liquidity in overnight deposits (by Denar 615 million) and in 7-day deposits (by Denar 778 million), has decreased the stock of deposits (by Denar 1,393 million). Hence, amid increased liquidity through autonomous factors (by Denar 1,450 million) and created liquidity through monetary instruments (of Denar 1,862 million), the average surplus on the banks' accounts with the NBRM over the reserve requirement in denars amounted to 0.9% in the analyzed period and was moderately higher than the average of the previous quarter (0.7%).

During the first quarter<sup>58</sup> of 2016, the interbank deposit market (unsecured segment) reported a turnover of Denar 4,185 million. The

<sup>54</sup> The analysis is as of 20 March 2016.

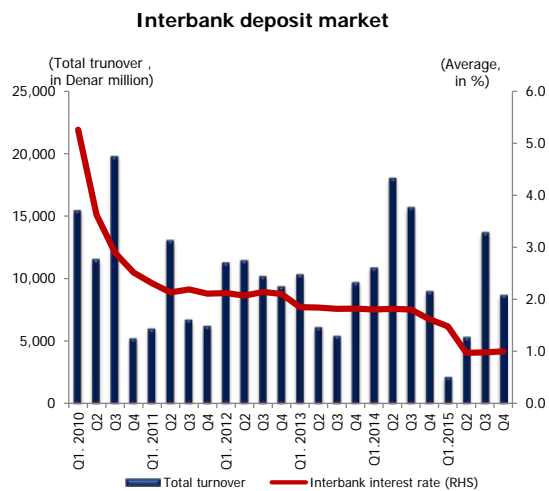
<sup>55</sup> Refers to the change in banks' account balances with the NBRM.

<sup>56</sup> Includes reserve requirement in foreign currency.

<sup>57</sup> The auctions of CB bills held in January, February and March registered lower demand than supply by Denar 513 million, Denar 868 million and Denar 894 million, respectively. The demand was also lower than the amount due (by Denar 88 million, Denar 355 million, and Denar 26 million, respectively).

<sup>58</sup> The analysis of this segment includes data for the period as of 20 March 2016.





Source: NBRM.

volume of trading on the interbank money market in the analyzed period is twice as low as the turnover reported for the fourth quarter of 2015 (Denar 8,732 million). Analyzed by maturity segments, 1-day transactions have dominated the total turnover on the interbank market since the beginning of 2016, accounting for 66% of total turnover, while the share of 7-day transactions was 33%, which is relatively lower, compared to the previous quarter (47.3%). In such circumstances, the actual interbank interest rate (MBKS) was lower and averaged 1.07%, versus 1.12% in the fourth quarter of 2015. On the other hand, the interbank interest rate on overnight transactions (MKDONIA) has remained stable and averaged 1.0%. **The secondary securities market** has reported total turnover of Denar 2.359 million<sup>59</sup>. The structure of turnover has been dominated by transactions in treasury bills and CB bills (share of 58.5% and 33.9% of the total transactions, respectively). There were also transactions in government bonds, and repo transactions, but their share in total transactions was relatively low (4.5% and 3.1%, respectively). In the period under observation, the total turnover on the secondary market was by 55% lower, on a quarterly basis.

## 2.2. Monetary and credit aggregates

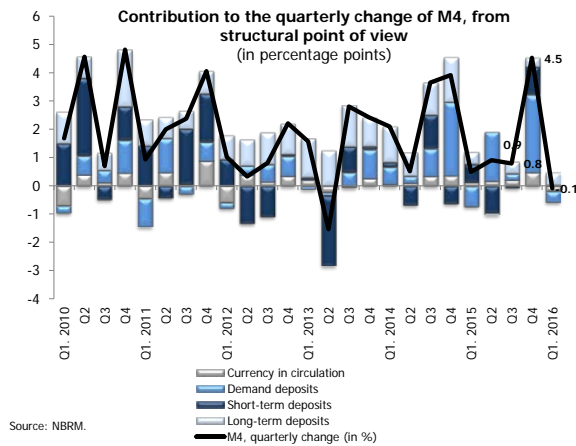
*After the strong growth in the previous quarter, in the first quarter of 2016, the broad money declined moderately on a quarterly basis. The adjustment is particularly pronounced in the most liquid component, which after the strong growth in the previous quarter, decreased in the first quarter. In addition, in this period there was a slowdown in the growth of short-term deposits, while savings in the long run continued to grow at a similar pace. The reduction in broad money in the first quarter, is partly seasonal, considering the usual slowdown in economic activity. Furthermore, these movements correspond with the slower lending to the private sector during this period. Analyzed by sector, the growth of deposits is solely driven by the increased household savings, making almost identical contribution to the growth of denar and foreign currency deposits. In the first quarter, the credit market was marked by slowdown in activity, typical for this period. After the strong growth in corporate loans in the last quarter, their level decreased moderately in the first quarter of 2016. The financial support to the households through loans from the banking system continued to grow in the first quarter.*

### 2.2.1. Monetary aggregates

**In the first quarter of 2016, the money supply in the economy marginally declined by 0.1%, compared to the growth of 4.5% in the last quarter of 2015.** Such dynamics can be partly explained by seasonal factors, given the slowdown of activity in this period, as well as the slower credit

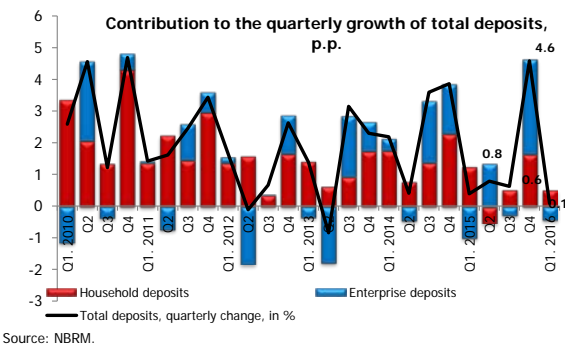
<sup>59</sup> As of 17 March 2016





Total deposits	2013		2014				2015				2016
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Kв.1	
	<b>q-q growth, %</b>										
Total deposits	2.3	2.2	0.4	3.6	3.9	0.4	0.8	0.6	4.6	0.1	
	<b>contributions to quarterly growth, p.p.</b>										
Deposit money	1.1	0.7	0.3	1.1	2.8	-0.8	1.9	0.3	3.2	-0.4	
Denar deposits	0.9	0.9	0.1	1.3	1.5	0.0	-1.1	0.3	0.3	0.01	
Foreign currency deposits	0.3	0.6	0.0	1.3	-0.4	1.2	0.0	0.1	1.1	0.5	
Short-term deposits	0.1	0.3	-0.7	1.3	-0.7	0.7	-1.0	-0.1	1.1	0.03	
Long-term deposits	1.1	1.3	0.9	1.2	1.7	0.5	-0.1	0.4	0.3	0.5	

Source: NBRM.



Household deposits	2013		2014				2015				2016
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Kв.1	
	<b>quarterly change, in %</b>										
Total household deposits	2.4	2.4	1.1	1.9	3.2	1.8	-0.7	0.7	2.3	0.8	
	<b>contribution to quarterly change of total deposits, in p.p.</b>										
Deposit money	1.0	0.5	0.2	0.2	1.9	0.1	-0.2	0.3	1.8	0.1	
Denar deposits	1.1	1.2	0.7	0.9	1.1	0.7	-0.4	-0.1	0.1	0.3	
FX deposits	0.3	0.7	0.2	0.9	0.2	1.0	-0.1	0.6	0.4	0.4	
Short-term deposits	-0.2	0.2	-0.2	0.2	-0.2	1.1	-0.7	0.1	0.2	0.1	
Long-term deposits	1.6	1.7	1.1	1.5	1.4	0.6	0.1	0.4	0.3	0.6	

Source: NBRM.

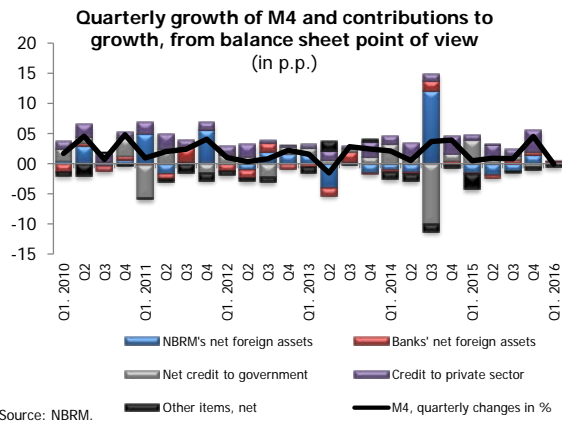
Enterprise deposits	2013		2014				2015				2016
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Kв.1	
	<b>квартални промени, во %</b>										
Total household deposits	4.1	1.7	-2.0	8.8	6.8	-4.2	5.9	-1.2	12.7	-1.7	
	<b>contribution to quarterly change of total deposits, in p.p.</b>										
Deposit money	-1.9	1.1	0.2	3.3	7.6	-4.3	8.1	0.6	8.3	-2.3	
Denar deposits	1.6	0.2	-1.8	2.8	1.3	-1.7	-2.6	-0.4	0.7	-0.1	
FX deposits	0.7	0.4	-0.4	2.7	-2.1	1.8	0.5	-1.4	3.7	0.6	
Short-term deposits	2.1	0.3	-2.0	4.8	-2.4	-1.1	-1.6	-1.2	4.3	-0.2	
Long-term deposits	0.2	0.3	-0.2	0.6	1.5	1.2	-0.6	-0.6	0.1	0.8	

Source: NBRM.

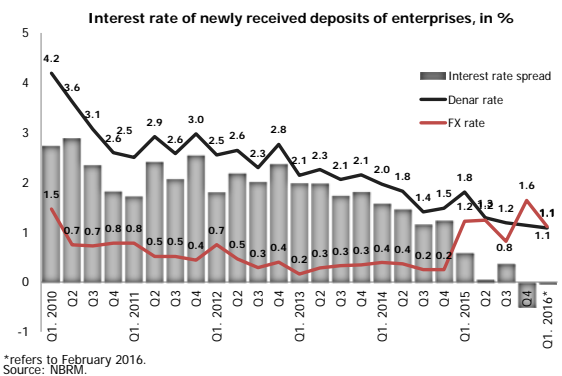
growth. Analyzing the structure, changes in the dynamics of money supply were caused by its most liquid component. Thus, the most liquid monetary aggregate M1 decreased quarterly, despite the high positive contribution to the monetary growth in the previous quarter. Private sector savings continued to grow, but at a significantly slower pace compared to the previous quarter, amid slower growth in short-term deposits. On the other hand, preferences for savings in the longer run continued, and long-term deposits registered a growth similar to that of the previous quarter. Analyzing the currency structure, in the first quarter of 2016, denar deposits declined, entirely driven by the declining demand deposits. On the other hand, deposits in foreign currency kept on growing quarterly, with some minor changes in the degree of euroisation (at the end of March, the share of foreign currency deposits in the money supply increased to 37.5% from 37.1% in December). On an annual basis, the growth of broad money slowed down to 6.2% in March from 6.8% at the end of 2015.

**Total deposit potential of the banks in the first quarter of 2016 continued to grow on a quarterly basis, but at a significantly slower pace (the growth slowed down from 4.6% in December to 0.1% in March 2016) as a result of the adjustment in all components.** Observing currency, denar deposits decreased due to the fall in demand deposits, while foreign currency deposits continued to grow on a quarterly basis. By sector, the growth of deposits in the first quarter of 2016 is solely due to the increase in household deposits. **Total household deposits registered a quarterly growth of 0.8%, which is a slowdown compared to the pace of the previous quarter.** The quarterly slowdown can be explained by the high performance during the fourth quarter, partly due to the payment of higher pensions and bonuses typical for the year-end. Analyzing currency, Denar deposits account for 52.9% of total quarterly growth, versus 82.2% in the fourth quarter. On the other hand, foreign currency deposits continued to grow, at almost the same pace as in the previous quarter. Observing the maturity structure, there was an increased quarterly contribution of long-term deposits to the growth of total deposits from 11.5% to 72.9%. Short-term deposits kept on increasing, but at a slower pace. **On an annual basis,** the growth rate of total household deposits continued slowing down from 4.1% at the end of December to 3.1% in March.

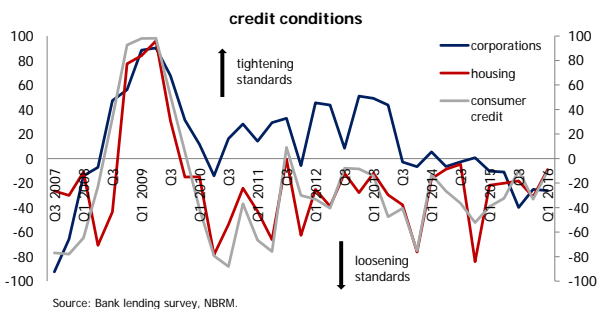
**In the first quarter of 2016, there was a decrease of corporate deposits by 1.7% on a quarterly basis, compared to growth of 12.7% in the fourth quarter.** This pace of corporate



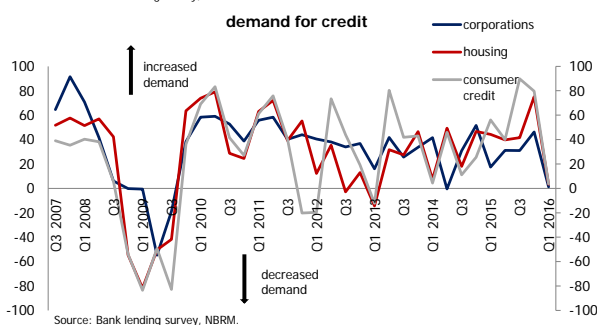
deposits is common for this period and is probably attributable to their business cycle and the method of financing their operations. In terms of currency structure, the quarterly decline is solely due to the reduction of deposits in local currency, while foreign currency deposits continued to grow, but at a slower pace. Observing the maturity structure, the quarterly decline in corporate deposits is solely due to the reduction of short-term deposits, amid accelerated growth of lend-term deposits. **Annually**, at the end of March, corporate deposits increased by 16%, compared to 13% at the end of December.



**According to the analysis of returns on new savings<sup>60</sup>**, the interest rate on newly received denar household deposits at the end of February, moderately increased by 0.2 percentage points, with minor decline in the interest rate on newly accepted foreign currency deposits. As a result, the interest rate spread expanded to 1.4 percentage points. Analyzing the newly received corporate deposits, the interest rate on foreign currency deposits decreased by 0.5 percentage points, at unchanged interest rate on denar deposits. Accordingly, interest rates on newly received denar and foreign currency deposits reduced to the same level. In terms of total deposits, in February, interest rates on Denar and foreign currency household deposits amounted to 2.6% and 1.1% respectively, while on Denar and foreign currency corporate deposits they equaled 2.3% and 1.1%, respectively.



**The analysis of the structure of money supply, from the balance sheet perspective**, shows that the fall of money supply in the first three months of the year is mainly due to other items, while net government loans and net foreign assets of the NBRM and the banks tend to increase the money supply. Loans to private sector acted in the same direction.



### 2.2.2. Lending activity

**The banking sector continued its lending activity in the first quarter, but at a slower pace. The quarterly growth rate of total loans to the private sector was 0.1% at end of March, compared to 4.2% at the end of December 2015.** Banks shied away from lending, typical for this period of the year. According to the results from the last Lending Survey<sup>61</sup>, the slowdown of lending in the

<sup>60</sup> 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 information see Quarterly Report, May 2015, p 53.

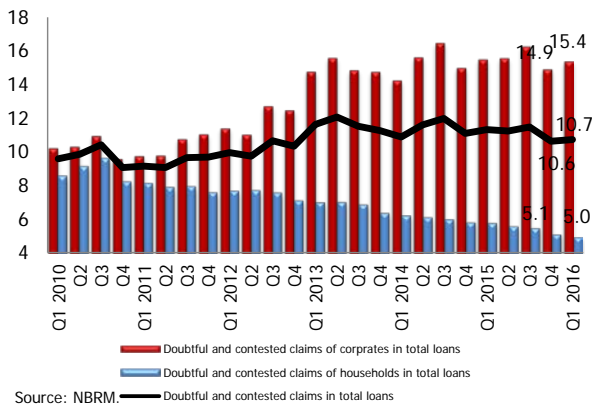
<sup>61</sup> For more information, also see Lending Survey at <http://nbrm.mk/?ItemID=F7AC78DDEE498764FBAF39049F726CE3C>.



Total credits of private sector									
	2014				2015				2016
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
<b>quarterly change, in %</b>									
Total credits of private sector	1.8	2.9	1.4	3.6	1.1	2.7	1.2	4.2	0.1
<b>Contribution in quarterly change of total credits (in p.p)</b>									
Denar credits	1.6	2.7	1.3	3.1	0.7	3.2	1.6	3.7	0.6
Foreign currency credits	0.2	0.1	0.1	0.5	0.4	-0.5	-0.3	0.5	-0.6
Short-term credits	0.7	0.4	0.0	1.7	-0.5	0.0	-0.4	1.8	-1.1
Long-term credits	1.2	1.3	0.9	2.4	1.2	2.5	0.3	2.9	-0.3
Households	0.9	1.6	1.2	1.0	1.0	1.8	1.4	1.1	1.1
Corporations	0.9	1.2	0.2	2.6	0.1	0.9	-0.2	3.2	-1.0

Source: NBRM.

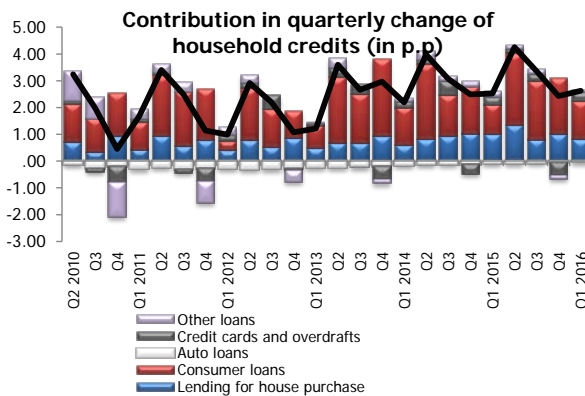
**Share of doubtful and contested claims in total loans**



Source: NBRM.

Total credits of households									
	2014				2015				2016
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
<b>quarterly change, in %</b>									
Total credits of households	2.1	3.9	2.9	2.4	2.4	4.2	3.3	2.5	2.5
<b>Contribution in quarterly change of household credits (in p.p)</b>									
Denar credits	2.1	3.9	3.0	2.3	3.9	3.2	2.4	2.5	2.5
Foreign currency credits	0.0	0.1	0.0	0.1	0.1	0.2	0.1	0.1	0.1
Short-term credits	0.2	0.3	0.4	-0.4	0.2	0.2	0.2	-0.3	0.2
Long-term credits	1.8	3.5	2.5	2.8	2.0	3.9	3.0	3.0	2.4

Source: NBRM.



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

Total credits of corporations									
	2014				2015				2016
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
<b>quarterly change, in %</b>									
Total credits of corporations	1.5	2.0	0.3	4.5	0.1	1.6	-0.4	5.7	-1.8
<b>Contribution in quarterly change of corporation credits (in p.p)</b>									
Denar credits	1.2	1.9	0.1	3.7	-0.5	2.7	0.3	4.7	-0.7
Foreign currency credits	0.3	0.2	0.2	0.8	0.6	-1.1	-0.7	0.9	-1.1
Short-term credits	1.0	0.6	-0.3	3.2	-1.1	-0.1	-0.9	3.4	-2.0
Long-term credits	0.7	-0.2	-0.2	2.2	0.6	1.4	-0.1	2.8	0.0

Source: NBRM.

first quarter corresponds to the significantly weaker growth of demand for corporate and household loans compared to the previous survey, while credit standards continue easing.

From a structural viewpoint, in the first quarter, lending to the private sector was driven by denar loans and loans to households. On the other hand, foreign currency lending and corporate loans declined on a quarterly basis. The analysis of the maturity structure indicates a quarterly decline in both short- and long-term loans. In terms of doubtful and contested claims, at the end of March, there was a slight deterioration in the quality of banks' loan portfolio for the corporate sector, while for the household sector, the rate of non-performing loans declined moderately. The share of doubtful and contested loans in total loans was 10.7% and mildly increased by 0.1 percentage point compared to December.

**Annually**, in March, total loans increased by 8.4% (9.5% at the end of December). Loan/deposit ratio<sup>62</sup> was 91.9% at the end of March, preserving the utilization rate of the deposit potential for lending to the private sector at the same level as in the previous quarter.

**In the first quarter of 2016, lending to household sector continued to grow at the same pace as in the previous quarter (quarterly increase of 2.5%).** The favorable trend in the sector, according to the Lending Survey, continued, partly due to the further moderate easing of credit standards, amid generally unchanged demand for all types of loans. The structural analysis points to denar and long-term loans as main generators of the growth of loans to households. As for the individual types of loans to households, the growth continues to be predominantly driven by the rising consumer loans, but their contribution to the growth has been decreasing. **Annually**, at the end of March, total loans to households increased by 13.0%, similar to the previous quarter (12.9% at the end of December).

**Corporate credits decreased quarterly by 1.8%, despite their strong growth of 5.7% in the previous quarter.** According to the Lending Survey, these movements correspond to the substantial slowdown in the growth of demand for corporate loans in this period, amid further net easing of the overall credit standards. By currency, the decline is predominantly driven by the foreign currency loans, as well as the decline in denar loans.

<sup>62</sup> According to monetary statistics data.

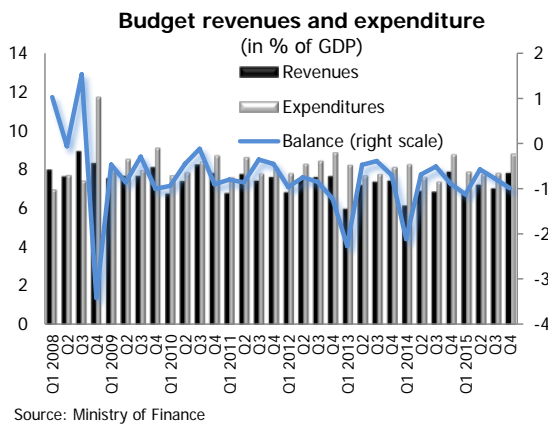


**Annually**, at the end of March, loans to enterprises increased by 5.1%, compared to 7.1% at the end of December.

**Latest data on interest rates on new loans as of February<sup>63</sup>** show increase in the interest rates on both corporate and household denar loans, and decrease in the interest rate on new loans to the both sectors.

### III. Public finances

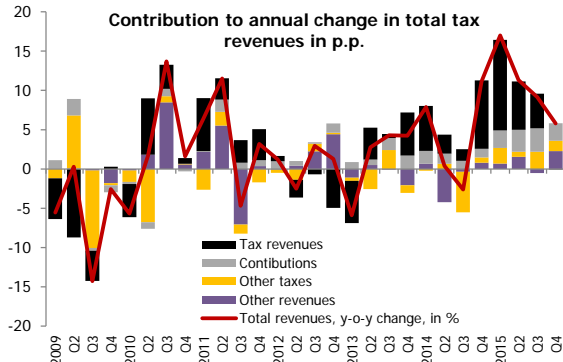
*Total budget revenues and expenditures (central budget and budgets of funds) continued to rise on an annual basis in the last quarter of 2015, but at a slower pace. The weaker realization of total revenue stems from the stagnation of tax revenues, as opposed to their growth in recent quarters. Amid further solid growth in direct taxes, such changes in the tax revenues have been entirely driven by declining inflows from VAT. Other components of budget revenues surged. Observing expenditures, the slowing annual dynamics arises from the smaller contribution to current costs. Capital expenditures have been significantly increasing annually for the second quarter in a row, and their contribution to the growth of total expenditure is higher compared to the previous quarter. Despite the slowdown in the annual dynamics, the quarterly growth of budget revenues and expenditures accelerated, and in this quarter the budget deficit was 1% of GDP, compared to 0.8% of GDP, in the third quarter. The budget deficit during this period was financed through borrowing on the international and domestic financial market. For the entire 2015, the budget deficit was 3.5% of GDP which is slightly better performance compared to the budget deficit of 3.6% of GDP as projected with the Budget Revision. The budget deficit was financed by a mix of domestic and foreign sources of funding.*



During the fourth quarter of 2015, total revenues in the Budget of the Republic of Macedonia<sup>64</sup> continued to grow on an annual basis and reached an annual growth rate of 5.8%, versus 9.2% in the third quarter. Analyzing relative indicators, the share of revenues in GDP was 7.8%, similar to the corresponding quarter of the previous year, but by 0.8 percentage points higher compared to the previous quarter. Besides the slow rate of growth, additional feature of the growth of budget revenues in this period was the change in the structure of the sources of growth. Thus, in the last quarter, the revenue growth was mainly explained by contributions and other revenues (foreign donations and non-tax revenues), as opposed to the past few quarters, when tax revenues were the main driver of the growth of total revenues. After the continued slowdown in the growth during the year, tax revenues in this period slightly declined on an annual basis, entirely deriving from the annual

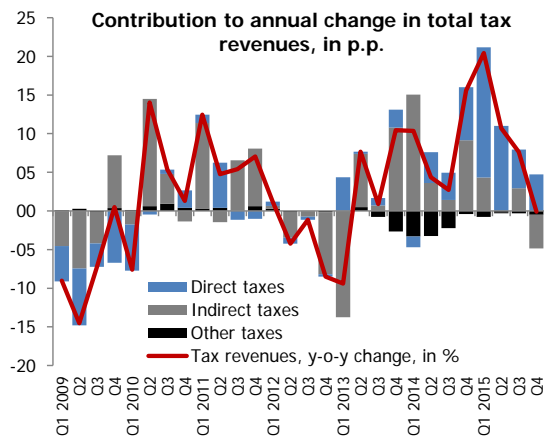
<sup>63</sup> As of January 2015, interest rate data of banks and savings houses have been collected under the new interest rate methodology, while data for the previous period were collected under the old methodology. For more information see Quarterly Report, May 2015, p 53.

<sup>64</sup> Central budget, and budgets of funds.

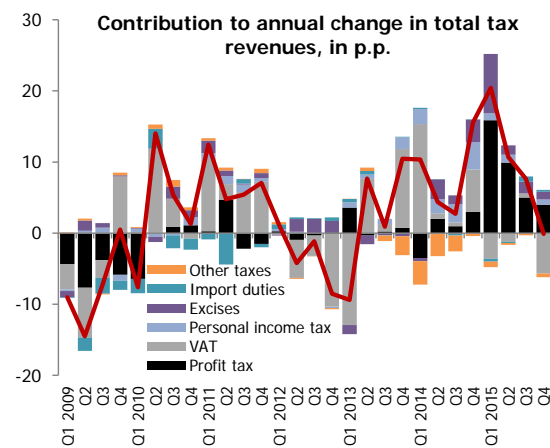


\*Other revenues include capital revenues, foreign donations and revenues from collected loans.

Source: Ministry of Finance and calculations at NBRM.



Source: Ministry of Finance.



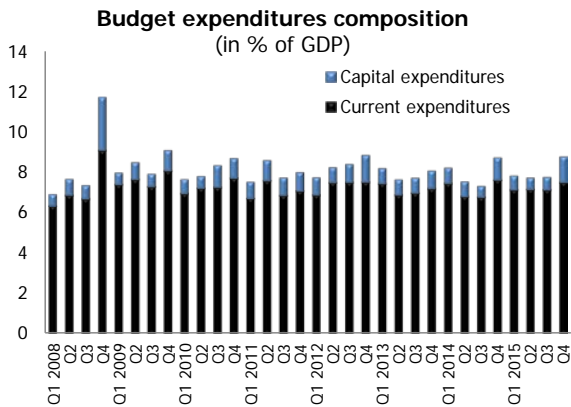
Извор: Министерство за финансии.

reduction in indirect taxes as a result of the drop in revenues from VAT, amid further solid collection of direct taxes. Thus, in the fourth quarter, tax revenues made a neutral contribution to the annual growth of total revenues, versus the continued positive contribution from the second quarter of 2013. The VAT revenues significantly reduced the tax revenues (by 5.7 percentage points), which given the strong growth in private consumption is partly explained by the higher base last year, and could be also attributed to the further reduction in oil prices during this period. On the other hand, revenues based on excise and import duties made modest positive contribution to the growth of total revenues of 1.1 percentage points and 0.3 percentage points respectively, which is slightly weaker performance compared to the previous quarter. With respect to direct taxes, the favorable developments are mostly driven by the further significant performance of profit tax, although with slower intensity compared to the performances early in the year<sup>65</sup>. Thus, profit tax revenues account for about 85% of the total growth of direct taxes, versus 95% on average in the previous three quarters. On the other hand, the contribution of the income tax revenues increased, making up 15% of the annual growth (5% on average in the previous three quarters) which is consistent with the continuing favorable trend in the labor market. Collection of social contributions in all subcategories further increased, with no significant changes in the structure of the generators of growth compared to the previous three quarters. Typical for the fourth quarter is that the largest individual contribution to the growth of total revenues was made by foreign donations, which constitute 42.7% of the total growth, with positive contribution of non-tax revenues.

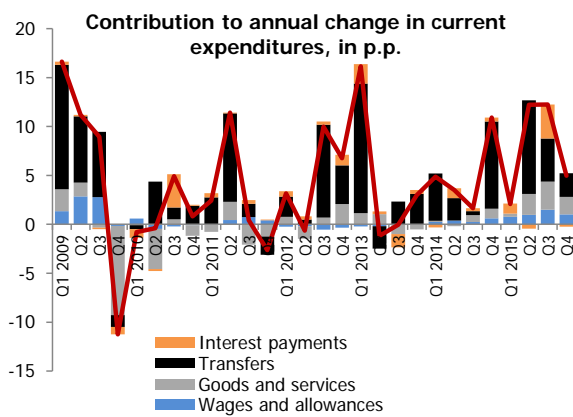
**In the last quarter of the year, the annual growth of total expenditures slowed down to 7.1%, versus 12.8% in the third quarter.** Expenditures to GDP ratio was 8.8%, same as the last quarter of 2014, which is an increase of 1 percentage point compared to the previous quarter. The slowdown in the growth of budget expenditures in this period was entirely due to the slower growth of current expenditures, while capital expenditures continued registering a solid growth rate. Accordingly, current costs contribute 61% to total growth versus 88% in the previous quarter, with increased contribution of the capital expenditures from 12% in the third quarter to 39% in the last quarter. In the individual categories of current costs, no significant changes were recorded in the structure of growth

<sup>65</sup> Since the beginning of 2015, there were high rates of annual growth of revenues on profit tax as a result of the abolition of the anti-crisis measure that exempted the retained earnings of the companies from taxation.

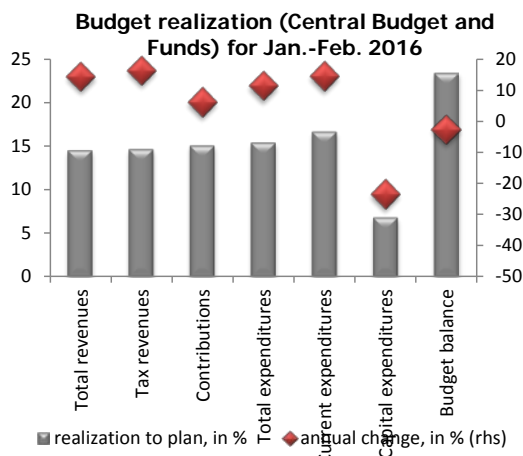




Source: MoF and NBRM calculations.



Source: MoF and NBRM calculations.



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

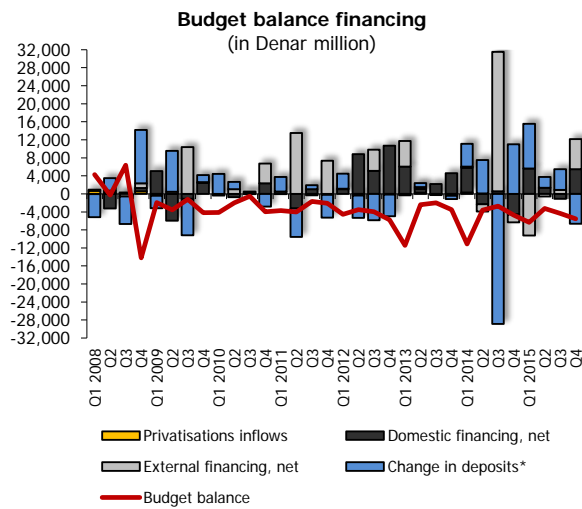
compared to the previous quarter, when transfers remained main drivers of growth, explaining about half of the growth of the current costs. Their growth is predominantly driven by the realizations in the PDIF, unlike the previous quarter when the growth was generated by health care transfers<sup>66</sup>. Other transfers, which include subsidies, registered a small positive contribution, despite the decline in the previous quarter. Cost of goods and services were the second largest factor of growth of the total current costs, accounting for 36% of the total growth, with additional positive contribution of the higher expenses for wages and benefits (making up 20% of the growth of current costs). The changes in interest payments during the fourth quarter were aimed at a moderate annual decline, thus reducing the capital costs, as opposed to the previous quarter, when a high annual growth was registered as a result of the repayment of the interest on the Eurobond issued in 2014. As a share of GDP, current costs and capital expenditures grew by 0.4 percentage points and 0.6 percentage points, respectively, to 7.5% of GDP and 1.3% of GDP, respectively, at the end of December.

**In the first two months of 2016, total budget revenues recorded a solid annual growth rate of 14.3%, mostly due to the stronger growth in tax revenues with additional contribution of the capital income and contributions.** Thus, tax revenues increased by 16.4% compared to the same period last year, primarily due to increased revenues of indirect taxes predominantly driven by higher collection of VAT in this period, as opposed to the performance in the fourth quarter when this budget component significantly reduced on an annual basis. Import duties made small positive contribution, while inflows from excise duties contributed to a slight decrease in total revenue from taxes. At the same time, inflows of direct taxes continued recording double-digit growth, making up 22% of the total generated growth in tax revenues, primarily through the faster growth of profit tax, and to a lesser extent by the growth of income tax. All categories of contributions recorded upward trends. The period January-February 2016 was also marked by high growth of capital income that constituted 26.3% of the total budget income in this period<sup>67</sup>. **Along with the growth of revenues, in the first two months of the year, budget expenditures also increased by 11.4%, annually.** The growth of total expenditures in this period is entirely driven by current costs, while capital expenditures made negative contribution. Most of the

<sup>66</sup> In July 2015, welfare increased by 10%.

<sup>67</sup> In January 2016, a domestic company paid dividend to the government.

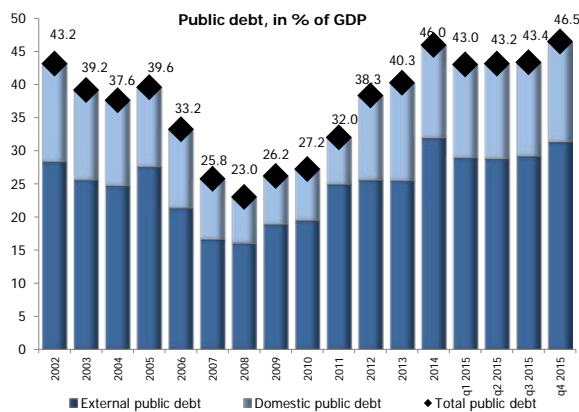




\* Positive change- deposits withdrawal; negative change-deposits accumulation.  
 Source: MoF.

growth of current costs (about 90%) was due to the rapid increase in transfers, amid moderate positive contribution of wage and benefit costs. **In the period January-February 2016, the budget deficit amounted to Denar 4,459 million, or 23.5% of the planned deficit for 2016.** In this period, the budget deficit was primarily funded by the higher net issuance of government securities on the domestic market, and less by withdrawing part of the government deposits with the NBRM.

**In the last quarter of 2015, the Budget of the Republic of Macedonia registered a deficit of Denar 5,551 million, or 1% of GDP which is slightly higher compared to the previous quarter (0.8% of GDP) and compared to the same period last year (0.9% of GDP).** With respect to financing, the fourth quarter witnessed higher inflows from the government borrowing on the foreign capital markets with the issuance of the fourth Eurobond<sup>68</sup> and through additional net issuance of government securities on the domestic market. Higher inflows than outflows<sup>69</sup>, in this period, have accumulated deposits on the government account with the NBRM. On a cumulative basis, the budget deficit for 2015 was Denar 19,425 million (or 3.5% of GDP), constituting 96.5% of the budget deficit for 2015 planned with the Budget Revision.



Source: MoF and NBRM calculations.

**As of 31 December 2015, the total public debt<sup>70</sup> was higher by 3.1 percentage points of GDP compared to the end of the third quarter, and made up 46.5% of GDP.** The analysis of its components indicates that the growth largely stems from the growth of external debt (of 2.1 percentage points of GDP), with a simultaneous increase in domestic debt of 1 percentage point of GDP. At the end of December, external debt to GDP and domestic debt to GDP were 31.3% and 15.2%, respectively. At the end of the fourth quarter, the total government debt<sup>71</sup> was 38% of GDP (35.6% of GDP in the third quarter), while the debt of public companies<sup>72</sup> made up 8.5% of GDP (7.8% of GDP at the end of the third quarter).

<sup>68</sup> In December, the state borrowed on the international financial market by issuing the fourth Eurobond in the amount of Euro 270 million with maturity of 5 years, an interest rate of 4.875%, and a yield rate of 5.125%.

<sup>69</sup> In December, the external liabilities on previously issued Eurobond of Euro 150 million were serviced.

<sup>70</sup> 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 entirely or predominantly owned by the state or by the municipalities, the municipalities within the City of Skopje and the City of Skopje, guaranteed by the Government.

<sup>71</sup> Government debt is defined as a sum of debts of the central and the local government.

<sup>72</sup> According to the public debt definition provided in the Law on Public Debt (Official Gazette of the Republic of Macedonia No. 165/14), it refers to guaranteed debt of public enterprises, and joint stock companies owned by the state.



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

	Supplementary Budget for 2015	Q1 Q2 Q3 Q4 2015					Budget for 2016	Jan-Feb	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.					Y-o-Y changes 2016 period over the same period of the previous year, in %		Contribution to y-o-y change, 2016 period over the same period of the previous year, in p.p.	
		planned, in Denar million	realized, in Denar million						planned in denar million	realized in denar million	Q1	Q2	Q3	Q4	2015	Q1	Q2	Q3	Q4	2015	Jan-Feb	Jan-Feb
<b>TOTAL REVENUES</b>	<b>166,842</b>	<b>37,779</b>	<b>40,352</b>	<b>39,314</b>	<b>43,762</b>	<b>161,207</b>	<b>177,292</b>	<b>25,848</b>	<b>17.0</b>	<b>11.3</b>	<b>9.2</b>	<b>5.8</b>	<b>10.5</b>	<b>17.0</b>	<b>11.3</b>	<b>9.2</b>	<b>5.8</b>	<b>10.5</b>	<b>14.3</b>	<b>14.3</b>		
Tax revenues and contributions	142,527	33,326	35,318	34,837	37,285	140,826	150,718	22,323	16.1	10.3	8.4	2.5	8.9	14.3	9.1	7.5	2.2	7.9	12.1	10.7		
Taxes	93,516	21,935	23,119	22,331	23,972	91,357	99,543	14,629	20.4	10.7	7.6	-0.1	9.0	11.5	6.2	4.4	-0.1	5.1	16.4	9.1		
Contributions	47,189	10,932	11,900	12,125	12,943	47,900	49,187	7,440	7.1	9.3	9.7	7.6	8.4	2.2	2.8	3.0	2.2	2.5	6.2	1.9		
Non-tax revenues	16,433	3,240	2,672	3,439	3,508	12,859	18,387	1,997	24.7	9.7	30.0	18.7	20.9	2.0	0.7	2.2	1.3	1.5	-3.7	-0.3		
Capital revenues	2,880	350	1,286	332	297	2,265	3,155	1,011	101.1	23.5	-4.6	-4.5	20.9	0.5	0.7	0.0	0.0	0.3	528.0	3.8		
Foreign donations	4,202	784	846	608	2,495	4,733	4,232	481	28.1	58.4	-20.6	69.6	39.9	0.5	0.9	-0.4	2.5	0.9	9.1	0.2		
Revenues from repayments of loans	800	79	170	98	177	524	800	36	-61.1	3.0	-11.7	-28.9	-28.0	-0.4	0.0	0.0	-0.2	-0.1	33.3	0.0		
<b>TOTAL EXPENDITURES</b>	<b>186,981</b>	<b>44,080</b>	<b>43,572</b>	<b>43,667</b>	<b>49,313</b>	<b>180,632</b>	<b>196,276</b>	<b>30,307</b>	<b>1.5</b>	<b>9.3</b>	<b>12.8</b>	<b>7.1</b>	<b>7.5</b>	<b>1.5</b>	<b>9.3</b>	<b>12.8</b>	<b>7.1</b>	<b>7.5</b>	<b>11.4</b>	<b>11.4</b>		
Current expenditures	164,747	39,936	40,106	39,919	42,004	161,965	170,698	28,557	2.1	12.2	12.2	5.0	7.7	1.9	11.0	11.2	4.3	6.9	14.6	13.4		
Capital expenditures	22,234	4,144	3,466	3,748	7,309	18,667	25,578	1,750	-3.8	-16.3	19.1	21.2	5.9	-0.4	-1.7	1.6	2.8	0.6	-23.6	-2.0		
<b>BUDGET DEFICIT/SURPLUS</b>	<b>-20,139</b>	<b>-6,301</b>	<b>-3,220</b>	<b>-4,353</b>	<b>-5,551</b>	<b>-19,425</b>	<b>-18,984</b>	<b>-4,459</b>	<b>-43.4</b>	<b>-11.1</b>	<b>61.5</b>	<b>18.6</b>	<b>-12.2</b>									
Financing	20,139	6,301	3,220	4,353	5,551	19,425	18,984	4,459														
<b>Inflow</b>	<b>48,958</b>	<b>16,709</b>	<b>5,142</b>	<b>9,300</b>	<b>16,695</b>	<b>47,846</b>	<b>40,546</b>	<b>5,385</b>														
Privatisation receipts	0	0	0	0	0	0	0	0														
Foreign loans	4,339	1,018	362	1,483	17,003	19,866	22,861	612														
Deposits	20,973	9,928	2,414	4,575	-6,607	10,310	-1,209	1,166														
Treasury bills	5,137	5,762	2,356	3,240	6,296	17,654	18,860	3,607														
Sale of shares	50	1	10	2	3	16	34	0														
<b>Outflow</b>	<b>28,819</b>	<b>10,408</b>	<b>1,922</b>	<b>4,947</b>	<b>11,144</b>	<b>28,421</b>	<b>21,562</b>	<b>926</b>														
Repayment of principal	28,819	10,408	1,922	4,947	11,144	28,421	21,562	926														
External debt	22,664	10,276	923	596	10,336	22,131	12,381	726														
Domestic debt	6,155	132	999	4,351	808	6,290	9,181	200														

Source: Ministry of Finance and NBRM calculations.

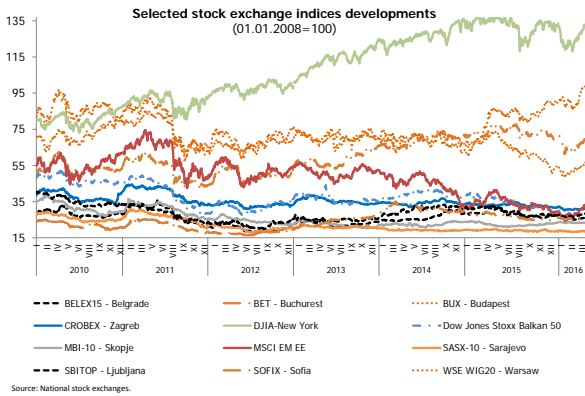
### IV. Stock exchange indices and real estate prices

*In the first quarter of 2016 the Macedonian MBI-10 recorded a quarterly decrease. The value of bonds index (OMB) continued to grow in the first quarter, but the growth was slowing down. The trends in most regional markets are also downward, mostly associated with country-specific factors. In order to increase the efficiency of regional capital markets, a regional platform for trading securities, SEE Link, became operational in March 2016, which linked the Bulgarian, Macedonian, and Croatian stock exchanges. The increase of real estate prices in the domestic market slightly accelerated in the first quarter of the year. Taking into account their variability over the past year, and the steady supply and demand for real estate, it is difficult to determine whether this change is temporary or permanent.*

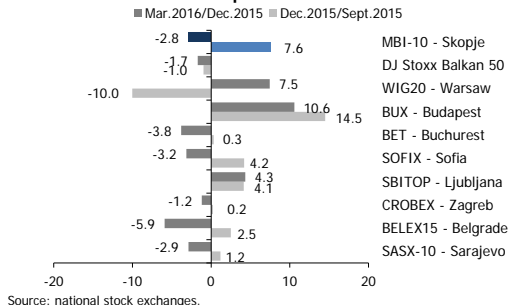


During the first quarter of 2016 the value of the Macedonian MBI-10<sup>73</sup> registered quarterly fall of 2.8%, whereby the index reached the value of 1781.03 at the end of the quarter (compared to 1833.26 at the beginning of the quarter). Thus the upward trend of the index from the second half of 2015, was interrupted in the first quarter of 2016. The total stock exchange turnover decreased by 13.6% compared to the previous quarter, also by the decreased trading volume of block transactions. Such movements of the index could reflect the lack of interest of domestic investors and the absence of major foreign institutional investors, as well as increased risk aversion, taking into account the current uncertain political situation in the country. Unlike MBI-10 index, at the end of March 2016, the OMB index increased by 0.3% compared to the end of December 2015, (slightly slower compared to the previous quarter, when the growth was 0.5%).

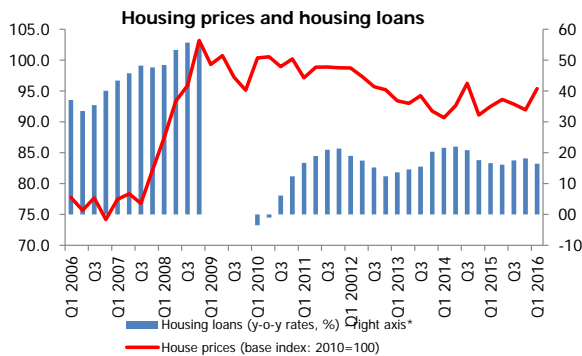
<sup>73</sup> On 15 December 2015, the MBI-10 index was revised, and as of 30 December 2015, the index includes the following companies: Komercijalna Bank AD Skopje, Granit AD Skopje, Alkaloid AD Skopje, Stopanska Bank AD Bitola, Makpetrol AD Skopje, Makedonijaturist AD Skopje, Stopanska Bank AD Skopje, Macedonian Telecom AD Skopje, NLB Tutunska Bank AD Skopje and Skopski Pazar AD Skopje.



Changes of the regional stock exchange indices, eop March 2016/eop December 2015 and



Source: national stock exchanges.



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

At the end of the first quarter of 2016, most of the regional stock indices decreased, except those in Budapest, Warsaw, and Ljubljana. The downward trend of indices could partially be attributable to the increased volatility in global financial markets, and uncertainty in the external environment. However, most of the shifts in the regional stock markets have been influenced by country-specific factors<sup>74</sup>. For the purposes of higher integration of the regional capital markets, the regional platform for trading securities, *SEE Link*<sup>75</sup> became operational on 29 March 2016. This platform ensured trade in 387 securities listed on the exchanges in Skopje, Sofia, and Zagreb, and will be joined by the exchanges in Belgrade and Ljubljana.

In the first quarter of 2016, the growth of house price index<sup>76</sup> moderately accelerated on an annual basis to 3.1% (increase of 0.9% in the fourth quarter of 2015). However, considering that last year, real estate prices registered slight divergent movements, it is difficult to conclude whether the change in the first quarter is permanent or temporary. This is also underpinned by the fact that after the considerable decrease in the previous year, apartment prices stabilized last year. Real estate supply and demand indicators do not point to significant changes. The construction of residential properties continues registering double-digit growth rate (average annual growth rate of construction of residential properties in 2015 of roughly 19%), with similar rate of approvals for construction of residential properties, as shown by relevant data. Analyzing the demand for apartments, the permanent solid growth of housing loans continued in the first<sup>77</sup> quarter of 2016 that suggest further increase in the demand.

<sup>74</sup> <http://wire.seenews.com/>

<sup>75</sup> <http://www.see-link.net/>

<sup>76</sup> Hedonic index of housing prices, prepared by the NBRM on the basis of the notices of sale in the capital city, and published by real estate agencies. The price of apartment is a function that consists of the size of the apartment, the neighborhood, the floor, whether the apartment has central heating, and whether the apartment is new.

<sup>77</sup> Data available for the first two months of the quarter.



## V. Macroeconomic forecasts and risks

The latest cycle of macroeconomic forecasts for 2016 and 2017 was rounded at the beginning of April and did not indicate major changes in the macroeconomic environment, compared to the October projection. Regarding the further presence of internal political risks, within the projections, relatively rapid stabilization of the political situation was assumed, without its major effects on the domestic economy. Available indicators for the domestic economy, together with incorporated external and domestic assumptions for the next period resulted in a similar projected path of key indicators, as well as within the October projections. The baseline macroeconomic scenario shows solid economic growth of 3.5% and 4% in 2016 and 2017, respectively, supported by structural changes in the export sector, public infrastructure investments and credit activity of domestic banks. Amid lower import prices, the projected inflation for 2016 is lower compared to the previous projection, averaging 0.5% for 2016, while for 2017, price growth is further expected of 1.6%, on average. Amid lower oil prices than expected, the current account deficit is smaller compared to the October projections and it is assessed at a moderate level of 1.2% and 1.4% of GDP in 2016 and 2017, respectively, financed through debt and non-debt flows, which will provide further growth of foreign reserves. **During April 2016, the political situation deteriorated, with more pronounced signals of its action on the confidence and expectations of the entities being noticed.** For these reasons, within this forecasting round, alternative macroeconomic scenario was developed, which assumes continuation of the political crisis for a certain period of time, with effects mainly during 2016. The macroeconomic landscape within this scenario shows significantly weaker economic growth compared to the baseline scenario, i.e. real GDP growth estimated at 1.6% in 2016, which will contribute to keeping prices in the negative zone. In the external sector, the alternative scenario shows a slightly higher current account deficit (2% of GDP in 2016), driven by the growing propensity for holding foreign currency and thereby lower private transfers, and effects on external financial flows would be adverse. However, in this scenario, foreign reserves adequacy indicators remain within the safe zone.

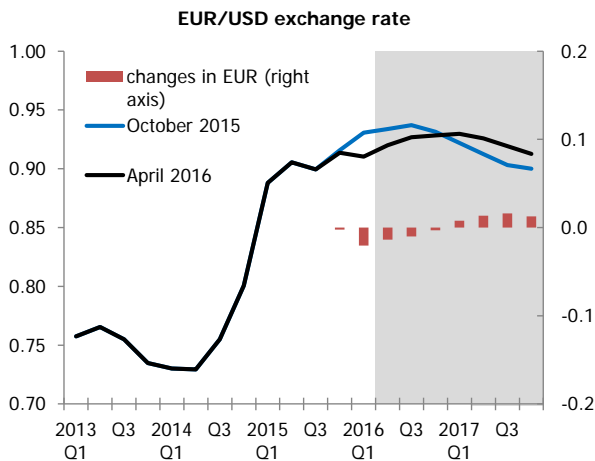
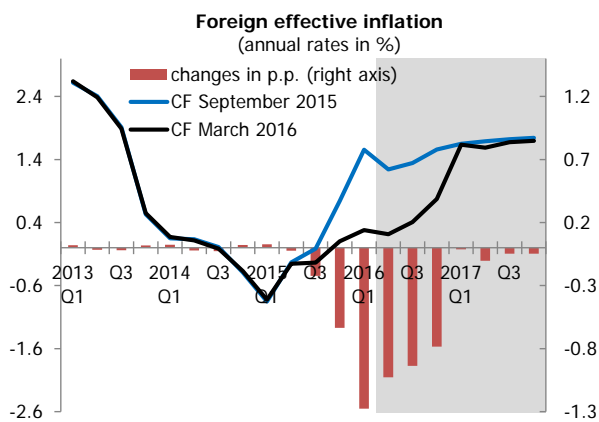
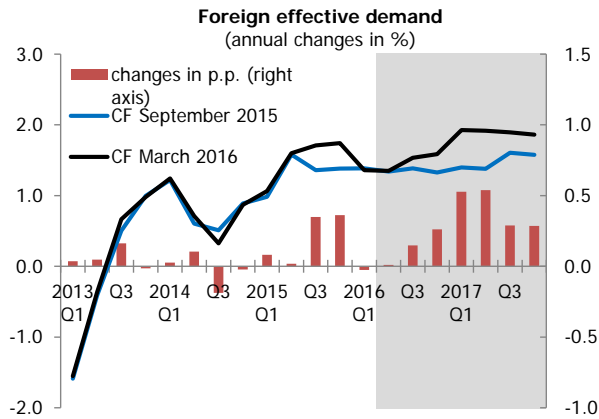
### 5.1. Assumptions in the external environment forecast<sup>78</sup>

*Global economic activity slowed down significantly in the fourth quarter of 2015, amid weak growth in the developed economies and unfavorable macroeconomic conditions in some developing countries. The latest projections<sup>79</sup> for the global growth in 2016 and 2017 were revised downwards, suggesting modest recovery compared to previous expectations. Given the downward revisions, and more pronounced downward risks, the global economic environment is assessed as less favorable compared to October cycle.*

**Contrary to the outlook of the global economy, according to the latest**

<sup>78</sup> The historical data on the foreign demand, foreign inflation, exchange rate of the US Dollar/Euro and EURIBOR are sourced from Eurostat, while the IMF statistics is a source of the data on prices of oil, food and metals. The projections of the foreign demand, foreign inflation, foreign exchange rate of the US Dollar and EURIBOR 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. The analysis uses various reports of the IMF, the World Bank, ECB, FAO, OPEC and specialized economic portals.

<sup>79</sup> World Economic Outlook, IMF, April 2016.



**estimates foreign effective demand<sup>80</sup> was revised upwards in the entire period of projections.** Thus, it is now forecasted that its growth in 2016 and 2017 will amount to 1.5% and 1.9% versus the forecast of 1.4% and 1.5% in October. The upward revisions in both years were mainly due to more optimistic assessments of the performance of the Greek economy, while additional positive contribution, particularly in 2017, derives from the upward revision of the economic growth in Bulgaria.

**The comparison with October indicates a significantly lower rate of foreign effective inflation in 2016,** which is estimated to be minimal and will amount to 0.4%, unlike earlier when it was expected to reach 1.4%. This change comes amid downward revisions of projected inflation rates with all our main import partners, of which the dominant contribution to the revision stems from the significant corrections in Germany, Greece and Serbia<sup>81</sup>. By contrast, in 2017, change to the projection of foreign inflation was not made compared to October, i.e. it is still expected to reach 1.7%.

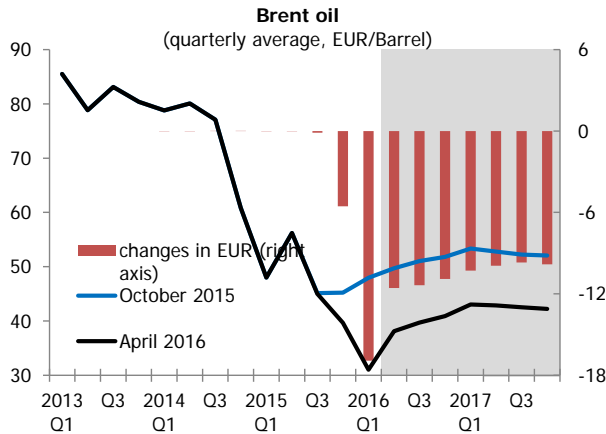
Regarding the projection of **the exchange rate of the US dollar against the euro** in 2016, a more moderate appreciation of the US dollar is projected on an annual basis compared to October (2.2% versus 3.4%). For 2017, significant change was made in expectations. Thus, the new forecast envisages continuation of the trend of increasing the value of the US dollar, unlike the October projection for its depreciation, taking into account the expectations of more pronounced divergence between the Fed and the ECB monetary policies in the coming period and asymmetric economic developments in the US and the eurozone.

**In the first quarter of 2016, sharper decline in the price of oil "Brent" was registered, which is expected to continue in most part of the rest of the year.** Consequently, for the entire 2016, the correction in oil prices compared with October estimates is significant. Thus, as moderate growth in oil prices was previously projected for this year, it is now expected their double-digit decline, given

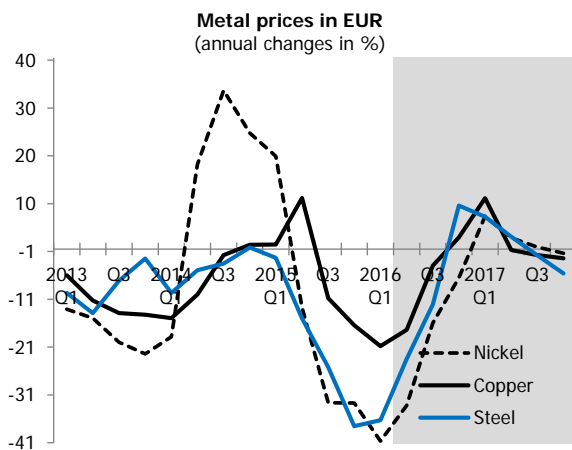
<sup>80</sup> Foreign effective demand is calculated as the sum of the weighted indices of the gross domestic product of the most important trading partners of the Republic of Macedonia. The calculation of the index includes Germany, Greece, Italy, the Netherlands, Belgium, Spain, Serbia, Croatia, Slovenia and Bulgaria.

<sup>81</sup> Inflation in Serbia has been adjusted for the changes in the exchange rate.

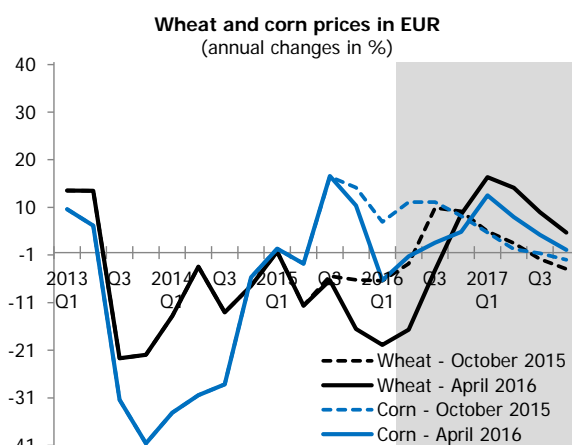




the continued existence of large surpluses of oil on the global market and continuously increasing supply by the OPEC Member States. Also, the projected slowdown of the growth in global demand is expected to further affect the fall in oil prices. In contrast, in 2017, growth in oil prices is expected, but the price level will remain lower than the October projection. In nominal amounts, oil prices are forecasted at EUR/Barrel 37.4 in 2016 and EUR/Barrel 42.6 in 2017, by around Euro 10 lower than previously projected.

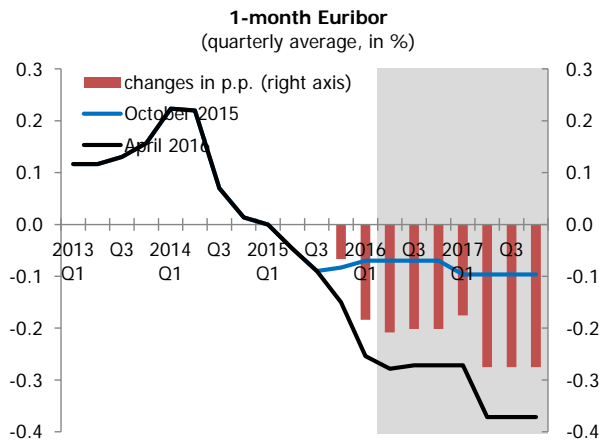


**The fall in metal prices continued to deepen at the beginning of 2016, whereby gradual depletion of the negative developments was estimated in the forthcoming period.** However, compared with October, the recovery in the metal market was prolonged, whereby the latest estimates in terms of prices of nickel, copper and steel in 2016 showed renewed downward correction. Deepening of negative growth rates has been predicted this year, amid still unbalanced foundations, taking into account the stocks on the supply side<sup>82</sup>, as well as the increased skepticism about demand from China as a key market participant. The recovery of the metal market would be more visible in 2017, when certain increase in the prices of nickel and copper is expected on global markets, as opposed to the October projection for their further decline, amid expectations for a gradual reduction of excess supply in the global market. On the other hand, expectations for growth of steel prices were maintained, although the growth rate was moderately revised downwards.



**In the period of projections, there were significant changes regarding the perceptions of the future movement of the prices of primary food products compared with October.** Thus, for 2016, a significant downward revision has been made to the projection for the prices of wheat and corn, whereby they are now expected to continue to decline as opposed to the October estimate for their growth. This change is a reflection of multiple factors, such as the current situation of having a solid supply of wheat and corn, the projections for high global inventories and favorable expectations for the coming harvest. In contrast, in 2017, an upward revision was made, whereby it is now envisaged significantly higher

<sup>82</sup> Additionally, regarding the price of nickel, there were announcements for revision of the ban on exports by Indonesia, which if realized, they would influence the increase in the supply of nickel on the global market.

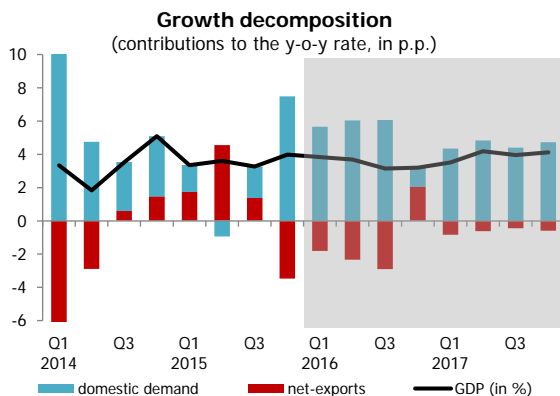


increase in the prices of wheat and corn compared with the October projections.

Compared to October, a downward revision of the **one-month Euribor** was made, amid further easing of the monetary policy of the ECB. The one-month EURIBOR is now expected to move deeper within the negative zone and amount to -0.27% and -0.35% on average, in 2016 and 2017, respectively, compared to -0.07% and -0.1% in the October projection.

## 5.2. Forecast and effects on monetary policy

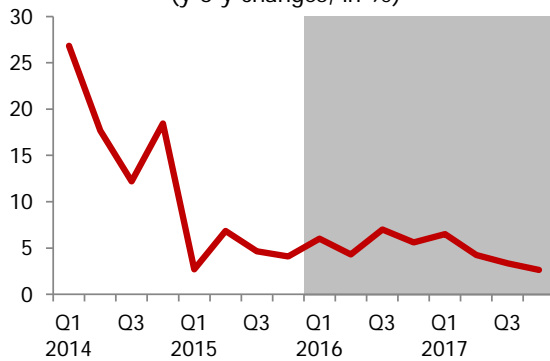
The **basic macroeconomic scenario indicates a stable external position of the economy and foreign reserves, which in the next period will be maintained at an appropriate level.** Although the growth of domestic economy is expected to create certain import pressures, it is however estimated that they will not cause disruption of external balance. For the next two-year period, it is expected that the current account deficit will be financed by direct investments and borrowing, which will condition growth of foreign reserves and their maintenance at an appropriate 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.** Thus, in the next two-year period, the interest rate of the one-month EURIBOR is expected to be maintained in the negative zone, taking into account the measures that the ECB undertook in March 2016 aimed at further monetary easing. **Key adverse risks to the baseline macroeconomic scenario are similar to those of the October forecasting round, but they are more pronounced.** It is estimated that there is a significant increase in the uncertainty due to **domestic factors associated to the domestic political crisis** and its prolongation which increases the prospects to spill over into the economy. **Exogenous risks** are associated to the uncertainty about the recovery of the global economy, increased volatility in global financial markets, maintaining low levels of metal prices, as well as pronounced geopolitical risks.



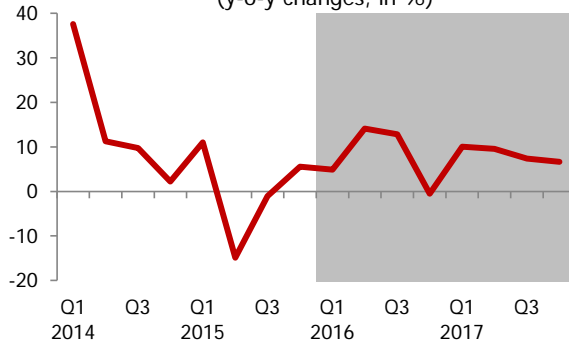
In 2015, the economic growth was 3.7%, which is somewhat higher compared to the October projection. The main factors for economic



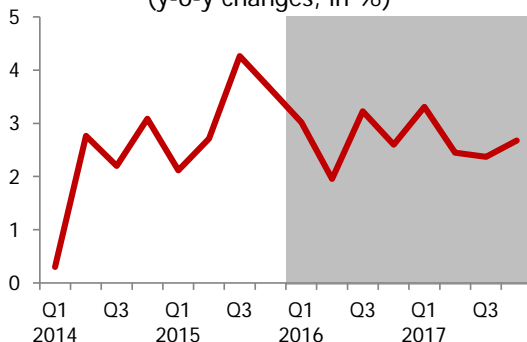
**Exports of goods and services**  
(y-o-y changes, in %)



**Gross capital formation**  
(y-o-y changes, in %)



**Private consumption**  
(y-o-y changes, in %)



growth were exports and private consumption, and public consumption made a small positive contribution, while the contribution of investments was neutral. Available high frequency data point to continued growth with similar intensity in the first quarter of 2016. **The economic growth in 2016 and 2017 will be driven by exports and investments and is expected to be 3.5% in 2016 and 4% in 2017.**

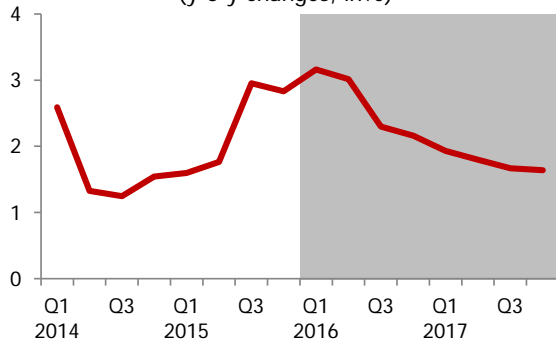
**Exports will be one of the main drivers of overall economic growth in the next two years**, which in 2016 is mainly associated with export growth of new production facilities, while amid unfavorable conditions in metal prices, reduced production and exports of metal industry are expected. Export growth will continue in 2017 amid further recovery of the foreign effective demand, further growth of exports of foreign facilities, entry of new facilities in the export sector, as well as gradual recovery of metal prices.

**The positive movement in domestic demand will continue during 2016 amid growth in all components. The gross investments will be one of the main factors for the projected economic growth** given the expected continuation of construction activity related to government investments in road infrastructure, growth of private investments (expectations for investments in new facilities by foreign investors) and increased lending activity amid expected favorable credit conditions. **In 2016, solid growth of private consumption** is expected, supported by higher real disposable income of households. Additionally, the growth of private consumption will be supported by further credit activity by domestic banks. **Such trends on the side of domestic demand are expected to continue in 2017.** The extension of the public investment stimulus in road infrastructure, taking into account the long-term nature of infrastructure projects, investments in new facilities with foreign capital and growth in export activity will support growth of gross investments in 2017. **Also, positive but moderate growth rates are expected in public consumption in the period of projection**, thus having small positive contribution to the growth.

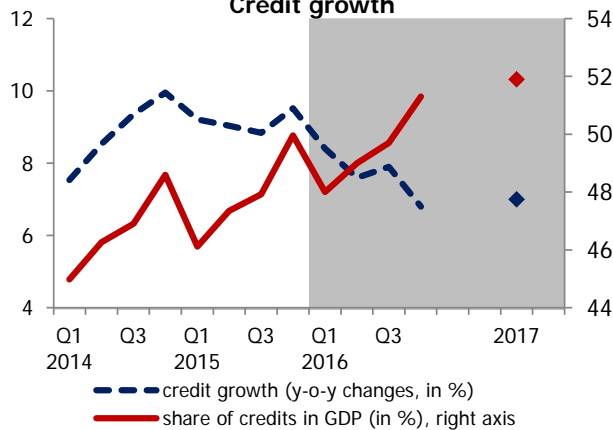
**Estimates for continuing economic growth will contribute to the continuation of solid credit growth**, which is expected to reach 6.8% at the end of 2016 and 7% at the end of 2017. The projected credit growth reflects the factors on both the demand and the supply side. Thus, demand for loans is expected to continue to



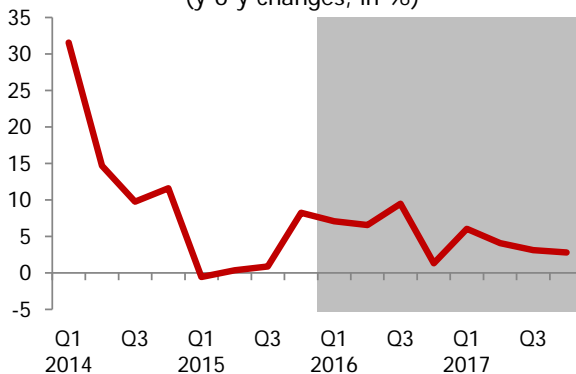
**Employed persons**  
(y-o-y changes, in%)



**Credit growth**



**Imports of goods and services**  
(y-o-y changes, in %)



**Balance of Payment Forecast** (% of GDP)

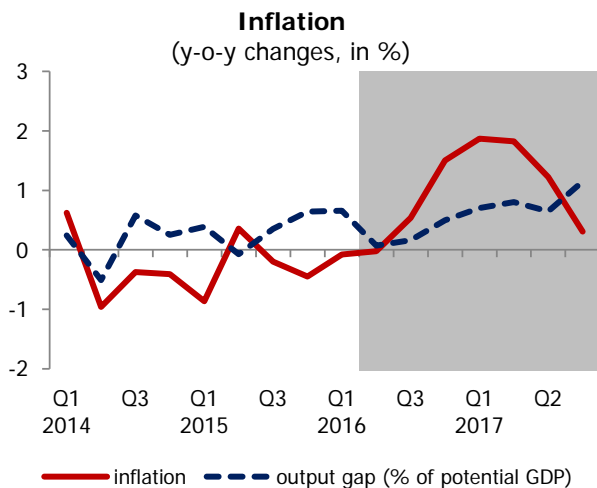
	2012	2013	2014	2015	2016	2017
<b>Current account</b>	-3.2	-1.6	-0.8	-1.4	-1.2	-1.4
Balance of goods & services	-22.4	-18.3	-17.6	-16.3	-16.0	-15.4
Goods, net	-26.5	-22.9	-21.8	-20.1	-19.9	-19.9
Services, net	4.1	4.6	4.2	3.8	4.0	4.6
Primary income, net	-2.2	-2.4	-1.9	-2.4	-2.3	-2.7
Secondary income, net	21.4	19.0	18.6	17.3	17.1	16.6
Private sector, net	20.6	18.1	17.3	16.8	16.4	15.9
<b>Capital account</b>	0.1	0.2	0.0	0.1	0.0	0.0
<b>Financial account</b>	-4.7	-0.8	-5.2	1.0	-1.1	-2.9
FDI, net	-1.7	-2.8	-2.3	-1.9	-2.1	-2.3
Portfolio Investment, net	-1.0	2.0	-5.7	-0.7	0.3	0.1
Other Investment, net	-1.9	0.1	2.8	3.6	0.7	-0.7

grow in the next two years, amid expected favorable trends in the labor market and increased investment activity. On the supply side, support of the growth of the deposit base is expected, given the assessments for relatively stable risk perceptions by banks. At the same time, 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 deposit potential**, in 2016, growth of the deposit base of 6% is expected, while in 2017, deposit growth is estimated to accelerate to 7.2%.

Increased investment and export demand, as well as further growth of private consumption **are expected to lead to growth in imports in 2016 and 2017**. According to the trends in exports and imports of goods and services in the next two-year period, **the contribution of net exports to the economic growth is expected to be negative**.

**According to the latest estimates for 2016, a slight narrowing of the deficit on the balance of payments' current account is expected, and accordingly, it will equal 1.2% of GDP**. The improvement in the deficit in the current transactions mostly arises from the further favorable developments with the foreign trade of goods and services, given the narrowing of the energy deficit, amid lower energy prices on world markets. Further positive effects are expected also from the new export facilities, while the estimated performances in the traditional export sector are less favorable. In terms of secondary income, it is still expected to deliver solid net inflows based on current transfers of 17.1% of GDP. **In 2017, the current account deficit is expected to deteriorate by 0.2 p.p. of GDP and equal 1.4% of GDP**. This small change is expected to result from the reduced surplus in secondary income and the increase in the deficit in primary income. By contrast, the foreign trade is anticipated to further narrow the balance of goods and services, which fully arises from the reduced non-energy deficit, amid improved global environment. **The financing of the current account in this two-year period is expected mostly to be provided through foreign direct investment and public sector external borrowing in the long term.**

*In 2016-2017 period, the current account deficit is expected to be fully covered by financial flows, which will provide further accumulation of foreign reserves. During the entire period of projections foreign reserves adequacy indicators*



are maintained in a safe zone.

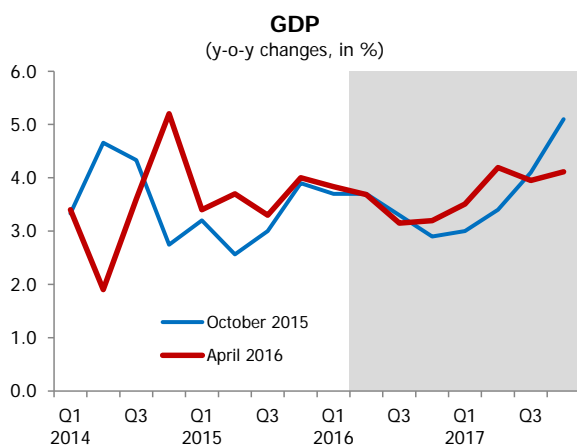
**In 2016, the inflation rate is expected to be low and to amount to 0.5%.** This small increase in domestic prices is in line with the performances in the first quarter, as well as the expected decline in import prices of energy and food for 2016 that will condition a decline in domestic prices of these two components. In contrast, given the expected growth in domestic demand, core inflation is expected to grow and contribute positively to the headline inflation. **In 2017, the inflation is expected to accelerate to 1.6%** in line with the growth of domestic demand, foreign effective inflation and import food and energy prices.

### 5.3. Comparison with the previous forecast

**Forecast of selected macroeconomic variables**

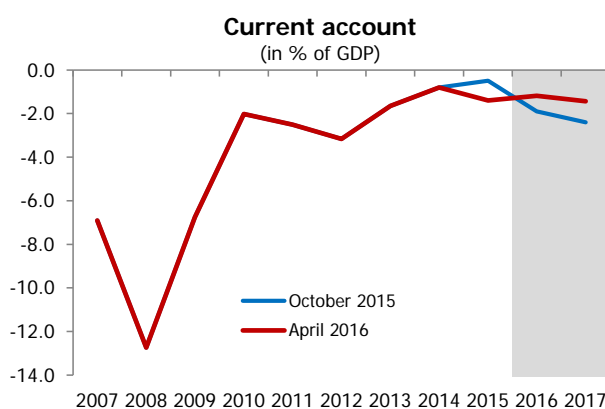
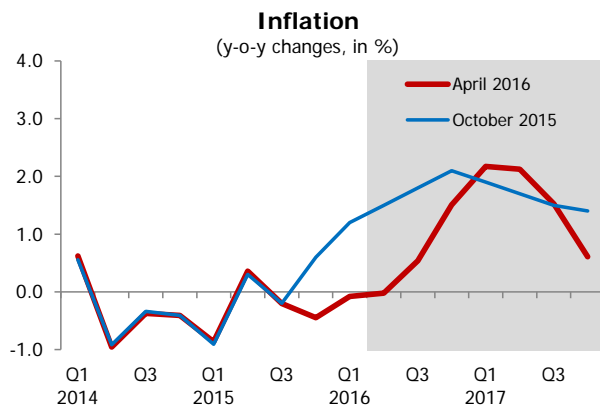
annual rates of change (in %)	2016 forecast		2017 forecast	
	Apr.	Oct.	Apr.	Oct.
<b>GDP</b>	<b>3.5</b>	<b>3.5</b>	<b>4.0</b>	<b>4.0</b>
Private consumption	2.7	2.2	2.7	3.2
Gross capital formation	7.9	10.4	8.8	7.1
Public consumption	3.4	1.4	1.4	1.3
Exports of goods and services	5.9	6.2	4.3	4.3
Imports of goods and services	6.2	6.8	4.1	4.2
<b>Inflation</b>	<b>0.5</b>	<b>1.5</b>	<b>1.6</b>	<b>1.6</b>
<b>Current account deficit</b> (% of GDP)	<b>-1.2</b>	<b>-1.9</b>	<b>-1.4</b>	<b>-2.4</b>

According to the baseline scenario, the projections for the growth of domestic economy in 2016 and 2017 remain unchanged compared with October assessments. On the other hand, recent developments and assessments indicate a lower rate of inflation in 2016, while for 2017, no changes were made. In this forecasting round, assessments point to smaller current account deficit in 2016 and 2017. On the other hand, the financial flows expected lower inflows on cumulative basis over the period 2016 - 2017, compared to October projections. The projected credit growth for the 2016 - 2017 period has been revised slightly downwards relative to the October projections.



Expectations for the growth of economic activity in 2016 and 2017 were unchanged compared to the October projection. **Thus, GDP growth continues to be projected at 3.5% in 2016 and 4% in 2017**, and the perspectives on the growth structure have been maintained. Namely, on a cumulative basis, growth is expected to continue to be driven by exports and investment, although the positive contribution of both factors is slightly higher compared to October. Also, the plans of the budget and fiscal strategy indicate somewhat higher positive contribution of public consumption. The positive contribution of private consumption is the same as in the October projection. These revisions indicated stronger positive effect of *domestic demand* on the growth on a cumulative basis. However, the faster growth of domestic demand will result in higher growth of imports, i.e. moderately more negative effect of *the net export* on the growth in 2016 and 2017.





The new estimates for price movements indicate a **significant downward revision of the inflation rate in 2016 compared to the October projection (from 1.5% in the October projection to 0.5%)**. Factors that explain this change are the keeping of inflation in the negative zone in the first quarter (compared to the expected growth in the previous projection) and the downward revision of the projections for the movement of world prices of energy and food. **The assessment of inflation for 2017 - growth of 1.6% remains unchanged.**

According to recent estimates, the current account deficit is expected to improve relative to the October forecasting round. **By the end of 2016, it is expected that the deficit will be 1.2% of GDP, i.e. 0.7 p.p. of GDP lower than previously expected.** The downward correction of the current account deficit, mainly results from lower deficit in primary income (lower estimated reinvested gain) and the lower deficit in foreign trade of goods and services, mainly due to lower import pressures from energy. On the other hand, the position of secondary income registered a downward change. **Downward correction in the current account deficit is made in 2017, when it is expected to amount to 1.4% of GDP, compared with 2.4% of GDP according to the October projection.** The smaller current account deficit is again a consequence of the lower deficit in goods. Thus, compared with the October projection, the improved balance is due primarily to lower energy balance and a lower deficit in primary income. **From the viewpoint of financial flows, cumulatively in 2015 and 2016, lower inflows compared to the October projection are expected.** The downward revision of the financial account for these two years is due to the lower financial flows with the direct investments and the long-term borrowing by the private sector.

**Comparison of GDP and inflation forecasts for Macedonia from various organisations**

Organisation	Month of publication	Real GDP growth, %		Inflation (average rate, %)	
		2016	2017	2016	2017
IMF	April 2016	3.6	3.6	0.5	1.5
World Bank	April 2016	3.7	4.0	0.9	-
European Commission	May 2016	3.5	3.5	1.1	1.4
EBRD	November 2015	3.5	-	-	-
Consensus Forecast	April 2016	3.7	3.6	1.5	2.3
National Bank of Greece	April 2016	3.6	3.4	-	-
Ministry of Finance of the Rep. of Macedonia	January 2016	4.0	4.3	2.0	2.0
National Bank of the Republic of Macedonia	April 2016	3.5	4.0	0.5	1.6

Source: IMF World Economic Outlook, April 2016; World Bank SEE Regular Economic Report No.8, April 2016; European Commission European Economic Forecast, May 2016; EBRD Regional Economic Prospects, November 2015; Consensus Forecast, April 2016; NBG Southeastern Europe and Mediterranean Emerging Market Economies, April 2016; Ministry of Finance of the Republic of Macedonia, 2016 Budget Proposal and Economic Reform Programme; and the National Bank of the Republic of Macedonia.

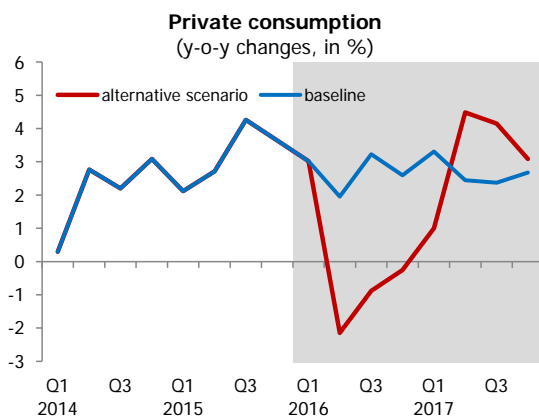


## 5.4. Alternative scenario

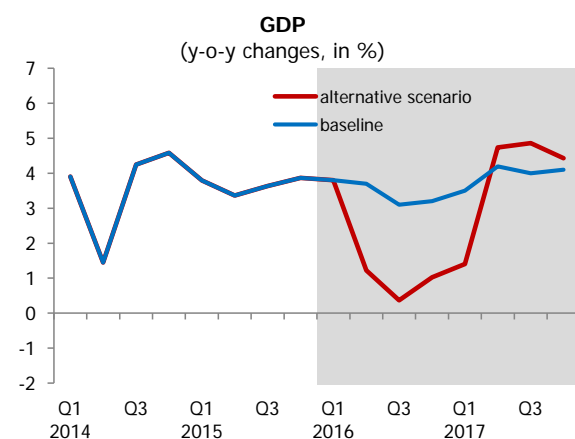
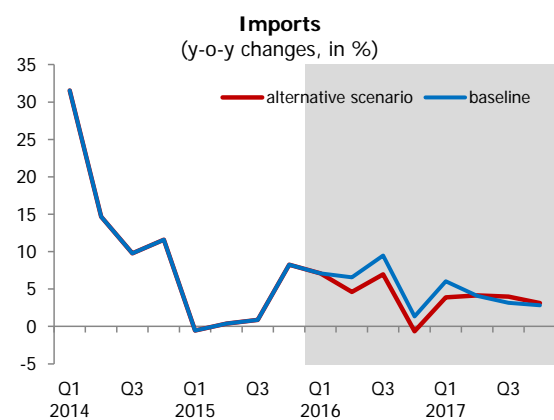
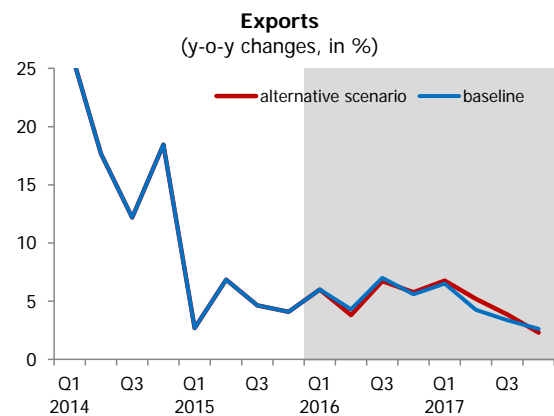
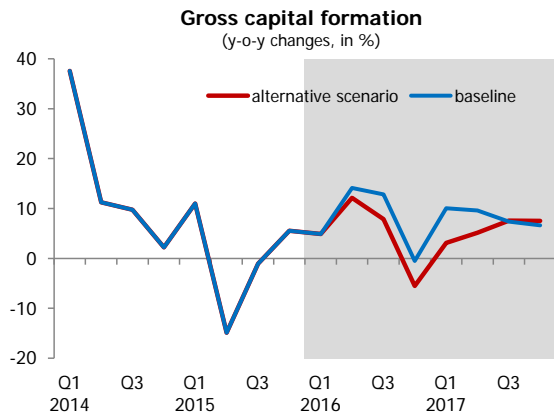
The continuation of the uncertainty in the domestic political context increases the possibility of spillover of this risk on the domestic economy. For these reasons, despite the baseline scenario, an alternative has been made, which assumes continuation of the current political situation for a certain period and shows the key transmission channels on the economy and possible effects. The confidence and expectations of households, domestic and foreign investors and lenders are the main transmission channel of this risk. In circumstances when the expectations are less favorable, greater restraint from consumption and investment is possible, which would reflect on the overall economic growth. At the same time, the uncertainty would increase the propensity of subjects for holding foreign currency, which along with the possible reduction of inflows in the financial account would act unfavorably on the balance of payments. Weaker growth and weaker foreign currency flows are transferred in a weaker banks' deposit base, which along with the deteriorating risk perceptions might slow down credit activity. Given the assumption that this situation will persist for a certain period, their effects under the alternative scenario, are visible mainly during 2016.

Comparison of baseline and alternative scenario

	2016 forecast		2017 forecast	
	baseline	altern.	baseline	altern.
GDP, %	3.5	1.6	4.0	3.9
Dom. demand (contrib., p.p.)	4.7	1.8	4.6	4.2
Net exports (contrib., p.p.)	-1.2	-0.2	-0.6	-0.3
Current account deficit (% of GDP)	-1.2	-2.0	-1.4	-2.8
Credit to private sector, %	6.8	3.0	7.0	5.0
Deposits, %	6.0	2.3	7.2	4.0



Taking into account these assumptions, the alternative scenario assumes significantly lower domestic demand compared to the baseline macroeconomic scenario. The uncertain environment may affect the confidence of the households, increasing the restraint from greater consumption. Despite the general restraint of psychological causes, the reduced disposable income would have an effect on private consumption. Namely, such uncertain environment reduces the propensity of the corporate sector for new investments and load balance through further wage increase and/or employees. Thus, the conditions on the labor market in this scenario are less favorable compared to the baseline scenario. Lower growth rate in the number of employees and wages is expected, compared to the baseline scenario. An additional effect could be expected from the fall in private transfers, which is typical in times of crisis and increased uncertainty. The restraint from consumption by the households during 2016, given the narrowed deposit base and certain restraint of banks from greater risk would lead to possible smaller credit support to



households. In such circumstances, it could be expected halt of the current growth in consumption and its stagnation during 2016. **Amid increased uncertainty, it is assumed that it can come to restraint from new investments by foreign investors.** At the same time, the possible restraint in some of the domestic private investors and lower demand for corporate loans, amid increased risk aversion by banks would further lead to reduced investment activity in the corporate sector. On the other hand, although this scenario probably determines slowdown in infrastructure projects of the government, however some of these projects for which sources of funding are provided would continue to be implemented, especially in road infrastructure projects. Hence, investment growth is still expected in the alternative scenario, but significantly smaller compared to the baseline scenario.

**The alternative scenario did not envisage major effects on overall export activity,** which was largely driven by the new export-oriented facilities, whose business plans would be implemented in accordance with the dynamics assumed in the baseline scenario, given the unchanged assumptions about the external environment. On the other hand, the weaker pace of domestic demand would reduce import pressures, whereby **the growth in imports is slower compared to the baseline scenario.**

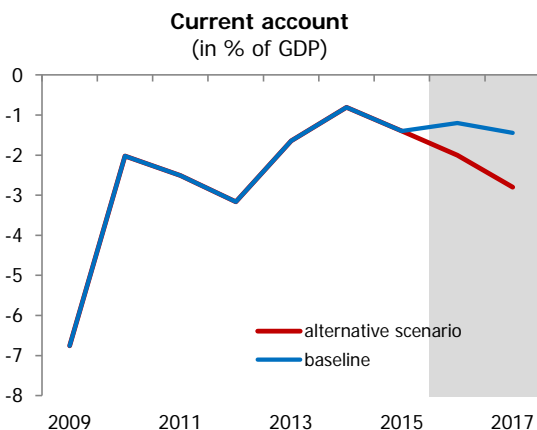
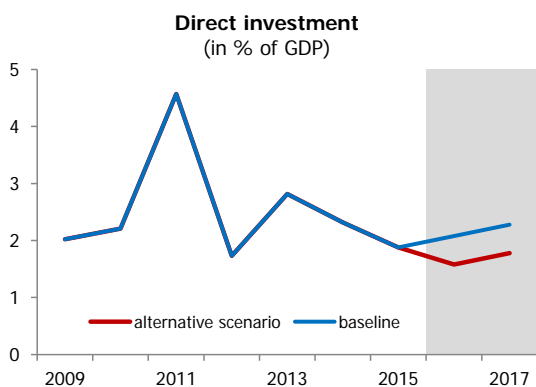
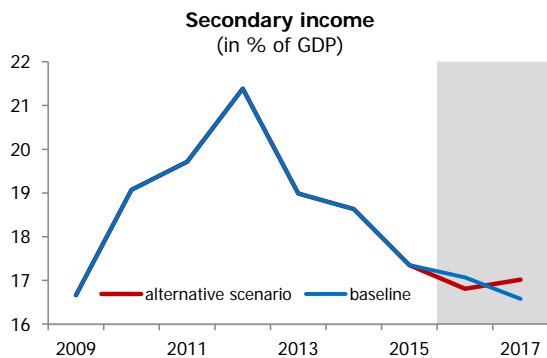
**These assumptions in the alternative scenario result in lower GDP growth in 2016 compared to the baseline scenario by about 2 percentage points (1.6% GDP growth, compared to 3.5% in the baseline scenario).** Generally, such downward correction compared to the baseline scenario is due to the slower growth in domestic demand, while net exports will have a lower negative contribution, due to the increased negative effect on imports. At this pace of economic activity, the output gap would remain in the negative zone and create downward pressures on prices in 2016, despite the expected moderate increase in inflation in the baseline scenario.

**Regarding the external position, the continued political crisis could be reflected through several points.** The first point is the increased propensity of the households for holding foreign currency, which is a common reaction in times of crisis. Hence, the alternative scenario assumes reduction of inflows through the channel of private transfers (less purchased cash on the currency exchange market). Also, larger effects were expected through the financial channel, in the



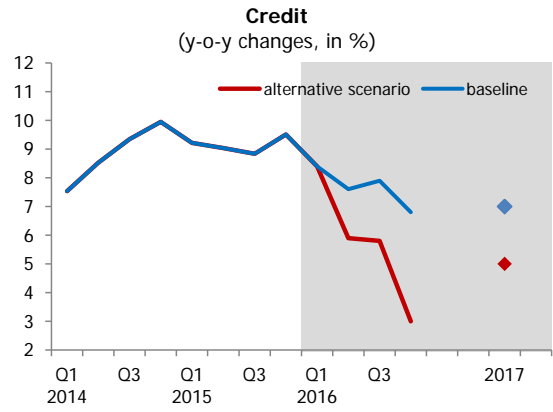
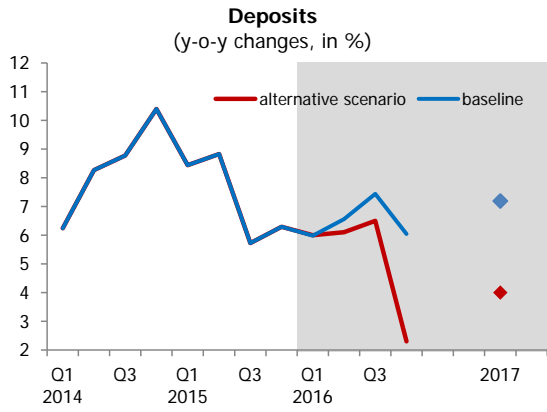
Balance of Payment Forecast (% of GDP)		2016		2017	
		2016	2017	2016	2017
<b>Current account</b>		<b>-1.2</b>	<b>-1.4</b>	<b>-2.0</b>	<b>-2.8</b>
Balance of goods & services		-16.0	-15.4	-16.5	-17.1
Export of goods and services		49.2	50.0	50.8	52.2
Import of goods and services		65.2	65.4	67.2	69.3
Primary income, net		-2.3	-2.7	-2.4	-2.8
Secondary income, net		17.1	16.6	16.8	17.0
Private sector, net		16.4	15.9	16.1	16.3
<b>Capital account</b>		<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Financial account</b>		<b>-1.1</b>	<b>-2.9</b>	<b>1.0</b>	<b>-1.5</b>
FDI, net		-2.1	-2.3	-1.6	-1.8
Portfolio Investment, net		0.3	0.1	0.3	0.1
Other Investment, net		0.7	-0.7	2.2	0.2

form of smaller inflows of direct investments and hampered access of the government and the private sector to new external borrowing. Increased preferences for liquid foreign assets in the alternative scenario are appropriately reflected on the higher net outflows in currency and deposits of other sectors. On the other hand, the alternative scenario envisages higher funding of the economy in 2016 through trade credits compared to the baseline scenario, which is a common feature of funding trade flows in such circumstances. With these assumptions, the alternative scenario shows a larger current account deficit, which still **remains moderate and is around 2% of GDP** (compared to 1.2% in the baseline scenario). The changes in individual financial flows resulted in net outflows in the financial account, as opposed to net inflows in the baseline scenario. The larger current account deficit, combined with weaker financial flows affects foreign reserves, but their level in such a scenario remains adequate and sufficient to deal with shocks.



**The weaker economic growth and weaker foreign exchange flows in the alternative scenario resulted in weaker growth in the banks' deposit base compared to the baseline scenario.** According to these trends, the growth in deposits in 2016 is estimated to amount to 2.3%, compared to the assessment of 6% in the baseline scenario. Amid uncertainty, demand for loans is expected to be lower under the assumption of a lower propensity for borrowing by the private sector, due to the deteriorating conditions in the labor market and weaker growth in the investment activity. Unfavorable movements are expected on the side of credit supply, amid restraint of banks from higher risk and lower deposit growth. Hence, in 2016, the alternative scenario shows lower credit growth than expected in the baseline scenario (3% annual growth, compared to around 7% in the baseline scenario).

**The alternative scenario assumes resolving the political crisis by the end of this year and gradual reduction of the possible effects on the economy in 2017.** Hence, in view of the main points affected by the crisis, relatively fast recovery of private consumption and investments is expected. There are similar expectations regarding the dynamics of private transfers and external and domestic financial flows, which dynamically speaking are expected to recover during 2017.

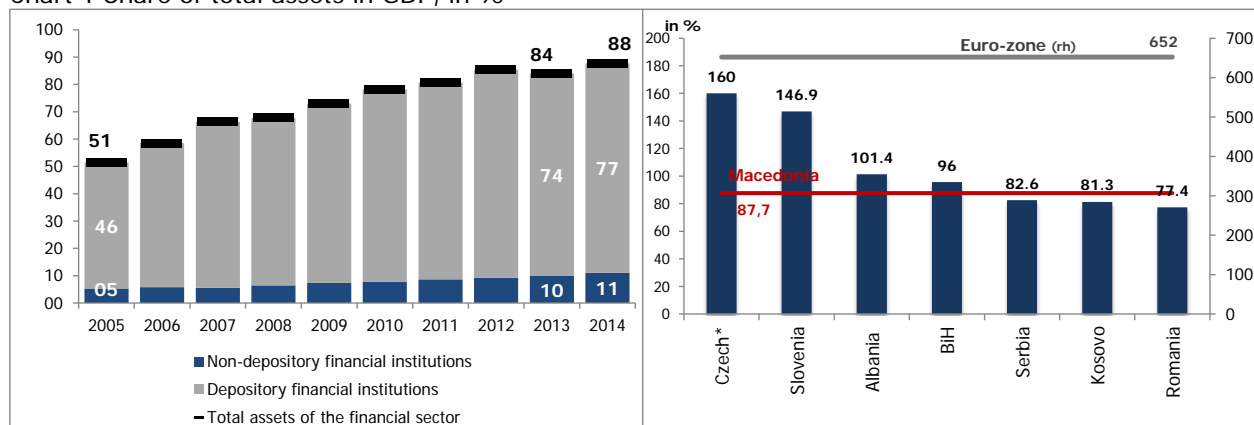


## VI. Analytical appendices

### Box 1: Brief analysis of the financial sector in the Republic of Macedonia with a particular focus on other non-depository institutions

**Well developed and efficient financial system is paramount for more dynamic economic growth. This link stems from the role of the financial system in the mobilization and allocation of resources needed to support economic growth.** In addition, increased availability of financial instruments and institutions greatly reduces transaction and information costs in the economy, thus stimulating savings, investment decisions, and technological innovations. The significance of financial intermediation for the overall economic activity in the economic literature is generally illustrated by total assets of the financial sector to GDP. According to this simple indicator, the share of assets of the Macedonian financial sector in GDP at the end of 2014 was 87.7% of GDP, significantly lagging behind the euro area, as well as some countries of the region. However, analyzing dynamics, financial intermediation in Macedonia registered a continuous deepening of 4 percentage points of GDP, on average, for the period 2006-2014 (except in 2013 when it slightly reduced). Financial deepening was also present during the global financial crisis. This is mostly explained by the domestic banking system who as a result of the strong solvency and liquidity position and reliance on domestic sources of funding, continued to intensify its activity even after the outburst of the crisis.

Chart 1 Share of total assets in GDP, in %



Source: NBRM calculations based on data from the competent supervisory authority of each institutional segment (NBRM, SEC, MAPAS, ISA and Ministry of Finance) and websites of the respective central banks.

\*Data on other countries refer to the share of total assets in GDP, in %, at the end of 2014.

**The purpose of this brief analysis is to provide a general overview of the structure and pace of growth of the financial sector in the Republic of Macedonia, with particular focus on the other non-depository institutions (OFI)<sup>83</sup>.** This simple descriptive analysis focuses on the period from 2005 through 2014, analyzing the main features that explain the operations of all other non-depository institutions, such as the pace of growth of their assets, and the number of institutions, concentration, ownership etc., as well as specific conditions that characterize the operations of these institutions within the domestic financial system.

**Analyzing the dynamics, with the development of the domestic economy, the services provided by the financial sector tend to increase their relevance for the system,** which is perceived not only by the continued expansion of the assets of depository institutions<sup>84</sup>, but also by the gradual growth of the assets of other non-depository institutions in the total assets of the financial sector. The financial sector in the Republic of Macedonia has a relatively simple market structure, absence of

<sup>83</sup> Other financial institutions include investment funds, pension funds, insurance companies, investment funds management companies, and pension funds management companies, financial companies and leasing companies.

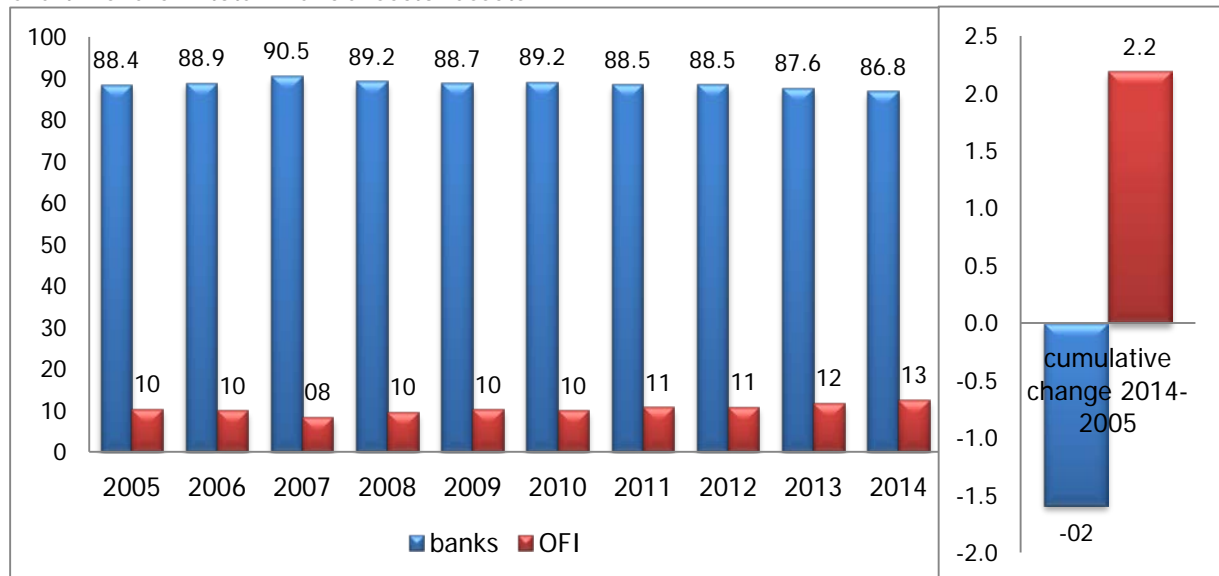
<sup>84</sup> Depository institutions include banks and savings houses.





complex financial groups, and generally limited supply of financial instruments and services. With such a structure, the financial system is classified as bank-based system, where bank assets make up the bulk of the financial assets in the system. However, in the period under observation, there was a gradual increase in the structural share and other financial institutions. Thus, in 2014, their share in total financial assets was 12.5%, up by 2.2 percentage points relative to the 2005.

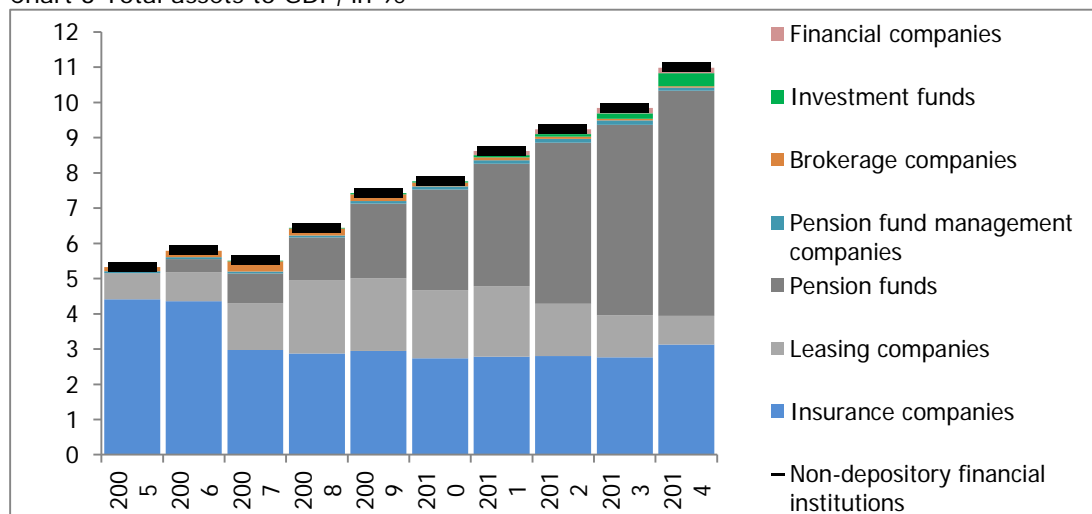
Chart 2 Share in total financial sector assets



Source: NBRM calculations based on data from the competent supervisory authority of each institutional segment (NBRM, SEC, MAPAS, ISA and Ministry of Finance).

**Along with the growth of total financial assets, this period also witnessed steady increase in the contribution of the annual growth in assets of other financial institutions in the total growth of financial assets.** At the end of 2014, the growth of non-depository financial institutions contributed 21.3% to total growth, from 8% in 2006. **The growing relevance of the non-banking financial sector is also confirmed by the relative indicators.** The share of total assets of non-depository financial institutions in GDP doubled in the period 2005-2014, from 5.3% of GDP in 2005 to 11% of GDP in 2014. Moreover, the marginal growth in the share of total assets in GDP in the last two years of the analysis is above the average for the entire period under observation, indicating the recent accelerating growth of non-banking financial sector.

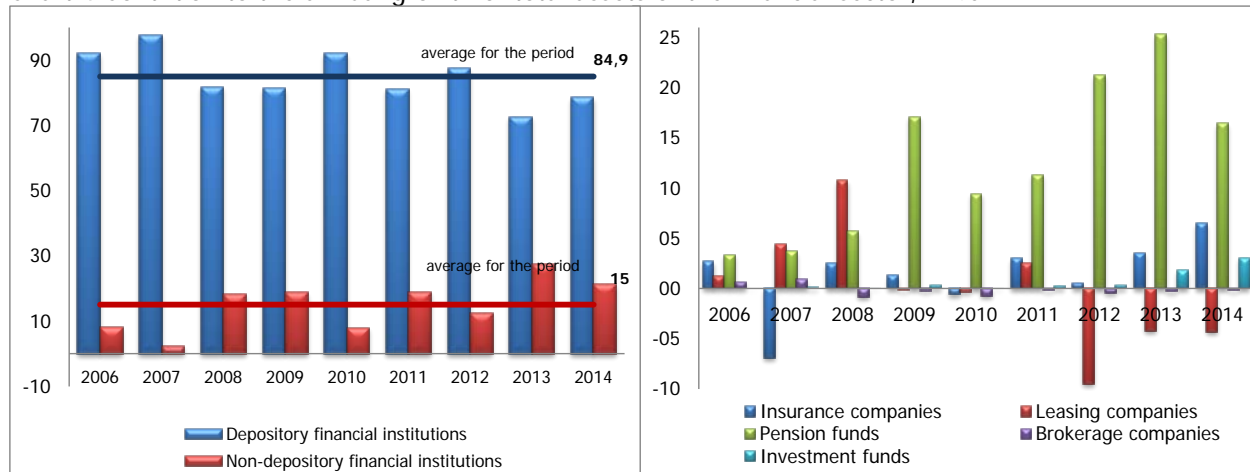
Chart 3 Total assets to GDP, in %



Source: NBRM calculations based on data from the competent supervisory authority of each institutional segment (NBRM, SEC, MAPAS, ISA and Ministry of Finance).



Chart 4 Contribution to the annual growth of total assets of the financial sector, in %



Source: NBRM calculations based on data from the competent supervisory authority of each institutional segment (NBRM, SEC, MAPAS, ISA and Ministry of Finance).

### Analyzing by segment, from among other non-depository institutions in the Macedonian financial sector, pension funds, and insurance companies stand out by relevance, size, and potential for further growth.

Changes in the share of these two segments in the overall financial sector in recent years have been divergent, i.e. the share of insurance companies has been generally decreasing, while the share of pension funds has been increasing. According to the data as of 31 December 2014, the total assets<sup>85</sup> of **pension funds**<sup>86</sup> constitute 7.3% of the total assets of the financial sector, i.e. 58.1% of total assets of non-depository financial institutions, making it the second largest segment in the financial system of the Republic of Macedonia. The favorable developments in the total assets of pension funds throughout the entire period of observation, besides being associated with the solid performance of the real economy, largely stem from the fact that these institutions are relatively "young" and in the initial phase of establishing their assets. Thus, inflows from regularly paid contributions significantly increased partly due to the continued increase in the number of members of mandatory pension funds, amid still minimal outflows based on paid pensions (as a result of the relatively young structure of their membership). The importance of pension funds in recent years, has further strengthened by the reforms and the establishment of multi-pillar pension system, as well as the changes in the method of wage calculation and payment in the Republic of Macedonia<sup>87</sup>. Against such background, the pension funds have strengthened their role in the long-term economic and social security of the households, and have increased their relevance to the overall financial system.

The **insurance sector** is the third largest segment of the financial sector holding assets of 3.6% and 28.4% of total assets of the financial sector and total assets of non-depository financial institutions, respectively. According to the current pace of growth and structure of gross premiums written (registering higher share of non-life insurance, and lower share of life insurance), we can conclude that the insurance market is still underdeveloped, but with a potential for further development. Such findings are underpinned by the recent developments in the life insurance segment, which is the fastest growing component of the sector, by gross premiums written.<sup>88</sup>

<sup>85</sup> Refers to total gross assets.

<sup>86</sup> Compulsory and voluntary pension funds are included in the total assets of pension funds.

<sup>87</sup> Changes in the method of wage calculation and payment in the Republic of Macedonia introduced in early-2009 provide increased regularity of inflows in the pension funds based on contributions. For more information see the Annual Report on Financial Stability in the Republic of Macedonia in 2008, p. 133.

<sup>88</sup> In 2007, there was significant reduction in the assets of the insurance sector mostly derived from the accounting changes introduced in the balance sheets in one of the insurance companies.

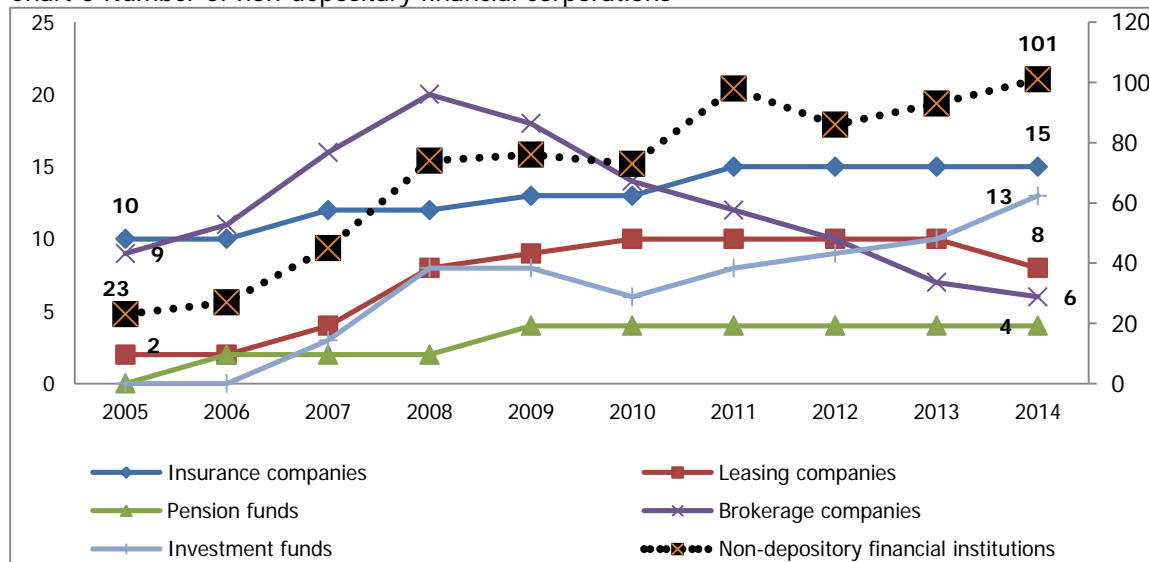


As of 31 December 2014, the total assets of the **leasing sector** accounted for 0.9% of total assets of the financial sector, i.e. 7.5% of total assets of non-depository financial institutions. Considering this modest share, the role and importance of leasing companies to the financial sector and accordingly, to the domestic economic activity is small and has been decreasing in recent years. Such downward trends have been present since 2009, which corresponds to the period of the global financial crisis, while in the period before 2009, the leasing sector represented one of the fastest growing segments of the financial system. The financial crisis tightened the conditions for financial services of leasing companies by raising interest rates and the required participation of the client in the financing. Additional factors that reduced the number and value of new contracts include measures for financial deleveraging of parent banking groups from the EU in this period (whose members are some of the domestic leasing companies), underdeveloped regulatory and supervisory function of this sector, inactive secondary market for sales of foreclosed items on leasing, the modest range of services offered and so on. In such conditions, the services rendered by the leasing companies have become less attractive and therefore, insufficiently competitive compared to credit products offered by domestic banks.

**Investment funds** still constitute a fairly small segment of the financial sector with a share of 0.4% of assets in the total assets of the financial sector, i.e. 3.4% of total assets of non-depository institutions in December 2014. However, interestingly, this sector in the last two years has been growing at rates that result in doubling of assets and has positioned itself as the fastest growing segment of the financial sector. The positive developments are particularly evident with the opening of cash funds, which given the uncertain financial markets accompanied by low yields on deposits, show the need of investors for higher yield bearing investment alternatives and availability of the money at any time.

**Despite the specifics of each non-depository institution in the Macedonian financial system, we can conclude that in general, there were positive developments in the analyzed period. In addition to the growth of their assets, this conclusion is also confirmed by the gradual increase in the total number of non-depository institutions, enriching the range of financial instruments they offer and the growing presence of foreign capital in the ownership structure of each institution.** Thus, at the end of 2014, 101 different non-depository institutions operated in the Macedonian financial market, which is a significant rise compared to 23 institutions in 2005.

Chart 5 Number of non-depository financial corporations<sup>89</sup>



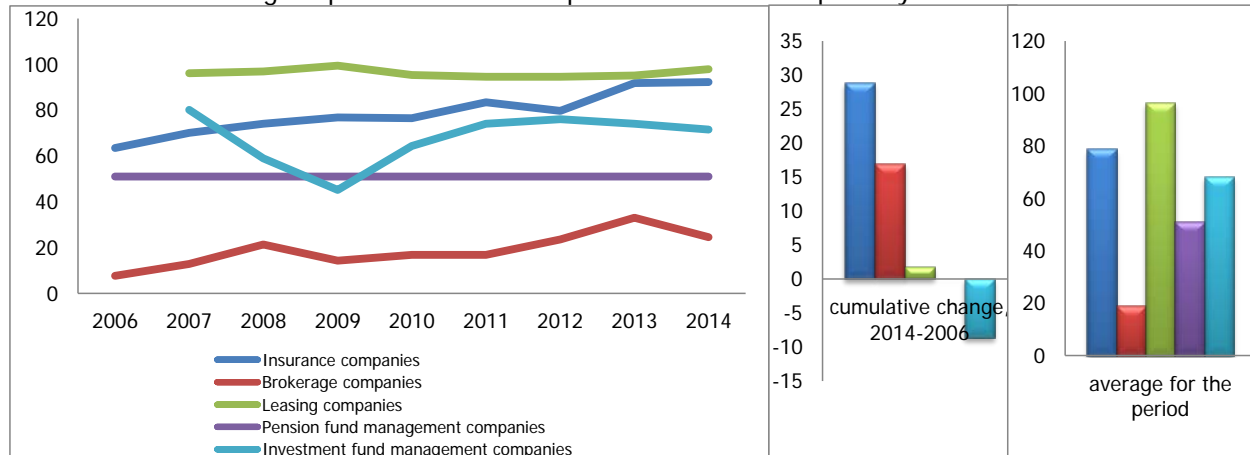
Source: SEC, MAPAS, ISA and Ministry of Finance.

<sup>89</sup> The chart presents the most relevant institutions by their assets. Despite the institutions presented herein, non-depository financial institutions also include another 30 insurance brokerage houses, 11 insurance representation companies, 7 financial companies, 5 investment fund management companies, and 2 pension fund management companies.



**Analyzing the ownership structure of financial capital, in the previous ten years, the role, and the relevance of foreign capital** in the ownership structure of some institutions of the non-depository financial sector **has been increasing** since strategic foreign investors have overtaken several financial institutions and foreign companies have established new financial institutions.

Chart 6 Share of foreign capital in the ownership structure of non-depository financial institutions



Source: NBRM calculations based on data from the competent supervisory authority of each institutional segment (NBRM, SEC, MAPAS, ISA and Ministry of Finance).

**The increased volume of activities, the new institutions, as well as the entry of foreign capital and investors, have reduced the concentration in the segment of non-depository financial institutions<sup>90</sup>.** However, despite the reduction of concentration in most segments (as measured by the Herfindahl index), it is still high<sup>91</sup>.

**In summary, under the current pace of growth of other non-depository institutions' operations, we can conclude that in the Macedonian financial sector there has been an intensification of the financial intermediation through these institutions. However, according to the current size, complexity, and relevance to the overall financial system and overall economic activity, the domestic non-depository financial sector still lags behind the developed economies.** Certain features associated with the continued growth of the real economy, the positive labor market trends, and consequently, the upward trend in the disposable income of households, enriched offer and increased financial literacy in the country, point to a great potential of this financial segment for intensive development in the future.

<sup>90</sup>Source: For each institutional segment, the competent supervisory authority (NBRM, SEC, MAPAS, ASO, and the Ministry of Finance).

<sup>91</sup> There is particularly high concentration in life insurance and reinsurance, investment funds management companies, and brokerage houses, while the insurance market for non-life insurance is moderately concentrated, with the Herfindahl index being within acceptable limits.

**Box 2: Dynamic and comparative analysis of budget revenues and expenses of Macedonia<sup>92</sup>**

**The role of fiscal policy has many dimensions, i.e. there are multiple channels through which fiscal policy can affect an economy.** One of these dimensions certainly includes the effects that fiscal policy may have on growth, which depends on many factors such as the size of the public finances, the structure of revenues and expenses, the level of institutional development of an economy, and the sources of funding the budget deficit, the mix of which may also affect the space for funding, and fuel the growth of the private sector in the economy. In this context, the purpose of this box is to make a simple dynamic and comparative analysis of the size and structure of public finance in Macedonia, thus giving a picture of the changes in the size of revenues and expenditures and their structure, and to show whether Macedonia significantly differs in size and structure of public finances compared to part of the CESEE countries.

**The dynamic analysis of public expenses in Macedonia in the period 2005-2015 indicates no significant changes in the share of public expenses in GDP** (Chart 1), which in 2015 accounted for 32.7% of GDP, which is almost unchanged compared with 2005, when it was 32.5%. Dynamically speaking, within this timeframe, a slight increase in expenses was recorded in two periods - in 2008 (when the share of expenses in GDP increased from 31.5% in 2007 to 33.8% in 2008), which is mainly attributable to the growth of capital expenditures in 2012 (growth of the share from 32% to 33.4% of GDP), reflecting the growth of several categories of current expenditures. Considering that this is a period of most intense effects of the crisis when a few sets of anti-crisis measures were taken, the shifts in expenditure can be partly attributed to this context. Similar dynamics is observed in the general government expenditures.

**Observing by category of expenditures, current costs that are dominant expenditure category (average share of about 89% in the analyzed period)** show no significant structural shifts. A change that could be distinguished, but with a relatively low intensity, is the reduction of the proportion intended for goods and services, while the share of other transfers<sup>93</sup> have increased. It is difficult to evaluate the economic effects of these changes. Lower share of expenditures for goods and services would basically mean lower public spending, which in part can be counterproductive, narrow the space for the private sector, and have adverse effects on the economy. However, the assessment of the effects of these shifts requires an in-depth analysis of the types of costs and their dynamic change.

**Capital expenditures (average share of about 11% in the analyzed period), as major expenditure component for the economic growth**, slightly intensified in 2008, but overall, for the period under observation, their share is stable. It is worth noting that the category of capital expenditures within the central budget is not the sole indicator of the size of public investment on the grounds that part of the capital investment, particularly in road infrastructure, is made through other public sector. The general conclusion of the brief dynamic analysis is that public expenditures have been relatively stable over the past ten years. There have been small structural changes whose effects on economic growth are difficult to specify. However, as a recommendation to support future economic

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<sup>92</sup> As permitted by the availability of consistent data series, the dynamic analysis covers the period 2005-2015. Within the structural analysis of Macedonia, the scope of the government is narrower and includes the central government, and funds. The comparative analysis for Macedonia uses data on the general government comparing total expenditures, capital expenditures, and total revenues (available for the period 2009-2014), while the comparative analysis of the expenditure and revenue structure for Macedonia uses data on the central government and funds. Data for other countries are taken from the database of the World Economic Outlook of the IMF and the database *Government Finance Statistics of the IMF*, and the data relate to the general government. The time horizon of these data is until 2013, because it is the last year for which consistent data are published for the countries included in the analysis (except for Serbia where the last available data is for 2012). Therefore, the comparative analysis of the structure of expenditures and revenues should be interpreted with a degree of caution.

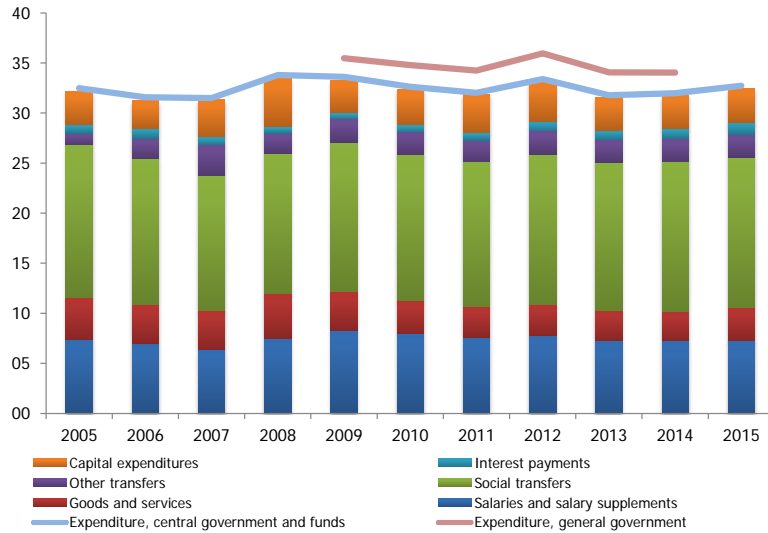
<sup>93</sup> For more realistic perception of the movement of expenditures for goods and services, and other transfers, the original data have been adjusted for the purposes of this analysis. Namely, within the implementation of the second phase of fiscal decentralization, wages and benefits for local governments are shifted from the category of wages and benefits to the category of other transfers, thus reducing the share of expenditures for wages and benefits and increasing the share of other transfers. In order to isolate this effect, starting from 2008, the category of other transfers excludes 55% of the total amount (the share of transfers to local government in other transfers in 2010, i.e. the latest available data), and it gets treatment of wage and benefit expenditure.





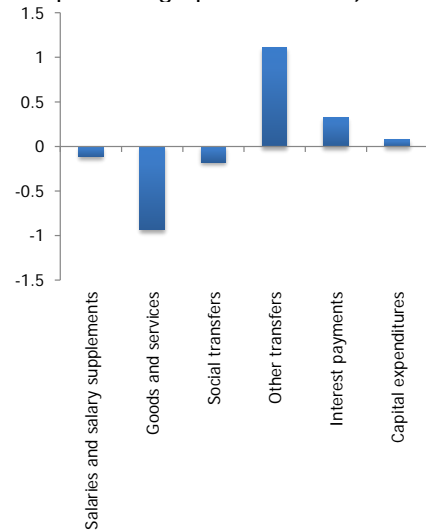
growth, taking into account the findings of empirical research and the specifics of the Macedonian economy, there is still a need for leaving room for higher capital spending.

**Chart 1** Public expenses and structure of public expenses (% of GDP)



Source: Ministry of Finance of the Republic of Macedonia and NBRM calculations.

**Chart 2** Public expenses (cumulative growth 2015/2005 in percentage points in GDP)

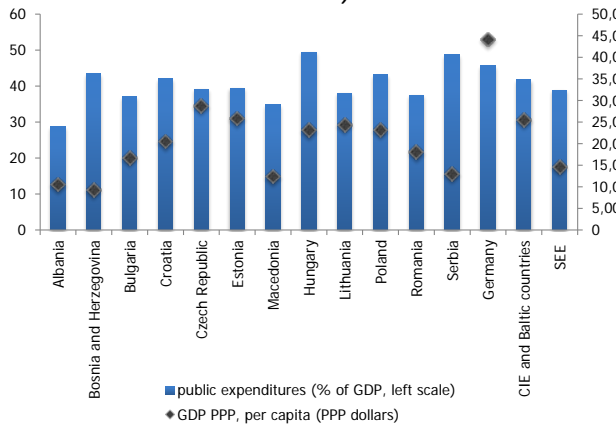


**Comparatively speaking, Macedonia is among the countries with a relatively low level of budget expenditures (Chart 3).** In 2014, the budget expenditures of the general government accounted for 34% of GDP (the average share of expenditures of the general government of Macedonia to GDP in the period 2011-2013 was 34.8%) which is lower not only compared to the developed economies, but also to the region. On the other hand, Macedonia, as a developing country and transition economy, is still in the stage of building and promoting institutional capacity. Illustratively, if we take GDP per capita as an indicator of the level of economic development, as the most comprehensive indicator, this indicator in Macedonia is twice as low as the average for the CEE and Baltic countries and by 3.6 times lower compared to Germany (Chart 3). The lower level of development of the Macedonian economy compared to some European economies leads to the conclusion that, despite the relatively small and stable public sector, a careful public expenditure policy planning is required to prevent the increased spending to cause distortions in the economy and any adverse effects on economic growth.

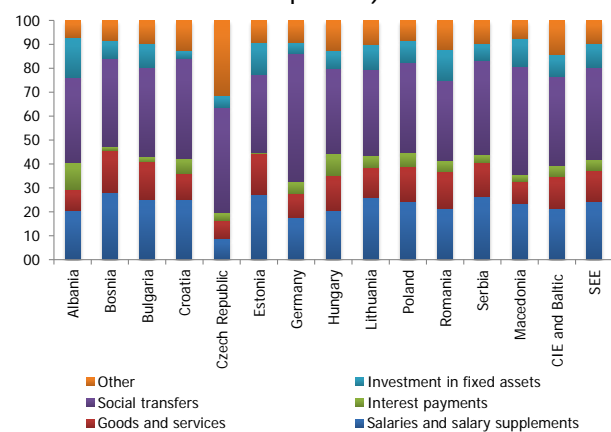
**When it comes to the public expenditure structure, the comparative analysis leads to the conclusion that Macedonia does not deviate from the general structure typical for the majority of European transition economies.** In Macedonia, the majority of public spending is current expenses, with dominant social transfers. Capital expenditures, same as in the other countries included in the analysis, occupy a significantly smaller proportion of total public expenditure. Moreover, in the area of capital expenditure, Macedonia, with an average share of approximately 13.8% in total capital expenditures for the period 2011-2013, is among the countries that allocate a significant portion of capital investments (in the same period, their share is 9% in CEE countries, while in SEE countries, it is somewhat higher and amounts to 9.9%).



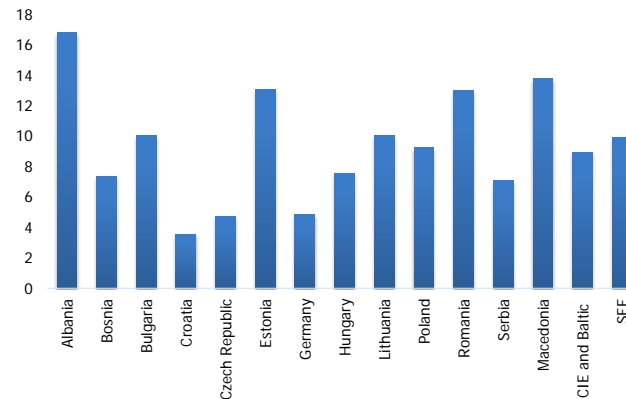
**Chart 3** Public expenses of general government in selected countries in the period 2011-2013 (% of GDP)



**Chart 4** Structure of public expenses in the period 2011-2013 in selected countries (% of total expenses)



**Chart 5** Investments in fixed assets of the general government in the period 2011-2013 in selected countries (% of total expenses)



Source: Government Financial Statistics and World Economic Outlook Database, International Monetary Fund, and NBRM calculations.

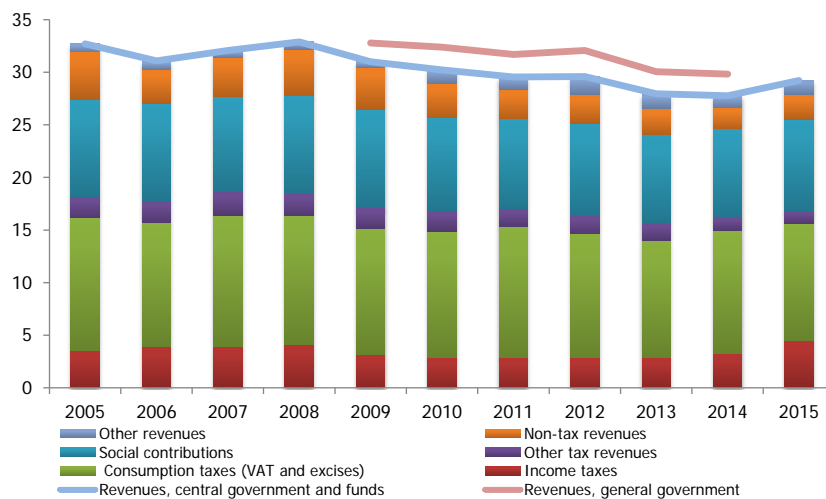
**An additional aspect that can be analyzed in context of fiscal policy is the perception of the budget structure in light of the size and structure of total revenues.** In this regard, the theory shows that the growth of direct taxation of income has unfavorable effects on the economy, compared to taxing consumption. In fact, very often, recommendations for fiscal consolidation in the post-crisis period are based on this thesis, i.e. they recommend fiscal devaluation (reduction of tax burden on labor, and growth of indirect taxes, such as VAT) as a solution that has less adverse effects on growth.

**What does the dynamic analysis of the revenues in the Macedonian economy show? Over the past ten years, the trend of the share of total revenues in GDP has been declining.** The total decrease in 2015 compared to 2005 was approximately 3.5 percentage points. The exception to this path are 2007 and 2008 when the relative share of revenues in GDP increased, which may in part be explained by the efforts for increasing the collection of taxes, i.e. reducing tax evasion, a process which is partly a consequence of the discretionary changes in tax policy that took place during that period. A flat tax on personal income and corporate income of 12% was introduced in 2007 which was reduced to 10% in 2008, which significantly reduced the tax burden. These tax changes tend to reduce tax evasion and

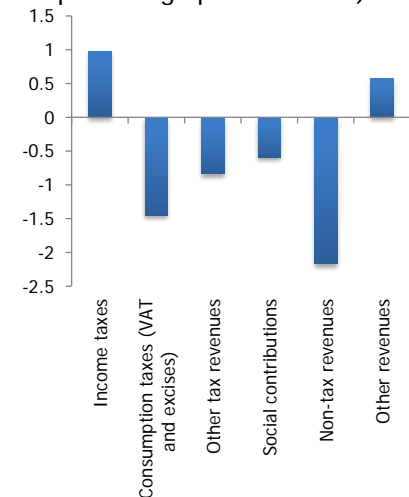


initially increased the share of the tax revenues particularly from profit tax<sup>94</sup> in this period. From 2008 to 2014, the share of revenues in GDP has been continually decreasing as a result of changes in both tax and non-tax revenues. General government revenues have followed similar dynamics. Analyzing the tax revenues, although all components contribute to their reduction, the effect is particularly pronounced in the profit tax revenues. In this period, an anti-crisis measure was introduced for exemption of retained earnings from taxation (in 2009), which halved the share of this tax in GDP. This discretionary measure was supported by the thesis of the stimulating effect of lower direct tax burden on growth. This was also underpinned by the decrease of contributions in 2009, which reduced their share in GDP. Some of these changes were temporary, primarily the anti-crisis measure in the profit tax from 2009. In 2015, this measure underwent certain changes requiring retained earnings to be again included in the tax base, resulting in growth of profit tax revenues and their return to the level before 2009. **Despite these changes, what can be concluded from this brief narrative is that the largest discretionary changes in tax policy, which took place in 2006-2007, aimed at reducing tax burden, were made through direct taxes to reduce the cost of production factors (labor and capital).** This *tax tool* was used at the onset of the crisis in 2009, as a measure to mitigate the effects of the crisis on the corporate sector.

**Chart 6** Public revenues and structure of public revenues (% of GDP)



**Chart 7** Public revenues (cumulative growth 2015/2005 in percentage points in GDP)



Source: Ministry of Finance of the Republic of Macedonia and NBRM calculations.

**The above conclusion that changes in tax policy in Macedonia are those that are less harmful to the growth, can also be seen through the structure of total revenues.** The analysis of the structure of budgetary revenues shows that tax revenues make up around 56%, on average. Analyzing individual taxes, consumption taxes (VAT and excise duties) dominate, averaging close to 40%. The relative weight of direct taxes on income (income tax and profit tax) is significantly lower, at about 11%. The exception is 2015, when the share of this group increased to 15.5% as a result of changes in income tax. Although, dynamically speaking, in both categories there are different stages of change in the share, however, this image of structural domination of consumption taxes is present in succession.

**The comparative analysis of total revenues shows that Macedonia belongs to the countries with relatively lower tax burden, as a share of total revenues in GDP.** In fact, with the exception of Albania, Macedonia is a country with the lowest level of budget revenues. The share of revenues of

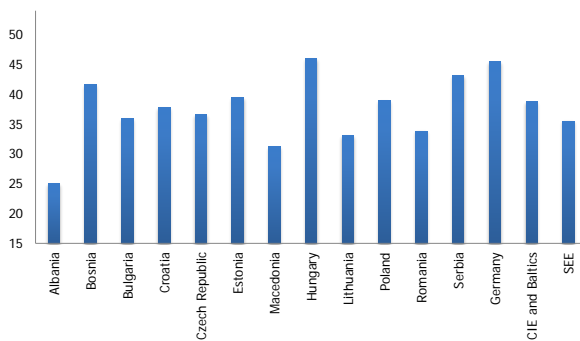
<sup>94</sup> The reduction of the share of total revenues in GDP in the last period can be partially associated with the technological and industrial development zones where companies are exempt from paying income taxes, while their activity stimulates the growth of GDP. So far, it has been hard to make an assessment of this effect.

the general government in 2014 was 29.8% of GDP, which is lower than the average of CESEE countries, which is about 38%, and of Germany, as a highly developed country.

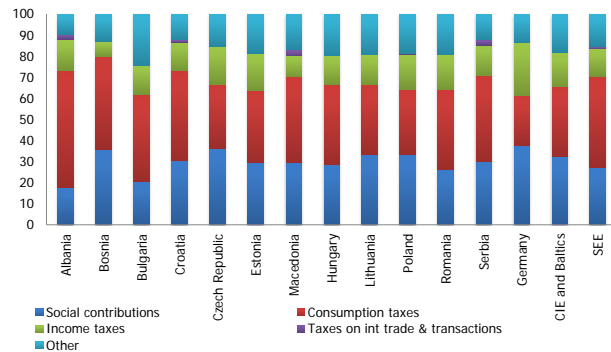
**Despite this difference in the size of revenues, the structure of budget revenues in Macedonia is similar to their structure in the region.** However, it should be borne in mind that the structure of budget revenues is largely determined by the structure of the economy. The share of indirect taxes is basically greater in open economies, rather than in closed economies, while direct taxes (income taxes) have higher weight in the highly developed economies, as opposed to economies that are on a lower level of development. The comparative analysis somehow confirms this thesis.

The dominance of consumption taxes versus direct taxation is typical for the region as a whole, and this feature is most pronounced in SEE countries (most of the countries in the region are open economies). Compared to Germany, as a highly developed economy, both in Macedonia and the region, the share of income taxes is lower, a conclusion that remains valid even after including contributions in the comparative analysis, as a category which is also a burden for the labor cost.

**Chart 8** Public revenues of general government in selected countries in the period 2011-2013 (% of GDP)



**Chart 9** Structure of public revenues in the period 2011-2013 in selected countries (% of total revenues)



Source: Government Financial Statistics, International Monetary Fund and NBRM calculations.

**This article presents a simple dynamic analysis of the size and structure of public revenues and expenditures in Macedonia, accompanied by comparative analysis of these features with a selected group of countries, mostly from the region.** The analysis indicated that generally, most of the changes made in the period 2005-2014 were changes which according to theory and experience, are aimed at creating a better environment for economic growth. In the last ten years, the share of capital expenditure is generally stable, and compared with the countries from the region, Macedonia ranges among the countries that commit significant part of their budgets for capital spending. Many discretionary changes were made in tax policy aimed at reducing the cost of production factors (labor and capital), thus creating room for greater economic activity, with the exception of 2015, when the temporary anti-crisis measures that addressed the profit tax were withdrawn. Compared with the European transition economies and some developed countries, Macedonia has a relatively smaller public sector, both in terms of expenditures and revenues. However, one should not overlook the fact that Macedonia, as a developing country and transition economy, still has less economic power and is in the process of building and improving institutional capacity. These features of the Macedonian economy require careful planning of the structural aspects of fiscal policy.



### Box 3: Direct and indirect effects of the slowdown of the economic growth in China on the Macedonian economy

One of the current major adverse risks to the growth of the global economy is the deceleration of growth in the Chinese economy and uncertainty about its future economic prospects. Following the strong growth on average of about 10% by 2010, the dynamics has registered visible slowdown, and this slower pace is expected to be kept in the next period. The slowdown reflects the reduction in the working age population, the natural process of convergence and growth of labor costs<sup>95</sup>. This is also a consequence of the structural upheaval in the country to a new stage of development - so called "New Normal" in which the dominant contribution of exports will be replaced with consumption and the growing role of the services sector. Considering that China is the second largest economy in the world (after the US) with a share of 12% in global trade flows, this Box gives a short review of the possible direct and indirect effects of the potential slowdown of the economic growth in China on the Macedonian economy.

Chart 1  
Economic growth in China (in %)

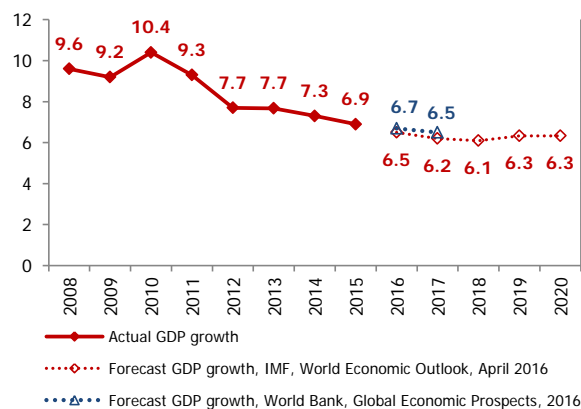
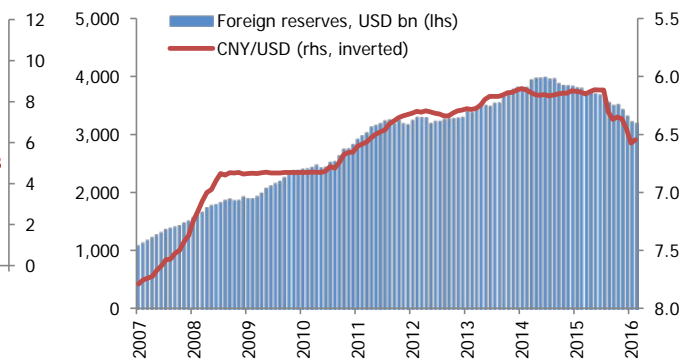


Chart 2  
Foreign reserves in billion US dollars and yuan/US Dollar exchange rate



Source: Bloomberg

**Direct effects on the Macedonian economy through the trade channel are assessed as very small.** In the case of Macedonia, the share of total foreign trade with China is relatively low, and on average, for the period from 2010 to 2015 was 4.8% of GDP. The trade is dominated by the import component, with an average share for the same period of 5.6% in the total imports and a share of GDP which averaged 3.6%. Despite the fact that China, on the export side, is among the ten most important export partners of the Republic of Macedonia, the importance of the Chinese economy as export partner is very low. The average share of the exports to China in the total Macedonian exports for the period 2010-2015 totaled 2.8%, while the average share of GDP for the same period was 1.2%. Although the direct export exposure to the Chinese market is not high and initially does not indicate a significant risk, analyzed in terms of structure, certain vulnerability can be noticed. Namely, exports to China is dominated by products of the metal processing sector, i.e. even 94% of the exports to China is exports of ferronickel, which makes this economy one of the most important markets for the Macedonian metal industry. On average for the period 2010-2015, the Chinese market absorbed 13.4% of the Macedonian exports of iron and steel, whereby in 2015, this share reached 21%. **In summary, the direct effects of the deceleration of growth in the Chinese economy on the external position of the country, analyzed through the trade channel, are relatively small. However, there is a certain structural vulnerability in one of the traditional sectors, due to the concentration of exports on one type of product from the metal processing sector where the direct effects could be potentially felt.**

<sup>95</sup> The process of convergence leads to growth of income per capita and growth in labor costs, whereby the price competitiveness of the economy can be reduced.





Chart 3 Exports of Macedonian companies in China

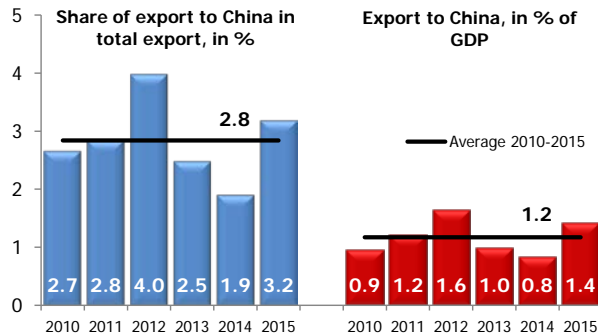
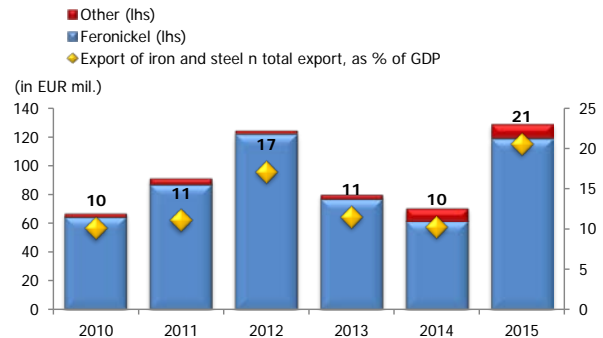


Chart 4 Structure of the Macedonian exports to China, in millions of euros



Source:SSO.

**Indirect effects from the potential slowdown in the Chinese economic activity, can be seen through analysis of three aspects: 1/ indirect trade connection, 2/ transmission channel through the prices of primary products and 3/ financial channel.** Indirect effects through the trade channel, above all, can be seen through the consequences of the slowdown in China on the economic growth of the EU countries. The possible slowdown in the European economies would be reflected on the growth of the Macedonian economy, given that these countries account for 68.3% of foreign trade in 2015, whereby they represent our most important trading partner. Analyzed dynamically, in recent years, the EU countries significantly increased the export activity to China from 4% in 2002 to almost 10% in 2015, thereby reducing the exports to traditional foreign trade partners (the US and Japan). However, despite the growing scope of exports, the foreign trade of the EU and China was dominated by imports (as in the case of Macedonia) which from 10% in 2002 rose to nearly 20% in 2015. These changes contributed to the positioning of China as the second most important trading partner of the EU (after the US) with share in the foreign trade of the EU countries of 14.8% in 2015.

**The increased importance of China for the European countries in recent period was the reason for the emergence of a number of economic research focused on empirical estimates of the effects of the slowdown of the economic growth in China. The general conclusion is that the direct vulnerability of the EU countries from reduced import demand of China is small<sup>96</sup>.** In an analysis by the European Commission<sup>97</sup>, an attempt was made to quantify the effects of the slowdown in the Chinese economy on the euro zone. Thus, a slowdown by 1 p.p. compared to the baseline scenario would lead to reduction in the gross domestic product in the euro zone by 0.2% in the current and 0.3% in the next year, compared to the baseline scenario. The conclusions of numerous scientific papers that attempt to assess the vulnerability of the EU countries from the slowdown in China through trade links were in the same direction, where estimates range between the cumulative negative effect on the countries in the euro zone in the medium term from 4.3%<sup>98</sup>, in case of extreme scenario, and 0.1% to 0.15%<sup>99</sup> annually, given the moderate scenario for the Chinese economy<sup>100</sup>. **These estimates for relatively small effects on European economies suggest a slight indirect impact of the slowdown in China on the Macedonian economy through the channel of foreign demand.**

<sup>96</sup> ECB Economic Bulletin, Issue 7/2015 – Box 1: “Trade links between the euro area and China”, ECB Financial Stability Review, Nov. 2015 – Box 1: “Understanding the links between China and the euro area”.

<sup>97</sup> EC, European Economic Forecast, Autumn 2015 - Box 1.2: “Spillovers from the slowdown in China on the EU economy - channels of contagion”.

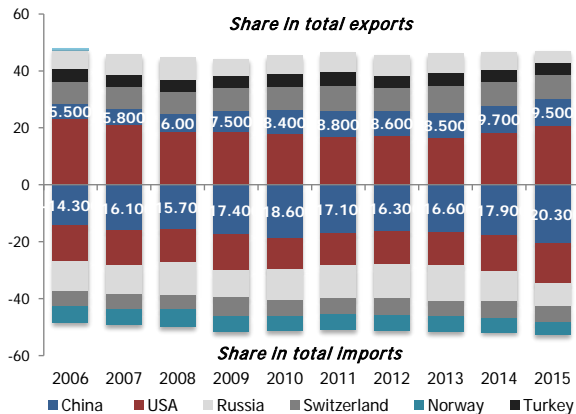
<sup>98</sup> Gauvin and Rebillard (2015) include gradual slowdown of the growth in China from 6% to 3%.

<sup>99</sup> Feldkircher and Korhonen (2012) use moderate shock after the growth in the Chinese economy of 1%.

<sup>100</sup> Percentages represent deviations compared to the basic projections for the euro zone.

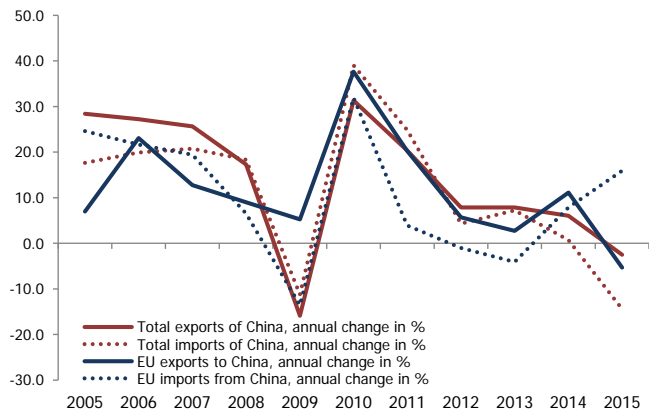


Chart 5 The most important trade partners of the EU, exports and imports (share in total exports and imports)



Source: Eurostat.

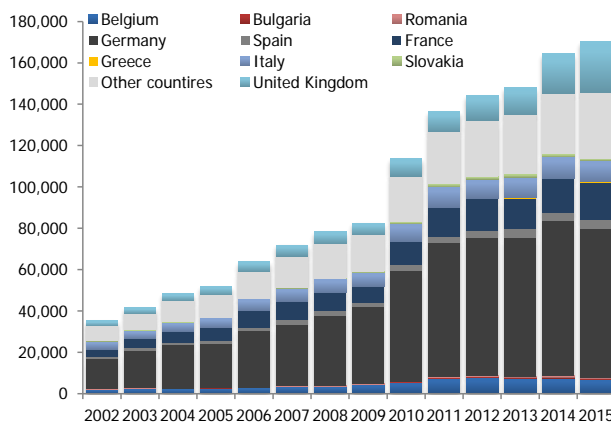
Chart 6 Dynamics of foreign trade of the EU and China



Source: Eurostat and IMF.

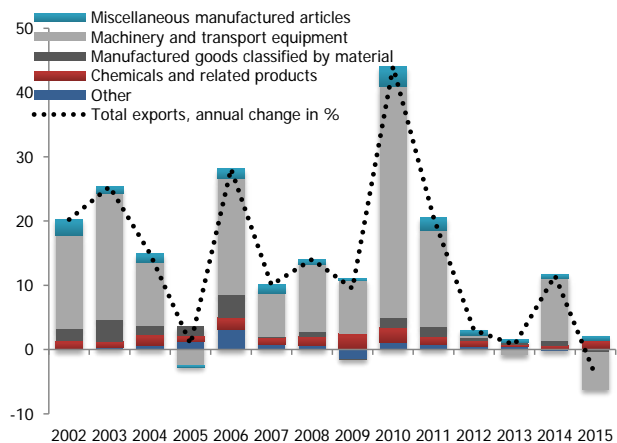
Another aspect for assessment of the indirect effects on the Macedonian economy is the structural analysis, observed from a viewpoint of the "country, trade partner - product" or the connection through the global value chain, which indicates possible vulnerability of the Macedonian exports, in the segment equipment, machinery and vehicles. In 2015, around 44% of the Macedonian export to the EU was directed towards the German economy, whereby two-thirds of it are equipment and machines, i.e. products of the automotive industry produced by the new foreign companies. The indirect vulnerability of this sector is evident from the analysis of the exports structure of Germany to China, where high concentration of this type of products is also registered (on average of over 70% share in total exports to China).

Chart 7 Exports of the EU countries to China (% of total EU exports to China, 2013)



Source: Eurostat.

Chart 8 Exports of Germany to China, by products (contribution to the annual change)



The redirection of the Chinese economy from the ongoing intensive investment activity, to the development of the services sector, created a corresponding change in the imports structure, with smaller imports of equipment, machinery and vehicles. The initial effects are evident in the performance in 2015, when after a long period of positive growth rates of the German exports to China, a decline was registered on an annual basis, fully driven by the decline of exported equipment and vehicles. Given that the Macedonian export sector is integrated into the global value chain, especially through exports of the new companies directed towards the German market, the increased vulnerability of the German economy as a result of the slowdown in the Chinese economic growth, points to possible indirect negative risks for the Macedonian export of equipment and machinery. However, if one takes into account the orientation of the new export facilities in the domestic economy towards the production of inputs for the automotive



industry, the increased reliance on the Chinese growth of private consumption could be reflected positively on the demand for cars and respectively on this sector of the domestic economy.

Chart 9 Exports to China, as % of GDP

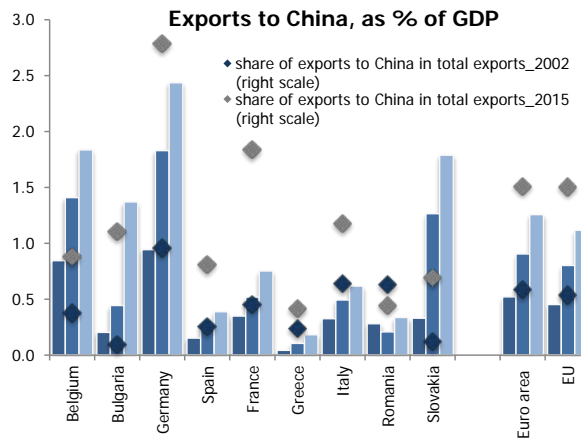
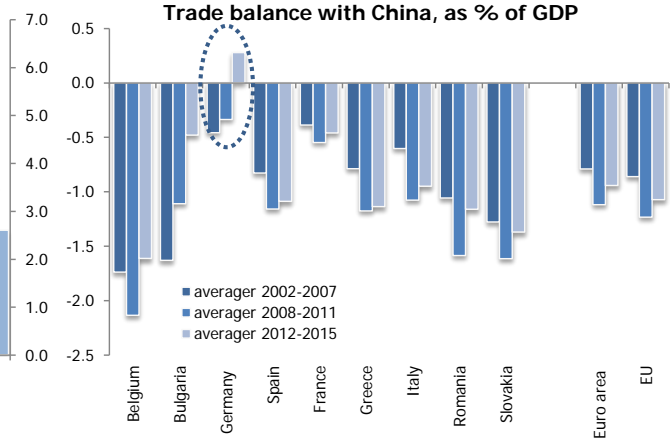


Chart 10 Trade balance in the trade with China, as % of GDP



Source: Eurostat.

**The slowdown of the economic activity in China as the second largest world economy is expected to have effects on world prices of primary products, but the impact in different products will not be with the same intensity.** Given that China is a significant consumer of metals and coal (uses even half of global production), it has major impact on the movement of world prices of metals, which is evident from the high correlation of stock prices of metals with movements and especially with expectations for future developments of the Chinese economy. On the other hand, China uses 12% of the world production of crude oil and 5% of the production of natural gas, which suggests relatively lower importance of the Chinese economy for the prices of crude oil<sup>101</sup> and natural gas, compared to the importance for the movement of world prices of metals.

Chart 11 Dynamics of prices of metals and crude oil

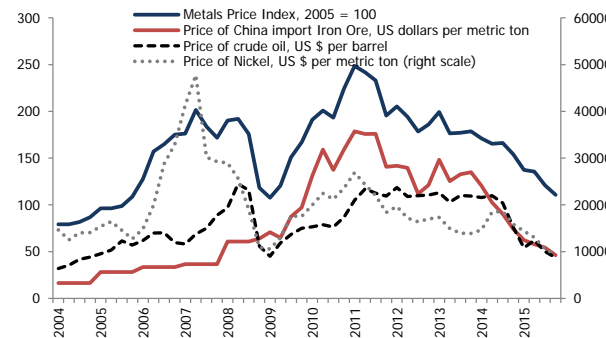
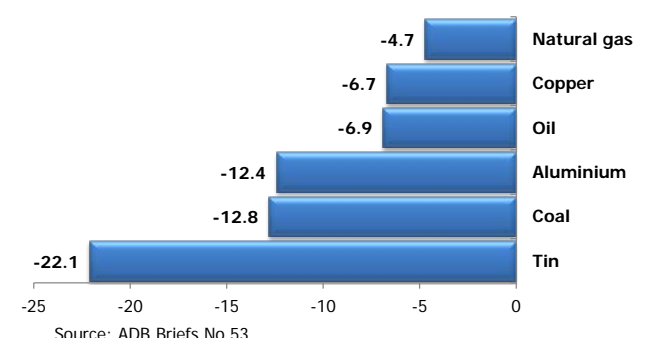


Chart 12 Change in the prices of primary products amid negative shock of 1 p.p. in the Chinese economy (in %)



Source: IMF.

These findings were confirmed by empirical research. The econometric quantifications of the effects on prices of primary products indicate a pronounced sensitivity to metal prices, with a cumulative decline of 66% in the next five years, compared to 41% drop in oil prices<sup>102</sup> given the significant slowdown in the Chinese economy, while more moderate slowdown would cause a fall in prices of metals and coal by 7% -22% and a milder decline in the price of oil and natural gas (from 5% to 7%).<sup>103</sup> The prices of both primary products affect the terms of trade of the Macedonian economy, but with a different effect. Given

<sup>101</sup> Stock prices of crude oil are strongly influenced by the economic and political factors that are not directly associated with China.

<sup>102</sup> Gauvin and Rebillard (2015).

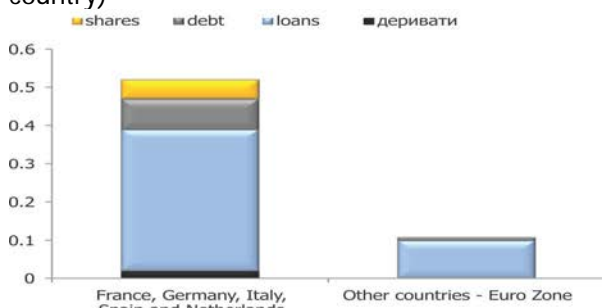
<sup>103</sup> Abaid, Lee, Pundit and Ramayandi (2016).



that metals<sup>104</sup> are one of the dominant export products with share in total exports of 24% on average for the period 2010-2015, as well as the average share in GDP of 10%, the reduction in metal prices adversely affects the terms of trade and the export activity of this sector. On the other hand, as energy importing country, where energy imports on average for the 2010-2015 period accounts for approximately 17% of total imports and 11% of GDP on average, lower energy prices have a favorable effect on the terms of trade and on the trade balance.

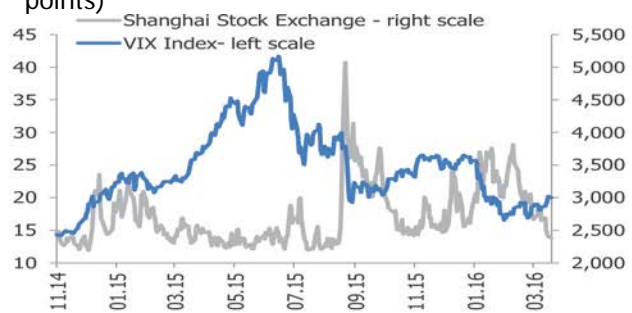
**The transmission of effects through the prices of primary products can affect financial institutions if they are directly and/or indirectly exposed to countries net exporters<sup>105</sup> or companies producers of primary products.** In the case of the Macedonian economy, these risks can be mainly analyzed through the exposure of financial institutions in the euro area to third countries, which are directly exposed to China. According to the ECB<sup>106</sup>, the direct and indirect risks for banks in the euro area, analyzed through their balances are assessed as relatively limited. In this regard is the conclusion of the analysis of the IMF<sup>107</sup>, according to which only large financial centers can have significant impact on financial stability in the euro area. However, the global shock, which in the third quarter of 2015 affected all types of risky assets, regardless of the risks typical for individual economies, confirmed the sensitivity of the asset markets globally on developments in China, through the expectations channel. That caused changes in the portfolios of assets globally, suggesting that the indirect effects of the slowdown of the growth in the Chinese economy can have larger effect than the direct.

Chart 13 Exposure of banks in the euro area to China (Q4 2014; percentage of the assets of each country)



Source: ECB

Chart 14 Stock exchange indices in Shanghai and the VIX index (Nov. 2014-March 2015, in index points)



Source: Bloomberg

Medium-term expectations for the Chinese economy predict average growth of 6.5% in the next five years, which is a moderate slowdown compared to the previous period, with growth rates of around 7%, which is still considered a potential risk factor for the global economy. Given the small direct exposure of the Republic of Macedonia to China through the trade channel, the direct effects of the decelerated growth in the Chinese economy on the external position of the country are small. However, there is a certain structural vulnerability in one of the traditional sectors, due to the concentration of exports on one type of product from the metal processing sector, while the potential negative effects on the new export facilities of the slowdown in the Chinese economy due to the inclusion of Macedonia in the global value chain, could be mitigated by the more dominant contribution of private consumption in the growth in China, which would be positively reflected on the global automotive industry. The effects of the economic performance of China on the world prices of primary products are also a channel through which developments in the Chinese economy are felt in the domestic economy, given that changes in these prices alter the domestic terms of trade.

<sup>104</sup> The exports of metals includes exports of metal ores, as well as exports of iron and steel.

<sup>105</sup> According to the US Energy Information Administration, the world's largest net exporters of oil from emerging economies with exports larger than 1,000 barrels per day in 2013 are: Saudi Arabia, Russia, the United Arab Emirates, Kuwait, Iraq, Nigeria, Venezuela, Qatar, Angola, Kazakhstan, Algeria and Iran.

<sup>106</sup> ECB Financial stability Review, May 2015 - Box 2: "Lower oil prices and their implications for financial stability in the euro-area".

<sup>107</sup> Espinoza-Vega, M.A, Sole, J. 2010, IMF working paper 10/105, "Cross border financial surveillance: A network perspective".