

National Bank of the Republic of Macedonia



Quarterly Report November 2015



Contents:

Introduction	3
I. Macroeconomic developments.....	7
1.1. International economic surrounding	7
1.2. Domestic supply	12
1.3. Aggregate demand	16
1.3.1. Private consumption.....	17
1.3.2. Public consumption	18
1.3.3. Investment consumption	18
1.3.4. Net external demand.....	20
1.4. Employment and wages	20
1.5. Inflation.....	23
Box 1: Inflation Expectations Survey	26
1.6. Balance of Payments	27
1.6.1. Current Account.....	28
Box 2: Foreign trade of goods and movement of the Nominal and the Real Effective Exchange Rate (NEER and REER).....	30
1.6.2. Financial account	34
1.6.3. International investment position and gross external debt	36
II. Monetary policy	39
2.1. Banks' liquidity and interbank money market developments.....	43
2.2. Monetary and credit aggregates	45
2.2.1. Monetary aggregates	46
2.2.2. Lending activity.....	48
III. Public finances	51
IV. Stock exchange indices and real estate prices	56
V. Macroeconomic forecasts and risks	58
5.1. Assumptions in the external environment forecast	58
5.2. Forecast and effects on monetary policy	61
5.3. Comparison with the previous forecast	67
VI. Analytical appendices	71
Box 1: Budget Revision of the Republic of Macedonia for 2015	71
Box 2: Budget of the Republic of Macedonia for 2016	72
Box 3: Assessment of money demand with reference to the equilibrated level of money supply in the Republic of Macedonia	73
Box 4: Indicators of the developments in the tourism sector in Macedonia	75



Introduction

During the third quarter of 2015, the NBRM kept the policy rate unchanged at 3.25%, assessing it as appropriate for the current macroeconomic and financial conditions and the estimated risks. In this quarter, changes were made in the reserve requirement¹ instrument in order to support further long-term savings in domestic currency, and to support the process of "denarization" of the economy. Observed by individual macroeconomic indicators, during the third quarter, changes in the **overall domestic inflation** were again mostly affected by the fall in world oil prices, leading to an annual decline in the domestic prices, which were lower than expected. On the other hand, food component and core inflation continued with moderate growth. It is again assessed that the adjustment of the general price level is temporary, without major risks to its incorporation in inflation expectations in the coming period. In the first half of the year, the real sector **activity continued to grow** at a solid pace as expected in April. The latest short-term indicators suggest growth in all key sectors of the economy, at a pace similar to that in the first half of the year, but significantly slower than expected in the April projections. Solid liquidity and capital positions of the banking sector contributed to the increase in the supply on the **credit market**, which along with the demand growth preserved the continuity of credit support to the private sector. In the third quarter, **foreign reserves** declined on a quarterly basis, mainly due to the regular servicing of external liabilities of the country. On the foreign exchange market, after the interventions with selling foreign currency in July, in August the NBRM purchased foreign currency, whereby the cumulative interventions in the period from July to August had an almost neutral effect. Since then, the foreign exchange market has been stable, with no need for interventions through foreign reserves. All reserve adequacy indicators still point to an appropriate level of foreign reserves with enough room for dealing with possible shocks. **Adverse risks predominated in the risk balance in the third quarter, including those arising from external environment and risks arising from the domestic political turmoil. As for the global environment**, this period again witnessed downward shifts in expectations for the world economy and increased adverse risks to the baseline scenario for global growth. The slowdown of growth in China and instability in financial markets are new risk factors that increase uncertainty in the environment. This period was marked by the re-escalation of the Greek economic and political crisis, especially at the end of June, however, with short-term and relatively limited effects on the domestic economy. **Domestic risks** were mainly associated with the volatile political context, whose economic effects were limited. Yet, the risk of delayed effects in the coming period is still present due to the potentially greater restraint of both domestic and foreign entities. **Despite present risks, the NBRM, within its regular assessments of the monetary policy setup, has estimated that the economic fundamentals are sound and that the economy has not been facing greater imbalances, and accordingly, the basic interest rate has remained unchanged. The changes in reserve requirement have been made as additional support to savings in the banking system in the long run and in denars. This is aimed to stimulate creation of stable sources of funding for banks, as well as "denarization" as a process that tends to reduce any pressures on foreign reserves.**

Between April and October projections, besides changes in the initial conditions in some indicators of the domestic economy, certain changes were made in the expected trends of the **main indicators of external environment**. The changes in **foreign effective inflation** are minor and in line with the general decline of most prices of primary commodities. In fact, the prices of energy and primary food products has been downwardly revised, indicating favorable terms of trade and lower pressures from import prices on inflation in 2015 and 2016. In 2017, further slight acceleration in the growth of foreign inflation is expected. Metal prices have also been changed downward, indicating less favorable position of the domestic steel industry, compared with previous expectations. **Changes also occurred in the assumptions for foreign effective demand** that is expected to further recover throughout this and next year, although in 2016, it will be at moderately slower pace than previously expected, mainly due to the weaker expectations for Greece, taking into

¹ In August 2015, the National Bank Council adopted the Decision on amending the Decision on reserve requirements that reduces the reserve requirement rate for the bank liabilities to natural persons in domestic currency with contractual maturity over one year from 8% to 0%, with these liabilities obtaining the same treatment as the liabilities with maturity over two years, for which rate of 0% since 2012 has been applied.



consideration the major political issues this country has been facing recently. The effect of the new estimates for the growth of other countries on external demand is either neutral or slightly improved compared to April. During 2017, the latest expectations show further recovery of foreign demand, at a pace similar to the previous two years.

The latest projections for the growth of domestic economy for 2015 and 2016 have been revised from 4.1% and 4.5% to 3.2% and 3.5%, respectively. Latest projections indicate positioning of the growth rate around 4% in 2017. Despite recent performances, which are in line with expectations, and small quantitative changes in the estimates for foreign demand, it is however estimated that under-stimulating external environment and domestic risk factors create uncertainty, limiting the recovery of domestic economy at a pace expected by April projections. The projection of the domestic growth still indicate a faster recovery compared to the foreign demand, or "decoupling" of the speed of growth due to specific structural changes in the domestic economy. Hence, despite the downward changes in estimates for the rate of growth, its key sources remain virtually unchanged. Exports is still expected to give strong impetus for the economic growth in this and the following two years, amid increased activity of the existing and the new export-oriented facilities with foreign capital and the gradual recovery of external demand. After falling in the first half of the year, the assessment of investment activity for the whole 2015 indicates a small positive impetus for the overall growth. Against the backdrop of solid growth in construction and imports of capital goods, these changes in investments point to possible temporary adjustments in inventories. Considering the current and the announced public investments in infrastructure, the inflow of foreign capital in export-oriented facilities and investments of domestic companies, for 2016 and 2017, investments are assessed as a significant driver of growth. These movements are expected to prompt further growth of private consumption by increasing wages and employment in the private sector. Under such assumptions, as in the previous projections, domestic demand is expected to continue being major generator of economic growth, whilst net exports is expected to make minimal negative contribution, with the exception of 2015, when the contribution of net exports is slightly positive.

Within the baseline macroeconomic scenario, credit activity of domestic banks continues to be an important factor supporting consumption and investment decisions of the private sector. Sound solvency and liquidity position of banks, amid growing profitability, prompts credit supply. Moreover, amid positive economic growth, the propensity to borrow, i.e. the demand for loans, is expected to increase further. Against this background, the latest projections point to annual credit growth of 7.7% in 2015, similar pace in 2016 and credit growth rate of around 8% in 2017. The growth rates for 2015 have been revised downwards (from 9% to 10% for 2015 and 2016, respectively) showing the limiting impact of weaker than expected pace of deposit growth and greater uncertainty compared to April assessments. The credit growth projections are conditional on the further positive developments in the private sector, as a major factor on the side of credit demand, as well as the growth of deposit base and the maintenance of stable risk perceptions of banks, as a major factor on the supply side.

The latest projections for 2015 indicate a setting free of inflationary pressures. It is expected that inflation will remain at a similar level as in 2014, i.e. it will be around zero on average. These assessments represent a downward revision compared with the expectations in the April projection, when inflation was expected to be 0.5% on average for 2015. The changes reflect the actual price movements as of September, as well as the downward revisions of assumptions for world prices of food and energy. Analyzing the components, the unchanged price level in 2015 was a result of expectations of retaining negative contribution of energy on overall inflation despite the estimates for small growth in food prices and core inflation by the end of the year. In 2016, the gradual opening of the positive output gap, given the steady growth of the domestic economy, and the expected increase of food and oil prices in the second half of the year will contribute to an increase to about 1.5% in 2016 (expected growth of 2% according to the April projections). Amid favorable global and domestic economic environment, inflation is expected to stabilize at 1.6% in 2017. The inflation projection is accompanied by risks, mainly related to the movements in the world prices of primary products.



The latest projections for the balance of payments show a smaller current account deficit in the period 2015-2017, compared with the April projection. Thus, a small deficit of 0.5% of GDP is expected for 2015, compared to the current account deficit of 1.6% of GDP as projected in April. This change in the projection mainly reflects the improved primary income balance and the favorable effects of the key components in the balance of payments (balance of goods and services and current transfers). Dynamically speaking, the external position of the economy in 2015 has been favorable. Namely, the estimated level of current account deficit is lower, compared to 2014, reflecting the increased balance of goods and services, and mainly attributable to the improvement of the energy balance as a result of the low energy prices. The new export-oriented facilities positively affected the trade balance in 2015, while performance of traditional sectors has been less favorable compared to the previous year. Current transfers (secondary income) have stabilized as expected, but their share in GDP has been declining. **In 2016, the current account deficit is expected to reach 1.9% of GDP (3.1% of GDP according to the April projection).** The gradual recovery of global and domestic economy is expected to widen trade deficit in 2016. This projection reflects expectations for further active use of existing export oriented facilities, entry of new foreign investments and increase in domestic demand, which tend to increase investment imports. Also, amid expectations for increase in oil prices in the second half of 2016, energy imports is also expected to rise, which would result in widening of trade deficit. A significant part of the deficit will continue to be funded with secondary income, with expectations for a moderate reduction of its relative share in GDP, which would mean continuity of relatively high inflows of private transfers. In 2017, current account deficit is expected to further expand to 2.4% of GDP, largely reflecting the assumption of significant, yet smaller inflows of secondary income (as % of GDP) and higher outflows in primary income. The present path of the current account deficit and its structure do not suggest major imbalances in the economy. **Amid a less favorable global environment in 2015, lower financial flows are expected for 2016, primarily through direct investments and external borrowing by the private sector. As previously projected, current assessments show that the structure of capital inflows will be a combination of debt and non-debt flows, mainly direct investments and borrowing by the public sector, and there will be net-outflows through part of short-term flows.** Overall, in 2015, net outflows are expected through the financial account, despite the high inflows in the previous year. Such developments have been expected, and are mostly associated with the government. Namely, in 2014, the government provided a significant amount of funds for servicing liabilities by issuing Eurobond of Euro 500 million. In 2015, government is again expected to borrow on the international capital market (Euro 350 million at the end of the year), which is still smaller amount compared to 2014². In 2015, transactions in the balance of payments are expected to result in a moderate decrease of foreign reserves. The estimates for 2016 suggest almost unchanged reserve position based on assumptions of a gradual increase of foreign investments and financial indebtedness of the private sector, and based on further debt inflows for the government. These financial flows, but in a larger amount, are expected to result in accumulation of foreign reserves in 2017. Cumulatively for three years, 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.

Overall, recent developments suggest similar macroeconomic landscape as projected in April, with assessments for slightly slower, yet solid economic and credit growth, absence of price pressures and balance of payment position that ensures maintenance of foreign reserves at an adequate level. Risks around realization of this macroeconomic scenario have arisen from both external and uncertain domestic environment, and are more pronounced compared to the previous projections. Exogenous factors remain associated with the possible changes in the pace of recovery of the global economic growth (the growth in the EU, the growth of the Chinese economy), as well as with the movements in the prices of primary commodities in world markets. Analyzing domestic risks, although thus far their impact has been relatively small and restricted, any prolongation of uncertainty associated to political developments tend to spill over into the economy due to the greater restraint of domestic and foreign entities. Hence, the NBRM will continue to closely monitor the developments in the period ahead, and if

² External government borrowing is consistent with the need for timely servicing of external liabilities, which are particularly pronounced in 2015.

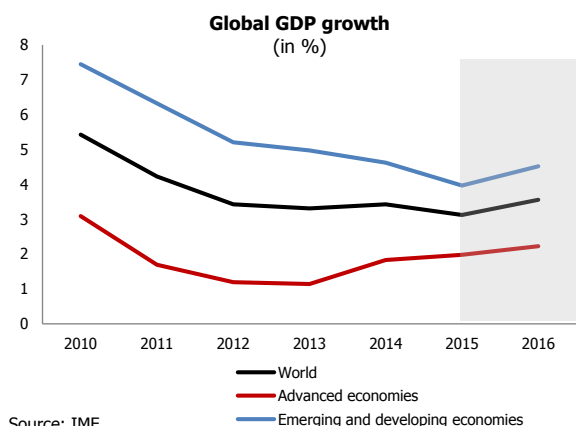


appropriate, will make adjustments to the monetary policy aimed at successful achievement of the monetary policy objectives.

I. Macroeconomic developments

1.1. International economic surrounding³

In the first half of 2015, the global economy continued to grow, but at a slower pace, which is also weaker than expected. With the IMF October projections, small downward correction of the global growth has been made. Namely, it is expected to be 3.1% in 2015 and to accelerate to 3.6%⁴ in 2016. The slowdown of global growth in 2015 reflects weaker performance of emerging economies, as a combined effect of the deteriorating economic performance of oil exporting countries, the slowdown of Chinese economy caused by weak investments, and the less favorable outlook for exporters of other primary commodities, given the decline in world stock prices. On the other hand, there are assessments for acceleration of GDP growth in advanced economies in this period, particularly in the euro area, due to lower oil prices, accommodative monetary policy, improved financial market conditions and depreciation of currencies. The intensification of global economic activity in 2016 is expected to be driven by the developed and some emerging countries. Significant economic recovery is expected in Japan, the US and the euro area, with contribution of the most affected emerging economies whose economic conditions are expected to stabilize. During the first two months of the third quarter, the global inflation slowed down to 2.5%. In terms of expected inflation developments in 2015 and 2016, inflation in developed countries is projected to remain below the central bank target (annual growth of 0.3% and 1.2%). In the developing countries, the inflation is expected to slow down, but the growth remains significantly higher than the inflation in the developed economies (increase of 5.6% and 5.1% in 2015 and 2016, respectively).



In the first half of 2015, the global economy grew by 2.9% annually, which is weaker performance compared to July's expectations. Although this performance partially results from temporary economic difficulties faced by certain countries, given the modest pace of recovery of the developed countries and the continued slowdown in activity in emerging economies, medium- and long-term factors constraining the global growth have become increasingly significant. One of the current challenges for the world economy is the slow adjustment of global markets to the lower stock prices of primary commodities. The dramatic decline in world oil prices in the developed countries has a stimulating effect on private consumption, but without any significant effect on investment activity, and a negative effect in oil exporting countries. Also, in recent period,

³ The analysis is based on the IMF's "World Economic Outlook" of July 2015; the ECB's Economic Bulletin; the announcements of "Markit Economics"; "Global Economic Prospects" of the World Bank; Bloomberg; "Roubini Global Economics" and "Capital Economics" reports, the monthly reports of the International Energy Agency and the weekly reports of the Bank of Greece.

⁴ World Economic Outlook, IMF, October 2015.



*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.

financial markets volatility has increased caused by the depreciation of the Chinese yuan, amid increased risk aversion globally and decreased stock prices, preceded by the economic and political developments in Greece. In the long run, the problem of weaker potential growth associated with low growth in labor productivity in advanced economies and post-crisis adjustment of investment activity in emerging countries have become growingly pronounced.

Observing individual economies, after the poor performance in the first quarter caused by the effect of temporary factors, in the second quarter, the US GDP accelerated on a quarterly basis (0.9%) and recorded an annual growth of 2.7%. Favorable developments have been observed in the labor market, and in August, the unemployment rate reduced to 5.1%. In terms of expectations, the IMF has predicted that the annual growth rate of the US economy in 2015 will be 2.6% and will rise to 2.8% in 2016, driven by lower energy prices, improved balance of the private sector and the recovered real estate market. Euro area is expected to continue its moderate recovery under the effect of stimulating monetary policy, drop in oil prices and depreciation of the euro. Thus, recent estimates predict that the economy of the euro area will grow at a rate of 1.5% in 2015 and 1.6% in 2016. On the other hand, the economic outlook for emerging economies and developing countries will continue to be marked by striking heterogeneity. According to the latest estimates, after the modest growth of these economies in 2015 (4%), in the coming year it will increase (to 4.5%), when the expected normalization of conditions in the most affected emerging economies (Brazil, Russia, Latin America and the Middle East) will offset the slowdown in China. The slowdown of growth of the world economy in the short run is also confirmed by the leading survey indicators of economic activity - PMI5. Thus, in the third quarter, the global composite PMI reached an average value of 53.5 index points, amid slightly less favorable developments in manufacturing and the service sector. **In the October forecast for global economy, the IMF predicts global growth of 3.1% for 2015 and 3.6% for 2016, which compared to the July forecast, is a downward revision of 0.2 percentage points in both years⁶.** Negative risks to the recovery of the world economy prevail and are even more pronounced.

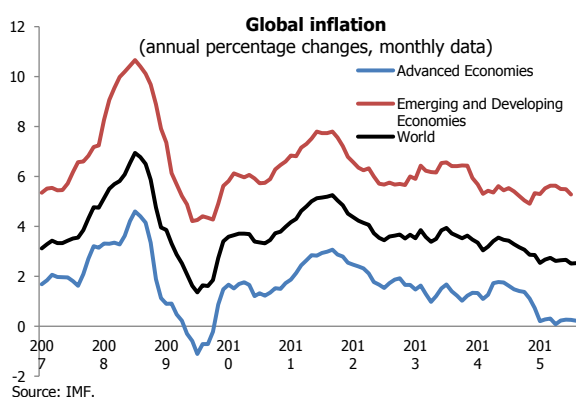
⁵ PMI (Purchasing Managers Index) is based on surveys of a representative sample of companies from the manufacturing and service sectors, and are often used as high frequency indicators for the current and future economic activity.

⁶ World Economic Outlook, IMF, October 2015.

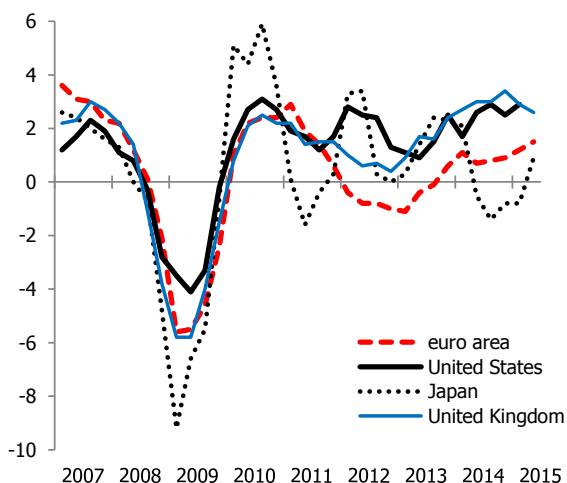
They relate to the implications of further downward movements in the world prices of oil and other primary commodities, the increase in financial instability and redirection of capital flows from emerging countries, the appreciation of the US dollar, the greater slowdown of the Chinese economy as well as the intensification of geopolitical risks.

In the first two months of the third quarter of 2015, the global inflation was slightly lower compared to the preceding quarter.

The annual inflation rate in this period equaled 2.5%, versus 2.6% in the second quarter of the year. The inflation in developed countries and in emerging economies continues to be affected by downward movements in global prices of energy and other primary commodities. According to the latest IMF projections, it is expected that after the slowdown of inflation in developed countries to 0.3% in 2015, in 2016, it will accelerate to 1.2%, which is significantly lower than the mid-term target. On the other hand, the inflation of emerging and developing countries is expected to be 5.6% in 2015 and to slow down to 5.1% in 2016, under the effect of the depreciation of part of their currencies.



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



The economy of the euro area continued to recover in the second quarter of 2015, with a quarterly growth rate of 0.4%, which is slightly slower than the growth of the previous quarter.

On an annual basis, the growth in the euro area reached 1.5%, and was higher compared to the first quarter by 0.3 percentage points. Notwithstanding the signs of recovery, the growth is somewhat slower than expected, and adverse risks have increased. One of these risks are the events in Greece in late June and early July, which however remained under control, and without major effects on financial markets. On the other hand, the decelerating growth of emerging economies, especially in China, is an external unfavorable risk whose effects on the European economy may be felt over a longer period. The analysis of individual components of GDP indicates that the recovery of the euro area is equally supported by domestic and external demand. A key driver of the positive performance is the increased private consumption, fueled by the gradual improvement of the situation on the labor market. In fact, the unemployment rate in the period June-July recorded a further decline, reducing to 11% on average. Net exports made additional positive net effect, which amid the depreciation of the euro is a result of the intensified export activity. On the other hand, the

reduced investment activity negatively affected the economic growth. In the second quarter of the year, most European countries reported favorable economic performance. Observing the larger countries in the euro area, Spain scored the best quarterly results (1%), Germany and Italy reported slightly lower growth (0.4% and 0.3%, respectively), while the French GDP was preserved at the level of the previous quarter.

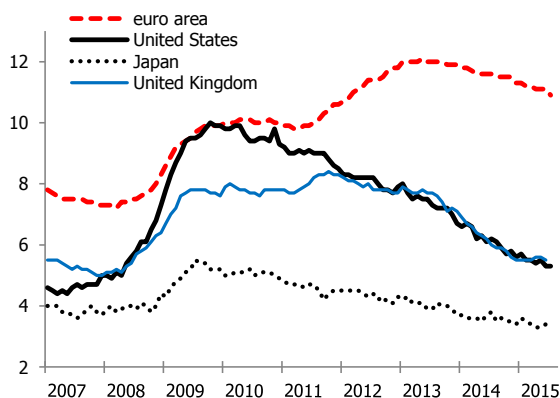
During July and August, inflation in the euro area remained low and significantly below the inflation target of the ECB.

Just like in the second quarter, in this two-month period, the annual rate of inflation stood at 0.2% on average. The stabilization of general price level in the euro area reflects the impact of two groups of factors with opposite effects. On the one hand, there is evident increase in the prices of food component and non-energy industrial products. On the other, this growth was partially mitigated by the fall in energy inflation component amid reduction of market prices of oil. Core inflation remained stable at around 1% and the spillover effect of the depreciation of the euro on non-energy consumer prices and the continued improvement of domestic demand point to a possibility for its gradual strengthening in the period ahead.

In the third quarter, the central banks of the developed countries did not make major changes in monetary measures and continued implementing accommodative monetary policy.

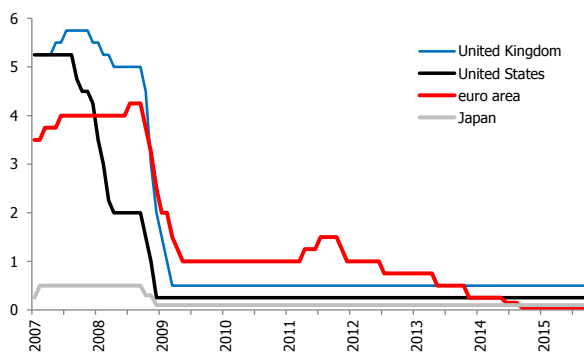
The policy rates of the Fed, the ECB and the Bank of England remained unchanged at levels near zero (0-0.25%, 0.05% and 0.5% respectively). In the September meeting, the Fed's Federal Open Market Committee (FOMC) confirmed that the current policy rate is appropriate for the current conditions. The FOMC also repeated its position concerning the decision to initiate the process of gradual normalization of monetary policy will take into account several labor market indicators, inflation performance and expectations as well as developments on the financial markets. Concerning non-standard monetary policy measures of the ECB, the implementation of the expanded assets purchase program in the euro area continued during the third quarter. In addition, in the September meeting, the ECB Council decided to raise the limit of share of the amount of each instrument intended for repurchase under this program, indicating the possibility of additional loosening of monetary policy in the period ahead. It was again communicated that the Eurosystem will continue

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

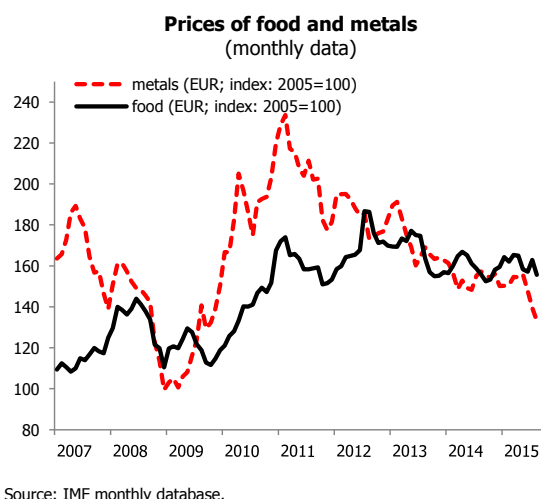
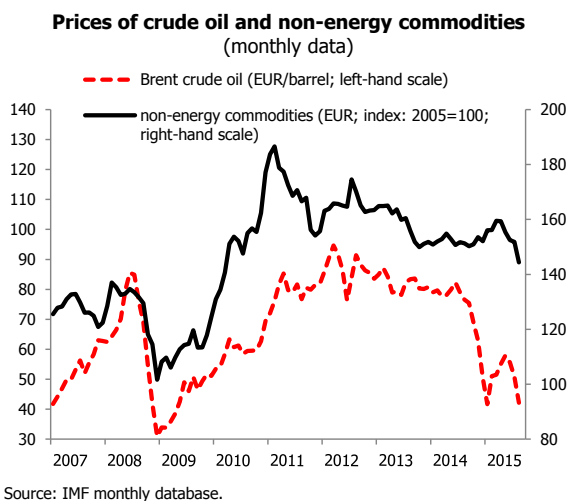
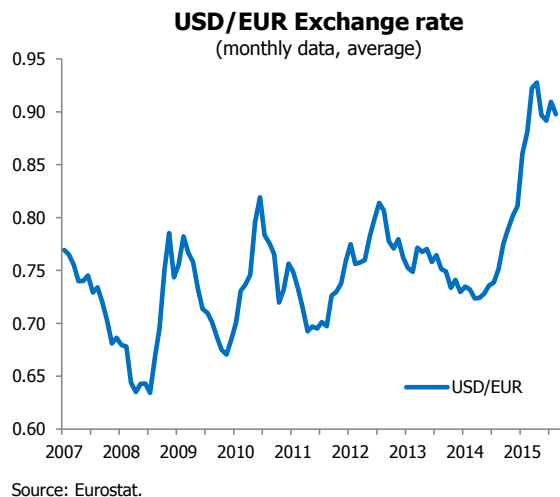


Source: Eurostat.

Policy rates in advanced economies
(in %)



Source: Central banks.



implementing this measure by September 2016, until establishing sustainable convergence path of the inflation to the medium-term target of 2%.

During July and August, the nominal exchange rate of the US dollar against the euro registered volatile movements. In fact, after four consecutive quarters of quarterly appreciation, in this two-month period, the US dollar depreciated by 0.2% against the euro. Analyzed by months, after the appreciation of 2% in July, in August, the US dollar depreciated by 1.3% on a monthly basis. Such movements of the US dollar in the reporting period are associated with the prolongation of the normalization of the Fed's monetary policy. However, on an annual basis, the value of the US dollar against the euro increased by 19.7%, and in August, one US dollar was exchanged for 0.9 euros.

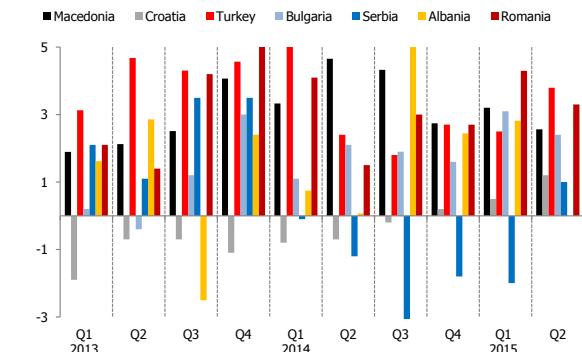
During the first two months of the third quarter, the average oil price, expressed in euros significantly dropped. Namely, following the growth in the second quarter, oil price returned to the zone of negative quarterly changes. On the supply side, such price movements reflect the large production of the OPEC countries and the Iran's announcement on launching the nuclear deal. The lower demand made downward pressure on prices when investors shifted funds to less risky investments, with the slower growth in China also making a certain contribution to the changes in the price of oil. In the period July-August, crude oil "Brent" was sold at an average price of 46.5 euros per barrel, which is a quarterly decline of 17.3%. These quarterly movements accelerated the annual price decline of 39.6%. **Prices of non-energy primary products⁷ denominated in euros registered a quarterly fall (4.9%) in the first two months of the third quarter⁸.** Moreover, there was a significant quarterly decline in the price of metals of 10.7%, in the backdrop of constant instability in the Chinese market and further increase of supply. Also, food prices decreased on a quarterly basis by 0.5%.

In the second quarter of 2015, the countries of the region reported positive economic growth. Moreover, there was recovery of economic activity in Serbia, after five

⁷ The price index of non-energy primary products includes prices of food, beverages, agricultural raw materials and metals.

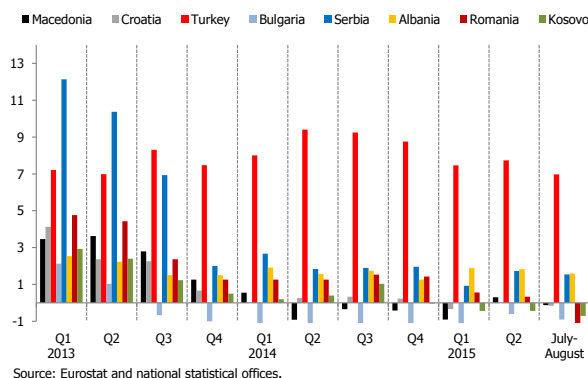
⁸ Expressed in dollars, the prices of non-energy primary products registered a quarterly decline of 2.7%.

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



consecutive quarters of negative annual growth rates. The main driver of the positive performance in Serbia's GDP is the intensified investment activity and net exports, despite weaker private consumption and public spending. Fueled by rising domestic demand, despite the negative contribution of net exports, the economy of Turkey has also seen rapid growth, while all GDP components have contributed to the improved economic performance of Croatia. Romania and Bulgaria reported solid economic growth, with a slowdown compared to the previous quarter, primarily due to the weaker performance of foreign trade.

Inflation in countries from the region
(annual percentage changes)



In the period July-August 2015, almost all countries in the region reported downward price changes. During this period, Romania and Croatia entered the deflation zone for the first time. While the downward correction of the general level of prices in Romania is associated with significant reduction in the VAT rate on food and beverages, the downward shifts in energy component are the main factor for the deflationary trends in Croatia. Moreover, Bulgaria and Kosovo continued to register negative price changes. Compared to the previous quarter, Turkey, Serbia and Albania also reported a downward trend of inflation.

1.2. Domestic supply

The solid growth of domestic economy continued in the second quarter of 2015, but at a slightly slower pace compared to the previous quarter (growth of 0.9% on a quarterly and 2.6% on an annual basis). These changes are as expected and lead to a conclusion that non-economic factors associated with domestic political developments and economic and political developments in Greece had limited effects on the economy at this time of year. Generators of growth, as in the previous quarter, were the activities of trade, transport and communication, and hotels and restaurants, with significant growth of value added being recorded in the construction sector. On the other hand, agriculture has been registering lower value added for the third consecutive quarter, and decline in value added have been recorded in industry. However, analyzing the overall industry, recovery has been registered in the manufacturing sector, given the more favorable assessments of the current economic situation of the companies operating in this sector and increase in the average capacity utilization.

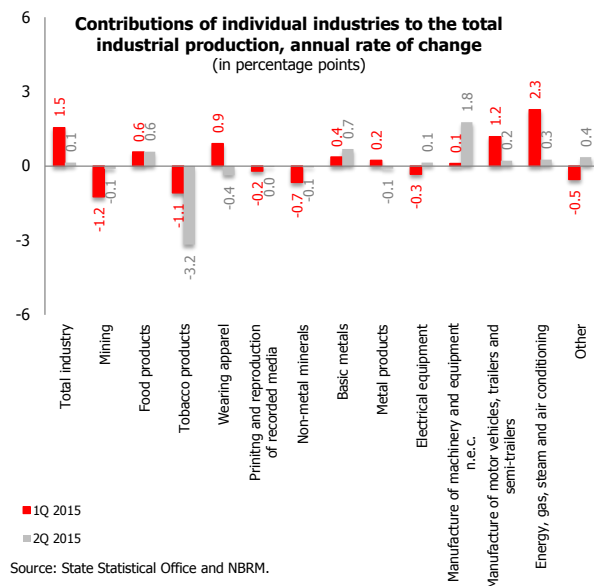
In the second quarter of 2015, the quarterly growth of gross domestic product was 0.9% (seasonally adjusted), while on annual basis, GDP increased by 2.6%, which compared to the first quarter of the year, is a slight slowdown. Moreover, as in the previous quarter, trade, transport and communications, and

hotels and restaurants were generators of the annual growth. Growth was also recorded in most of other service activities (excluding activities of public administration and defense, education, health and social care and arts, entertainment and recreation) and in construction. On the other hand, the value added of the agricultural sector continued to decline, and the second quarter registered a slight decline in the value added in industry, despite the recovery of the manufacturing industry.

	annual growth rates, in %												contributions to GDP growth (in p.p.)											
	Q1 2013	Q2 2013	Q3 2013	Q4 2013	2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014	2014	Q1 2015	Q2 2015	Q1 2013	Q2 2013	Q3 2013	Q4 2013	2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014	2014	Q1 2015	Q2 2015
Agriculture	16.0	7.3	1.7	14.3	9.0	3.8	8.7	0.9	-3.1	2.0	-0.4	-2.1	0.9	0.5	0.2	1.2	0.7	0.2	0.6	0.1	-0.3	0.2	0.0	-0.2
Industry	6.7	5.8	4.5	6.2	5.8	2.6	5.7	5.9	2.8	4.3	3.1	-0.5	0.8	0.7	0.5	0.8	0.7	0.3	0.7	0.7	0.4	0.5	0.4	-0.1
Manufacturing	10.8	7.8	7.8	10.4	9.2	8.2	11.3	16.6	4.5	10.0	-1.8	2.3	0.8	0.7	0.7	1.0	0.8	0.7	1.0	1.5	0.5	0.9	-0.2	0.2
Construction	5.8	4.0	8.9	5.7	6.0	9.5	0.3	3.2	11.1	6.1	3.1	6.2	0.7	0.4	0.8	0.5	0.6	1.1	0.0	0.3	0.9	0.6	0.4	0.6
Trade and transport	10.6	5.7	3.4	-0.2	4.5	3.5	5.8	3.9	-0.9	3.1	6.3	5.5	1.5	0.9	0.6	0.0	0.7	0.5	1.0	0.6	-0.1	0.5	0.9	0.9
Information and communication	10.4	10.7	9.2	10.0	10.1	2.3	4.7	4.0	2.0	3.3	3.5	2.5	0.5	0.5	0.5	0.5	0.5	0.1	0.3	0.2	0.1	0.2	0.2	0.1
Financial and insurance activities	2.6	1.1	0.5	3.6	1.9	4.2	3.5	7.5	3.8	4.7	6.2	13.8	0.1	0.0	0.0	0.1	0.1	0.2	0.1	0.3	0.1	0.2	0.2	0.5
Real estate activities	-10.4	-2.5	3.5	5.8	-1.3	4.8	4.1	2.8	0.9	3.2	-0.2	1.2	-1.4	-0.3	0.4	0.6	-0.2	0.6	0.5	0.3	0.1	0.4	0.0	0.1
Professional, scientific and technical	-3.0	7.8	11.7	17.4	7.6	2.0	6.9	8.2	12.4	7.2	9.9	12.6	-0.1	0.3	0.4	0.5	0.3	0.1	0.2	0.3	0.4	0.2	0.4	0.4
Public administration	2.0	1.5	1.0	0.4	1.2	0.6	0.6	0.8	0.0	0.5	-1.9	-1.8	0.3	0.2	0.1	0.0	0.2	0.1	0.1	0.1	0.0	0.1	-0.2	-0.2
Other service activities	-19.6	-7.5	10.5	22.0	-1.0	12.2	11.3	11.6	11.7	11.7	6.6	-0.6	-0.6	-0.2	0.2	0.4	0.0	0.3	0.3	0.3	0.3	0.3	0.2	0.0
Gross Domestic Product	1.9	2.1	2.5	4.1	2.7	3.3	4.7	4.3	2.7	3.8	3.2	2.6	1.9	2.1	2.5	4.1	2.7	3.3	4.7	4.3	2.7	3.8	3.2	2.6

*At the end of september 2015, the State Statistical Office published final GDP data for 2013, as well as previous data for 2014. Revised GDP quarterly data for 2014 have not been published.

Source: State Statistical Office and NBRM calculations.

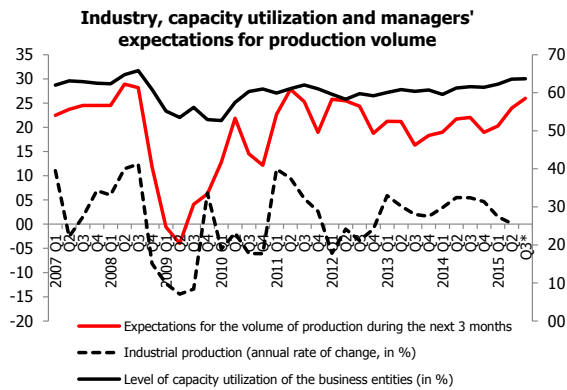


Source: State Statistical Office and NBRM.

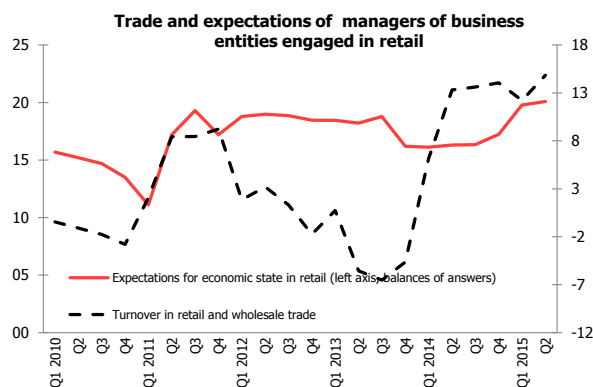
During the second quarter of 2015, after nine quarters of continuous growth, the value added of the industrial sector saw a small annual decline. At the same time, the value added in industry also declined on a quarterly basis. Considering that GDP data point to growth of value added in the manufacturing industry, these unfavorable trends in the industry could be explained by the deterioration in the mining and/or energy sector. Analyzing manufacturing industry⁹, the activities of new export oriented facilities still register favorable developments, with growth also being observed in part of the other facilities. Analyzed by individual activities, the annual industry growth is mostly explained by the growth in the production of machines and devices, metals and food products. In support of the improved performances in manufacturing industry are the results of the **Business Tendency Survey in the manufacturing industry¹⁰**, where managers assess the economic standing of their businesses as more favorable, amid higher average capacity utilization in the second quarter of the year. Observing the limiting factors, corporate managers stress the lack of skilled labor and insufficient domestic demand as factors with highly negative impact in the second quarter (compared to the same period last year). **Contrary to the fall in the activity of the industrial sector in the**

⁹ The analysis is based on data on industrial production.

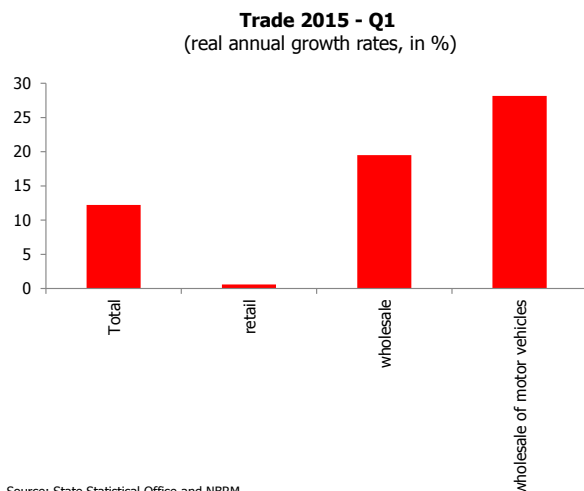
¹⁰ It refers to the surveys conducted in the second quarter of 2015.



Source: State Statistical Office.
* average of expectations for 4 and 5 month of 2015.



Source: State Statistical Office and NBRM.



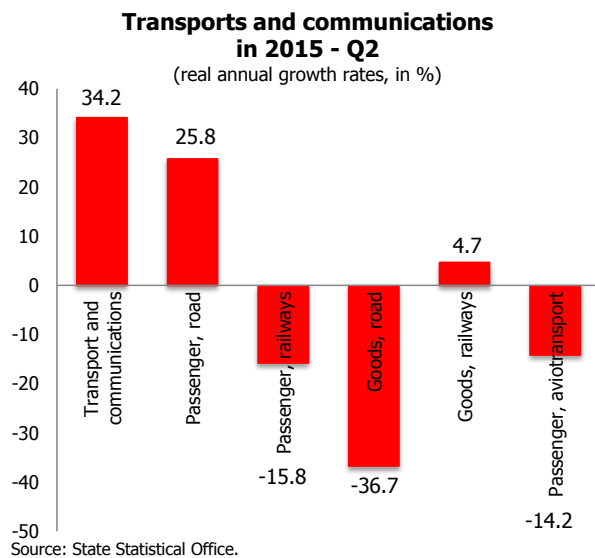
Source: State Statistical Office and NBRM.

second quarter, the available data for this sector for the period July-August indicate more favorable movements in the third quarter. Namely, in the first two months of the third quarter, industrial output recorded an average annual growth of 4.3%, with a decline in activity in July and high growth in August, indicating volatility of movements. Most of the growth is driven by manufacturing and mining, and to a lesser extent by the power supply. In support of favorable developments in the industrial sector are the surveys conducted in July and August indicating continued growth of the degree of capacity utilization, as well as more optimistic perceptions of the managers of the manufacturing sector about the output volume and the number of employees in the next three months.

In the trade sector, the trends that started in 2014 continued in the second quarter¹¹. Namely, in this quarter, the annual growth in turnover in the retail and wholesale trade in motor vehicles continued, same as the growth of turnover in retail trade which continued increasing for the second consecutive quarter. Improved performances in retail trade are confirmed also by the results of the **Survey of Retail Trade Managers¹²** conducted in the second quarter. Thus, in the second quarter, managers assess the current business situation of companies as more favorable. From the viewpoint of limiting factors for the activity of trade companies, the second quarter registered a significant increase in the number of respondents who indicated absence of limiting factors, which is also indicative of improved situation in this sector. In the same period, the weak customer demand, increased financial expenses and increased competition (compared to the same period last year) were less restrictive factors. Favorable movements in trade are expected in the third quarter amid growth, but at slower pace, of the value of total trade turnover in the July-August period. Additionally, the results of the Survey of managers in retail trade for the second quarter point to favorable expectations about the business situation in companies in the next six months.

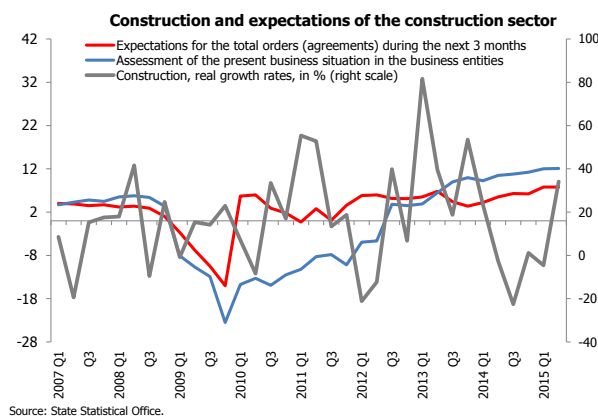
¹¹ The analysis of trends in trade is based on data on the trade turnover.

¹² SSO's Business Tendency Survey in retail trade for the second 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 the corporate managers.



With respect to the developments in the transport and communications sector, this quarter registered maintenance of generally favorable trends in passenger transport and less favorable trends in freight transport. The freight transport (road and air) has been declining for the second quarter, on an annual basis, compared to the growth in the previous year. The volume of rail freight transport has been following a downward path for a longer period, while in the second quarter, same as in the first quarter it registered acceleration of the annual decline. **The small number of high frequency indicators prevents the precise assessment regarding the developments in the transport and communications sector in the third quarter**, although the currently available data suggest activity growth (high annual growth of passenger rail transport during July).

The annual growth of value added in construction continued in the second quarter of the year, with increased intensity, and noticeable slowdown of the quarterly decline¹³. In terms of the types of buildings, the annual growth is explained by the growth of construction in the area of civil engineering, apartment buildings and waterworks. The favorable annual developments in this sector in the second quarter of the year are in line with the results of the **Business Tendency Survey in construction**¹⁴ according to which the current business and financial standing of the corporate sector is regarded as more favorable compared to the same period last year. However, also in this quarter, the managers highlighted several factors that limited the growth in construction activity, such as lack of skilled labor, higher labor costs and increased financial costs. **For the second quarter, the managers of companies in the construction sector expressed favorable expectations** about the volume of orders and the number of employees. Such expectations of managers are in line with the latest data on the developments in the construction sector in July that registered two-digit annual growth in the value of completed construction works.

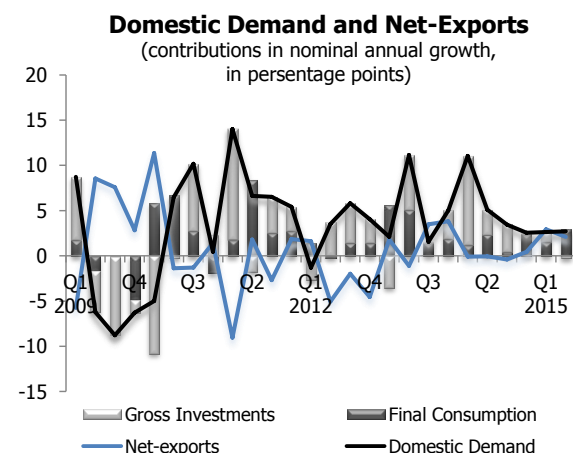


¹³ Seasonally-adjusted.

¹⁴ It refers to the surveys conducted in the second quarter of 2015.

1.3. Aggregate demand

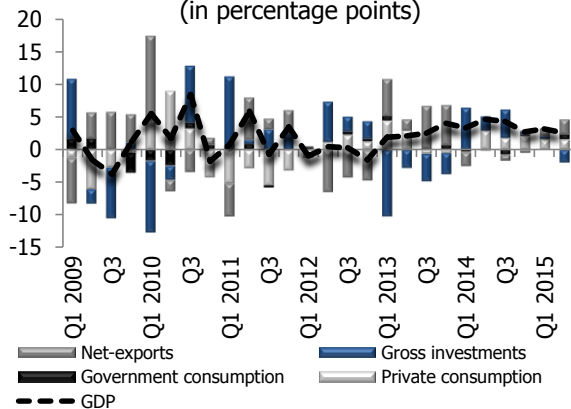
In terms of demand, the annual growth of gross domestic product of 2.6% in the second quarter of 2015 results mainly from the positive contribution of net exports. The domestic demand made positive, yet relatively lower contribution to growth unlike the previous few quarters, when it was the engine of growth. Observing individual components, as in the previous period, export demand registered the highest annual growth, but slower compared to the previous period. Thus, this component made the largest individual contribution to the growth of economic activity. As before, export growth was largely attributable to the activity of new production facilities and the gradual improvement of foreign effective demand. Domestic demand made minor positive contribution to economic activity, amid decline in gross investments after their positive input for several quarters in a row. On the other hand, the other two components of domestic demand, private and public spending, have increased. The growth in household consumption was supported by favorable developments in the labor market and increased credit support to households, with the intensified annual growth in public consumption making significant contribution to the overall GDP growth. The smaller investment demand and slower pace of growth in export demand slowed down the growth in imports.



Source: State Statistical Office and NBRM calculations.

In the second quarter of 2015, the gross domestic product (GDP) grew by 0.9% compared to the previous quarter (seasonally adjusted) and by 2.6% compared to the same period last year, which is slightly slower growth compared with the growth rate recorded in the previous quarter. The analysis shows that economic growth is generated mainly by net exports, with positive contribution of domestic factors. Thus, the structure of growth is similar to the previous quarter, with a simultaneous positive contribution of domestic demand and net exports. Yet, in this quarter, net export demand made the highest positive contribution of to the overall growth. Analyzing individual components, exports, same as in the previous five quarters, made the greatest individual positive contribution to growth. Such continuing favorable developments in the export sector are mainly due to the activity of the new production facilities. The favorable trends in the global economy related to lower oil prices and demand growth in the economies of the EU have had further positive impact on export demand. The low positive contribution of domestic demand in the second quarter of the year is due to the decline in gross capital formation, which was offset by the growth of private and public consumption. Namely, investments decreased after the steady annual growth in the previous five quarters, reflecting the likely decline in inventories, given that most of the high-frequency indicators point to growth in investment in fixed assets. However,

Contribution to real annual GDP growth
(in percentage points)



Source: State Statistical Office and NBRM calculations.

taking into account the domestic political developments, which were especially pronounced during this period, it is likely that this factor also had an impact on investment. On the other hand, positive developments in the labor market, lending by domestic banks and the growth of real wages enabled further increase in household consumption. Growth was also registered in public spending at stronger pace compared with the previous two quarters. Increased export and domestic demand intensified imports, which was significantly weaker compared to the increase of exports.

Real annual growth rates (%)

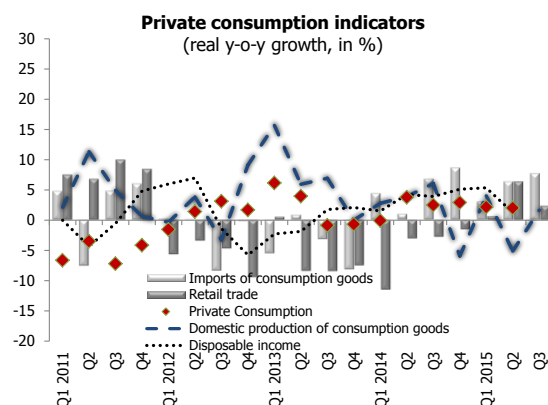
	2012-Q1	2012-Q2	2012-Q3	2012-Q4	2012	2013-Q1	2013-Q2	2013-Q3	2013-Q4	2013	2014-Q1	2014-Q2	2014-Q3	2014-Q4	2014	2015-Q1	2015-Q2
Private consumption	-1.5	1.4	3.1	1.7	1.2	6.1	4.0	-0.9	-0.7	2.1	-0.1	3.8	2.5	2.9	2.3	2.2	2.0
Government consumption	2.2	0.8	3.7	3.1	2.4	4.4	-0.1	1.2	4.4	2.5	-1.7	0.0	-5.2	1.9	-1.2	0.9	5.8
Exports of goods and services	-1.5	-0.1	3.7	5.2	2.0	-5.0	-0.7	-3.3	-1.9	-2.7	14.2	15.9	15.2	22.4	17.0	9.4	7.4
Imports of goods and services	-1.3	12.1	10.4	11.8	8.2	-13.1	-3.4	-12.9	-10.7	-10.0	14.8	11.5	14.3	17.4	14.5	4.7	1.6
Gross capital formation	-0.4	27.7	8.9	8.7	10.2	-32.6	-9.8	-15.2	-9.6	-16.6	31.0	8.9	19.1	1.8	13.5	1.3	-7.6
Domestic demand	-0.7	6.6	4.5	3.7	3.5	-4.3	0.1	-4.0	-2.5	-2.6	5.4	4.4	4.9	2.5	4.2	1.8	0.3
Net exports*	-1.0	54.6	36.8	28.6	26.3	-30.2	-9.4	-41.6	-28.8	-27.0	16.3	0.8	9.8	3.2	6.6	-8.6	-14.8
GDP	-1.0	0.5	0.3	-1.6	-0.5	1.9	2.1	2.5	4.1	2.7	3.3	4.7	4.3	2.7	3.8	3.2	2.6

*decrease represents lower deficit

Source: SSO and NBRM calculations.

1.3.1. Private consumption

In the second quarter of 2015, household consumption recorded a quarterly increase of 2.5% (seasonally adjusted) and an annual real growth of 2.0%, which is similar to the growth of the previous quarter. Such annual growth of private consumption corresponds to the increase of available funds, given the growth in the main components of disposable income. Thus, the wage bill in the economy continued to grow at a solid pace amid real growth of average monthly salaries paid and further increase in employment. Also, pensions increased in the second quarter of the year, albeit at considerably slower pace than in previous quarters. Among the main income components, decrease in this period was recorded only in inflows of private transfers from abroad. Despite the favorable movements of the disposable income components, the real growth of retail lending continued in the second quarter, mainly in the form of consumer loans, which represented additional support to the consumption

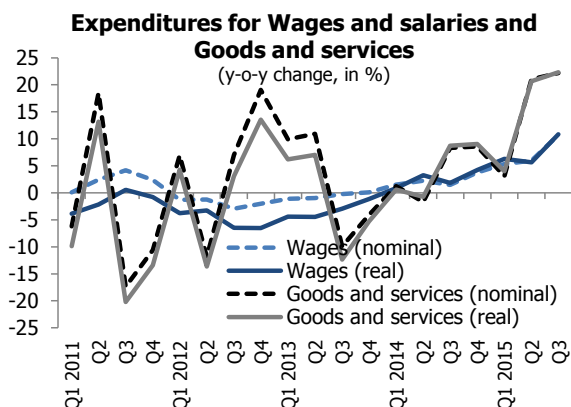


Source: State Statistical Office, Ministry of Finance and NBRM calculations.

in the second quarter. The movement of short-term indicators of household consumption largely corresponds to the growth registered in the second quarter of 2015. Thus, an annual growth with slower dynamics was recorded in import of personal consumption goods and retail trade.

According to the recent available data, private consumption is expected to increase annually in the third quarter of 2015. In fact, total funds available to households are assessed to continue increasing in the third quarter in line with the increase in real wages, pensions and transfers. According to lending data, in the period July-August, the high growth of consumer loans is expected to continue in the third quarter of the year, which corresponds to the banks' expectations for further growth in demand for loans and unchanged credit standards in this period¹⁶. As for the remaining short-term indicators of private consumption, real annual growth has been recorded in retail trade for three consecutive quarters, as well as in the import and production of consumer goods that also underpins the expectations for higher private consumption in the third quarter.

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 second quarter of 2015, public consumption recorded a quarterly growth of 4.3% (seasonally adjusted) and stronger annual growth of 5.8%. Real annual growth mainly stems from the high increase in costs of goods and services as well as the higher costs for wages and health care transfers¹⁷. Available data for July-August 2015 point to further annual increase of public spending in the third quarter of 2015, given the further high real growth in cost of goods and services and higher health care transfers and increased costs for wages of public sector employees.

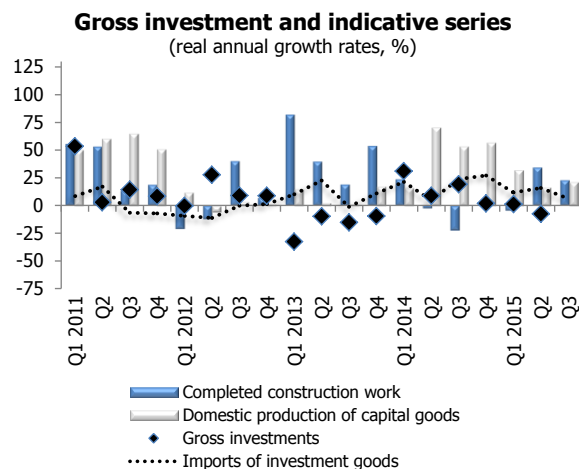
1.3.3. Investment consumption

In the second quarter of 2015, the gross capital formation registered a quarterly decline of 1.8% (seasonally adjusted). On an annual basis, investments dropped by 7.6%, which is the first decline after the continuous growth for

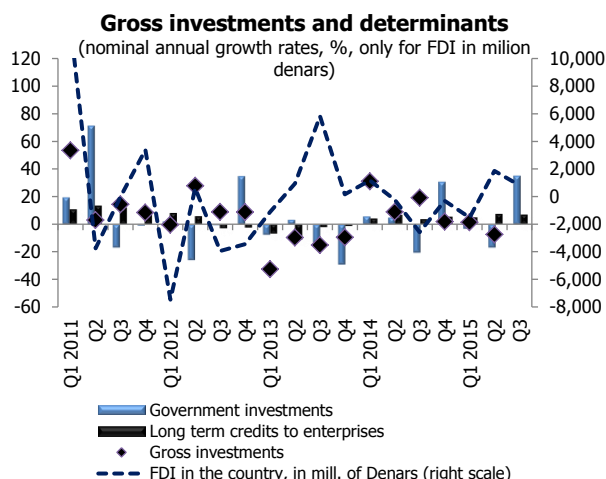
¹⁵ Data on wages, private transfers and import of consumer goods are as of July, while other data are as of August.

¹⁶ NBRM's Lending Survey conducted in June 2015.

¹⁷ Most of these assets relate to expenditures for goods and services.



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



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

five consecutive quarters. According to data on short-term indicators of investment activity, the decline probably reflects a shortage of inventories, given that most of the short-term indicators point to growth in investments in construction and investments in machinery and equipment - the two most important components of GFCF. The growth of construction activity comes after its reduction at the beginning of the year, mainly due to the increase in investments in road infrastructure. Import of capital goods, which is an indicator of investment in machinery and equipment continued to grow in the second quarter. Positive trends in investments in equipment and machinery are partly associated with foreign direct investments, which increased in the second quarter. Most other short-term investment indicators also experienced positive shifts. Thus, growth in the second quarter was registered in domestic production of capital goods and in corporate loans as a result of increased demand for loans amid mainly unchanged conditions for approving loans by most banks¹⁸. Among investment indicators, only government expenditures for capital investments marked stronger downward movement.

Most of the available short-term indicators of investment activity point to a moderate annual growth of investments in the third quarter of 2015¹⁹. Thus, annual growth was observed in the import of investment goods and in the domestic production of capital goods. Meanwhile, in the period from July to August, there was further annual growth of long-term lending to companies in line with the banks' expectations for further growth of demand for corporate loans and easing of credit standards in this period²⁰, with growth being also registered in inflows of foreign direct investment. An increase has also been seen in the value of completed construction works, which is in line with the expectations of managers in the construction sector for the third quarter, which are more favorable in terms of total orders and number of employees²¹. Favorable developments have also been registered in government expenditures for capital investments, pointing to support of the public sector for the investment activity in the third quarter. An additional indicator that points to stronger investment activity in part of the companies is the acceleration of industrial output. Analyzing short-term investment indicators,

¹⁸ NBRM's Lending Survey conducted in June 2015.

¹⁹ Data on completed construction works, foreign direct investments and import of working capital are as of July, while other data are as of August.

²⁰ NBRM's Lending Survey conducted in June 2015.

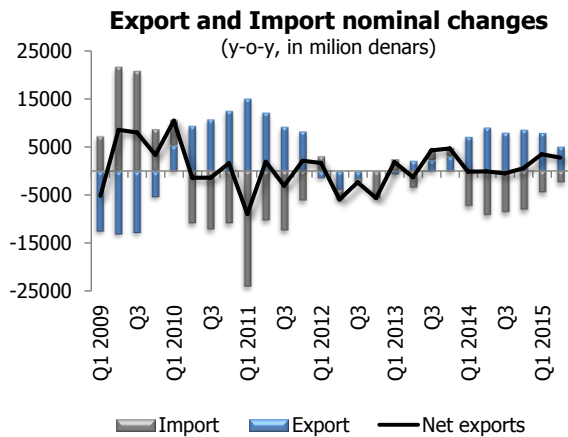
²¹ Business Tendency Survey in construction conducted in the second quarter of 2015.

decline was registered only in stocks of finished products.

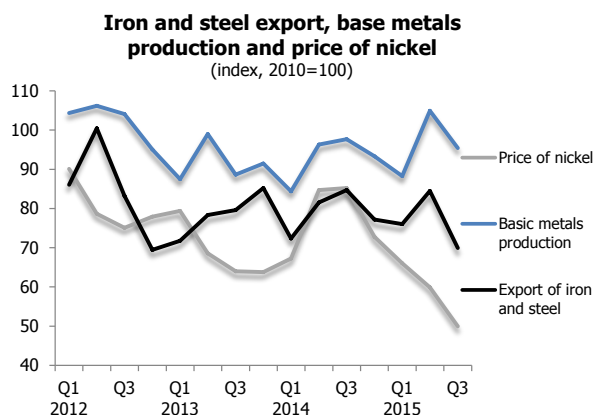
1.3.4. Net external demand

The favorable external sector developments, typical for the previous quarter, continued in the second quarter of 2015. Namely, amid faster growth of exports than imports, the foreign trade deficit declined, so that net exports in the second quarter of 2015 made a positive contribution to GDP growth, which is more significant compared to the positive contribution from the previous quarter. Real exports of goods and services recorded an annual growth of 7.4% (moderate deceleration of the annual growth pace) and quarterly growth of 1.2% (seasonally adjusted). The annual growth is mainly a result of the increased exports of new production facilities. The largest export from these facilities was registered among manufacturers of chemical products, electrical equipment and machines. Solid performances were registered in part of other exports, i.e. exports of manufacturers of furniture and metals. Despite the growth in the exports of metals, the constellation in the domestic metal industry remains unfavorable, given the still low metal prices on the world market. Import of goods and services in the second quarter of 2015 increased by minimum 1.6% annually, which is slower compared with the annual growth previous quarter. Import growth is explained by increased imports of intermediate goods as a result of reliance on the domestic production on imports, while the slowdown in the pace of growth corresponds to the lower investment demand and slower growth of exports in the second quarter. As in exports, a quarterly increase was also registered in the imports, of 1.4% (seasonally adjusted).

Data for the third quarter point to moderate developments on the export side. Thus, slight nominal annual growth in the exports of goods was registered in July-August 2015. Imports registered a moderate nominal annual growth in the first two months of the third quarter. Nominal net export data for July and August show that certain narrowing of the trade deficit is expected for the third quarter, given the faster growth in exports compared to the increase in imports.



Source: State Statistical Office .

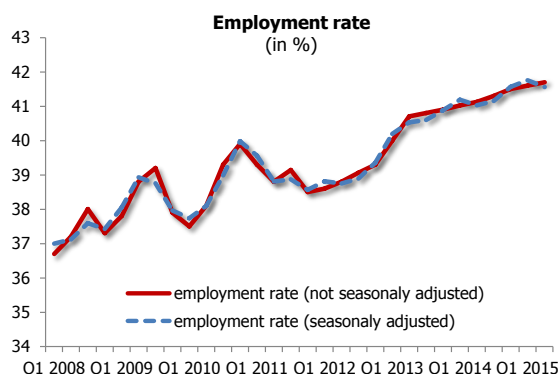


Source: State Statistical Office, IMF monthly database and NBRM calculations.

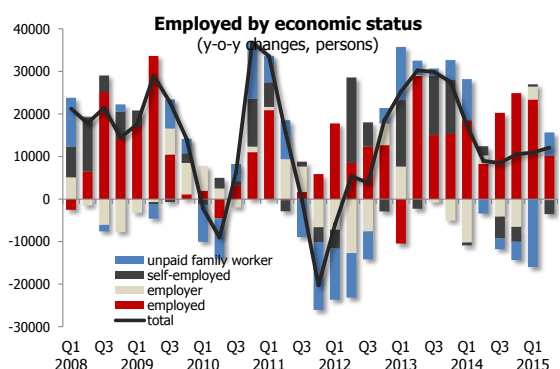
1.4. Employment and wages

In the second quarter the number of employees grew by 1.8% annually, which is a pace of growth similar as in the past few quarters. Thus, for more than

three years in a row, this indicator has been in the zone of positive annual change, indicating steady growth in the absorption of labor in the domestic economy²². These developments are in line with the real sector performances, which are also favorable. The aggregated signals from business tendency surveys point to strengthening of employment prospects in the coming three months. In the second quarter, some deterioration in cost competitiveness of the economy was registered, in view of the faster annual wage growth compared to the growth of labor productivity, a tendency present for three consecutive quarters.



Source: State Statistical Office, Labour Force Survey.

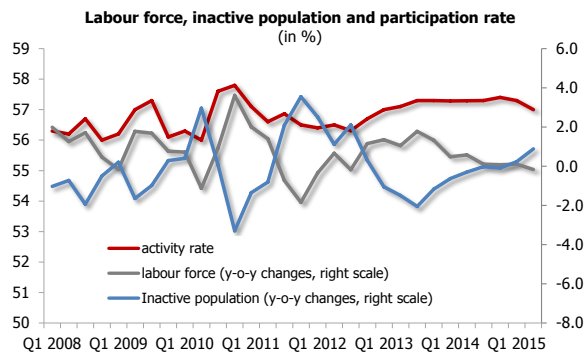


In the second quarter, the number of employed persons increased by 1.8% annually, which is a pace of growth similar as in the past few quarters. On a quarterly basis, however, employment dropped by 0.4%²³. Quarterly downward shift follows the continuous positive performance of this indicator in the previous three quarters. The annual growth in the number of employees is driven by industry and agriculture, amidst simultaneous almost stagnant performance of the services sector. Observed by sectors of activity, employment growth on an annual basis is characterized by relatively high dispersion, but according to the size of the positive contribution "manufacturing", "other community, social and personal service activities", as well as "public administration, defense and compulsory social security" stand out. In terms of the economic status²⁴, the growth is mostly a result of the category of employees. These developments caused an increase in the employment rate by 0.6 percentage points annually, to 41.7%. The results of the Job Vacancy Survey confirm the positive developments in the

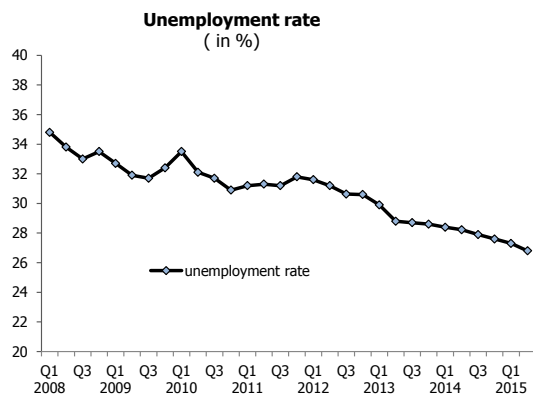
²² The growth in the demand for labor, for several years has been associated with the operation of the new facilities in the technological-industrial development zones. Also, for a longer period, the labor market has had a solid response also to the fiscal policies aimed at accelerating economic activity and employment, such as the active employment measures, the implementation of public infrastructure projects, policies of subsidizing agricultural production, and credit lines provided through the European Investment Bank (EIB), offered in the form of subsidized loans intended to improve the liquidity of the investment activity of SMEs.

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

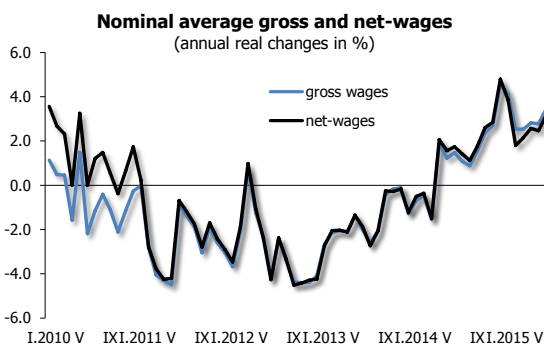
²⁴ The classification by economic status applies to the following groups: **employers** - persons who operate their own business entity or engages independently in their own shop, or farm owners who hire other employees; **employees** - persons who work in government institutions, business entities in 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).



Source: State Statistical Office, Labor Force Survey.



Source: State Statistical Office, Labor Force Survey.



Source: State Statistical Office.

employment²⁵. Namely, the number of vacancies, as an additional indicator of the movement of labor demand has registered an annual growth of 12.2% in the second quarter. Meanwhile, the rate of vacancies²⁶ recorded an upward movement compared to that registered in the same period of the previous year and positioned at the level of 1.47%. The sectors "mining", "other services" and "education" are characterized by the highest annual growth rate of vacancies.

In view of the trends for the upcoming quarter, certain indicators point to further improvement in employment prospects in the short term. The aggregated signals from business tendency surveys²⁷ suggest increased optimism among managers of business entities regarding the employment for the next three months.

Also in the second quarter, there are no significant changes in labor supply. Namely, compared to the same period last year, the total active population has decreased by 0.2%, which given the faster growth of the inactive population, has led to a decline in the activity rate, which is positioned at 57%, which is a level lower than the average for the last year by 0.3 percentage points.

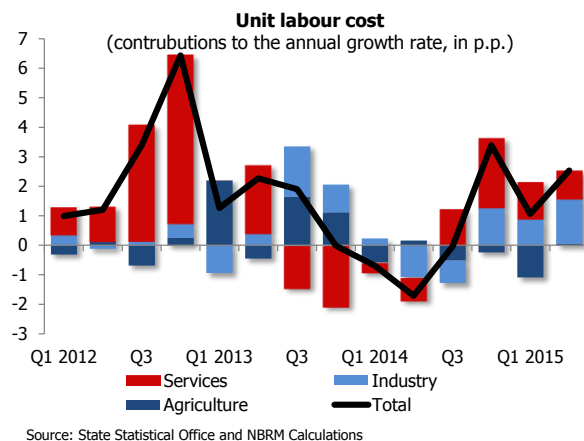
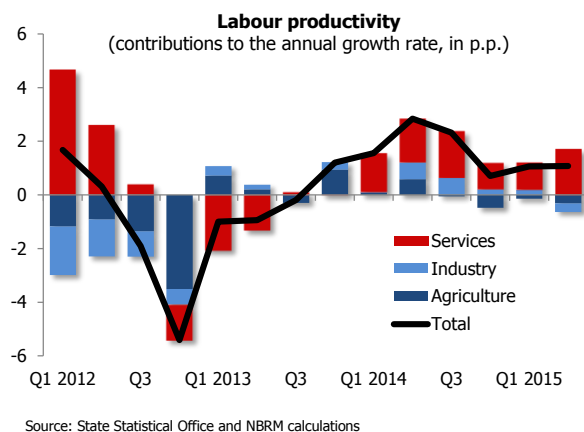
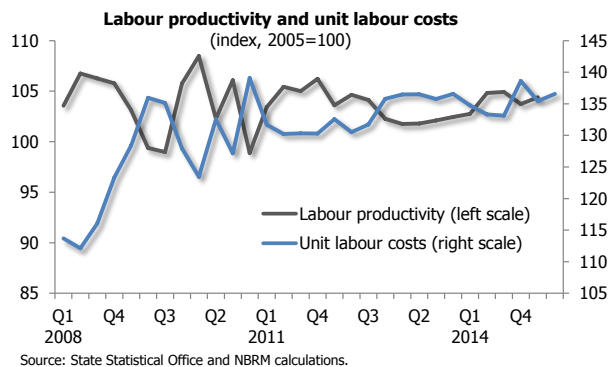
In the second quarter, the decline in unemployment continued, amid increased demand and reduced supply of labor. Namely, the number of unemployed in the second quarter decreased by 5.1% on an annual basis. Consequently, the unemployment rate fell by 1.4 percentage point and reduced to 26.8%.

The average wages paid in the second quarter increased on an annual basis, at somewhat faster pace than that registered in the previous quarter. Thus, the nominal net and gross wages in the second quarter increased by 3.1% and 3.3%, respectively, on an annual basis. The upward adjustment of wages was registered in all three major economic activities. From the viewpoint of individual sectors,

²⁵ For the first time in 2012, the State Statistical Office began to conduct a Vacancy Survey as part of the labor market research. The purpose of this Survey is quarterly reporting on vacancies in companies in the Republic of Macedonia, as an important indicator for the macroeconomic developments and policies in the labor market.

²⁶ 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.

²⁷ Source: State Statistical Office, business tendency surveys in manufacturing industry (July 2015), construction (second quarter of 2015) and trade (second quarter of 2015).



according to the intensity of the positive change most outstanding are the segments "arts, entertainment and recreation," and "mining and extraction of stone", followed by "other services". Nominal net and gross wages moved upward also on a quarterly basis, in all three major economic activities. **In the second quarter, amid stronger nominal growth and concomitant upward correction of the general price level, the real net and gross wages registered an annual growth of 2.7% and 3%, respectively, which is an almost unchanged dynamics compared to that of the previous quarter.** Also, after the fall in the first quarter, real wages again returned to the zone of positive performances on a quarterly basis (growth of 1.3% and 1.1% for net and gross wages, respectively), in circumstances of nominal growth and simultaneous increase in the general price level.

Labor productivity in the second quarter registered an annual growth of 1.1%, thus completing the series of seven quarters of uninterrupted maintenance of this indicator in the positive zone. The above comes as a result of the more intense annual growth of economic activity compared to the employment growth. Analyzed by sector, the annual productivity growth in the current quarter is mostly associated with the services sector. At the same time, the positive quarterly dynamics of productivity has intensified further, amid growth in the economic activity and simultaneous reduction in employment. **Unit labor costs registered an annual increase of 2.5%, which is more than twice faster pace than that registered in the previous quarter.** Upward adjustment is due to the faster growth of gross wages compared to productivity growth. At the same time, the annual growth in unit labor costs is driven mostly by the industry and services sector. After the downward correction in the previous quarter, labor costs registered a quarterly increase amid more intense growth of gross wages compared to productivity growth.

1.5. Inflation

After the small growth in the previous quarter, in the third quarter of 2015 minimal annual price decline of 0.2% was registered. The decline in domestic prices is driven by the further decline in domestic energy prices, due to lower prices of oil derivatives. On the other hand, food prices and core inflation have positively contributed to the change in the total inflation for two consecutive quarters. Lower prices of oil derivatives also affected the producer prices, which

continued to decline also in the first two months of the third quarter. In terms of the expectations for the future period, the Inflation Expectations Survey conducted in September pointed to unchanged inflation expectations relative to the previous quarter.

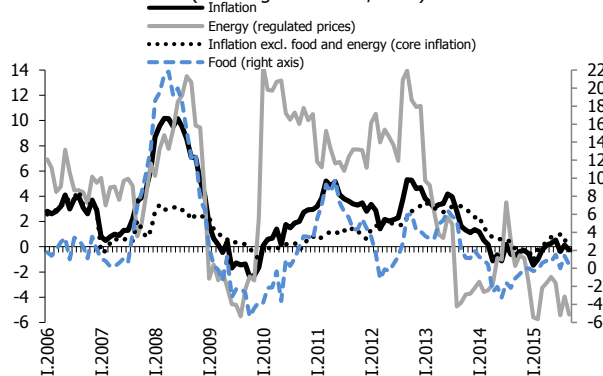
Домашна инфлација и странска ефективна инфлација (годишни стапки на раст, во %)



* Ефективната странска инфлација е добиена како пондеризиран збир од инфлациите во земјите најзначајни трговски партнери на РМ.
Извор: ДЗС, Еуростат и пресметки на НБРМ.

Following the growth in the previous quarter, in the third quarter of 2015 consumer prices again entered the negative zone, i.e. they declined by 0.2% on an annual basis. Analyzed by components, the decline was entirely due to the energy component, primarily due to the lower prices of liquid fuels and lubricants, in line with the fall in oil prices on world markets. On the other hand, the other two components within the index grew in the third quarter. The positive rate of core inflation is mainly explained by the higher prices of tobacco, the products for home maintenance and catering services, while the rise in food prices is mainly due to the increased prices of fruit, vegetables and oil and grease.

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



Source: State statistical office and NBRM calculations.

Unlike domestic, **foreign effective inflation²⁸ followed an upward path**, i.e. in the third quarter it amounted to 0% versus the decline of 0.2% in the previous quarter.

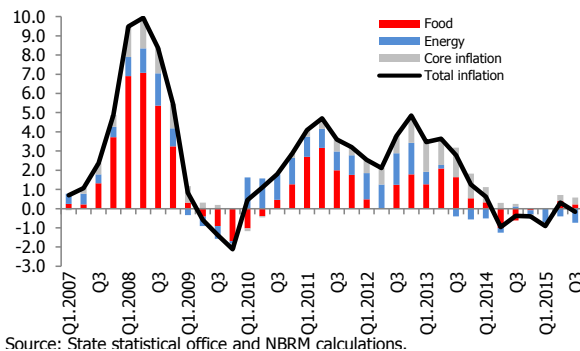
	2014					2015			2014					2015		
	Q1	Q2	Q3	Q4	2014	Q1	Q2	Q3	Q1	Q2	Q3	Q4	2014	Q1	Q2	Q3
Consumer price index - all items	0.6	-1.0	-0.4	-0.4	-0.3	-0.9	0.3	-0.2	0.6	-1.0	-0.4	-0.4	-0.3	-0.9	0.3	-0.2
Food	0.9	-2.6	-1.6	-0.2	-0.9	0.1	1.0	0.6	0.3	-1.0	-0.6	-0.1	-0.3	0.0	0.4	0.2
Energy	-3.3	-1.6	0.8	-1.5	-1.4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

Source: State Statistical Office and NBRM calculations.

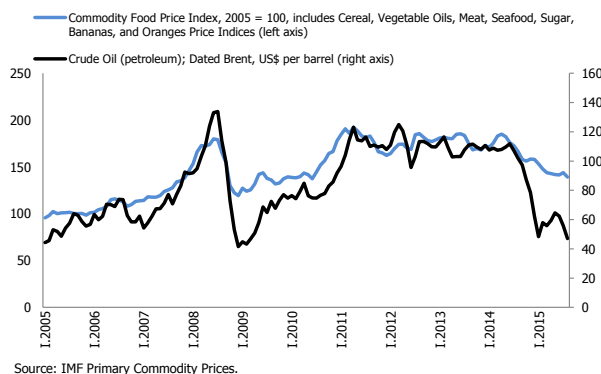
Analyzing the dynamics, the annual decline in consumer prices, as opposed to their rise in the previous quarter, is mainly explained by the sharper fall in energy prices, but the reduction of the positive contribution of the growth in food

²⁸ The calculation of foreign effective inflation derives from the weighted sum of consumer price indices of countries that are most important partners of the Republic of Macedonia in the field of import of consumer goods. The weight structure is based on the normalized shares of nominal imports from each country in the total nominal imports in the period 2010-2012. The calculation of this indicator includes Bulgaria, Germany, Greece, France, Italy, Austria, Slovenia, Croatia and Serbia.

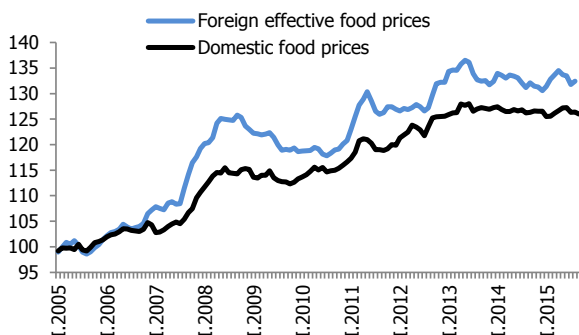
Volatile (food and energy) and core inflation (contribution to inflation, in percentage points)



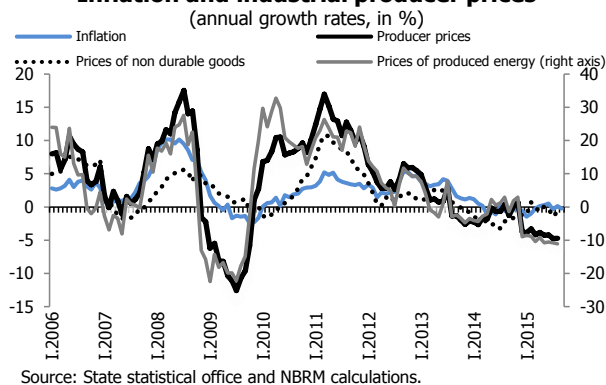
Crude oil and food prices



Foreign effective food prices* and domestic



Inflation and industrial producer prices



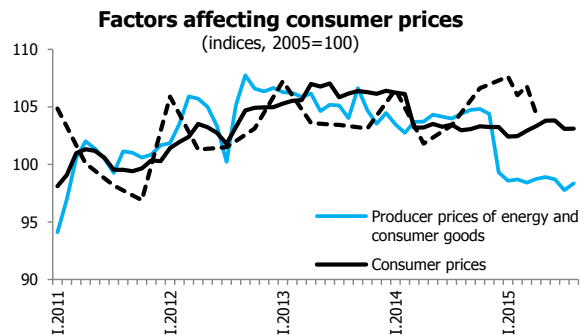
prices also had its effect. On the other hand, the rate of core inflation remained unchanged i.e., as in the second quarter, **core inflation was 0.7% also in the third quarter.**

On a quarterly basis, consumer prices in the third quarter of 2015 were lower by 0.6%, which is explained by the downward movements in two of the three components of inflation. Thus, a decline was observed in the food and energy components, while core inflation is still in the positive zone (for second consecutive quarter). The largest contribution to the decline is that of the food component (a quarterly decline of 0.6%), mainly due to the fall in the prices of fresh vegetables. In addition, the prices of energy registered a quarterly decline of 0.2%. **On the other hand, seasonally adjusted data indicate a quarterly increase in consumer prices of 0.3%**, reflecting the growth in food prices and core inflation.

In the third quarter of 2015, the change in producer prices in the domestic market remained in the negative zone for the eighth consecutive quarter. Thus, the annual decline in producer prices in the first two months of the third quarter averaged 4.7%, which compared to the previous quarter, is an acceleration of the decline (4.1% in the previous quarter). The largest contribution to the annual decline is that of the lower energy production prices, primarily of refined petroleum products. **Also on a quarterly basis, producer prices dropped by 0.7%** (seasonally adjusted rate of decline was 0.8%), which is explained by the lower producer prices in the manufacturing industry, as well as the lower prices for the supply of electricity, gas, steam and air conditioning. **The movement of producer prices which affect domestic inflation component²⁹ indicates downward pressures.** The annual decline in these prices accelerated to 6% (as opposed to the fall of 5% in the previous quarter), amid simultaneous quarterly fall of 5.6% versus the fall of 5.1% in the previous quarter (seasonally adjusted data). Keeping these prices in the negative zone indicates lower inflationary pressures in the coming period.

In the second quarter of 2015, unit labor costs grew by 2.5% annually, and by 1% on a quarterly basis. Considering that the estimates for the output gap do not point to

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

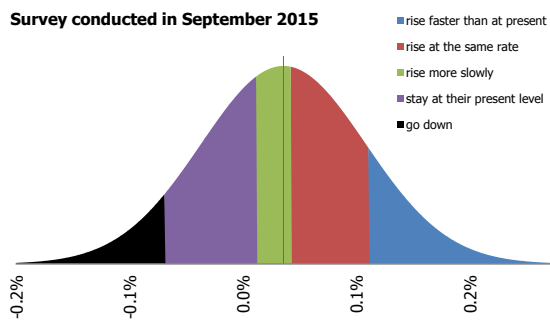


Source: State statistical office and NBRM calculations.

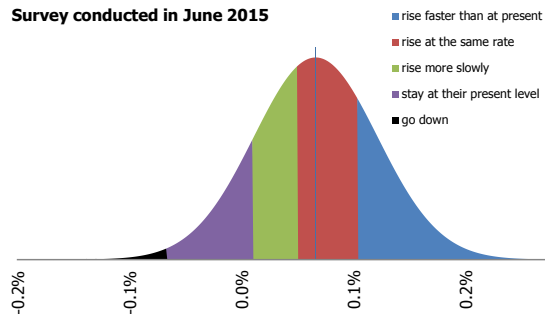
significant pressures from the demand³⁰, for the time being no inflationary pressures on prices of final products through this channel are expected.

Box 1: Inflation Expectations Survey³¹

Survey conducted in September 2015



Survey conducted in June 2015



indications for the direction of the respondents' expectations.

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 months³². 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 years³³. The overall expected rate is calculated as a simple average of the responses of all participants. The resulting indicator is useful for obtaining

³⁰ Estimates of the Central Bank show that the output gap is around zero by the end of 2015.

³¹ 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.

³² 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"

³³ The quantitative question reads as follows: "What are your expectations/forecasts for the average inflation rate for 2015 and 2016?"

The Inflation Expectations Survey was conducted in September 2015³⁴. In September, as in the previous survey cycle, **the average inflation rate for the previous 12-month period remained in the negative zone**³⁵. The results of the September Survey indicate **unchanged inflation expectations relative to the previous Survey**, i.e. as in June, respondents expect inflation to be around 0% in the next 12-month period. Expectations for the inflation rate of around 0% in the next 12 month period are common for all three groups of respondents (economic analysts, enterprises and financial institutions).

In terms of the quantitative question on the expected rate of inflation for 2015 and 2016, little changes compared to the expectations in the previous survey round are registered. Namely, in the period between the two surveys, the respondents' expectations for inflation in 2015 decreased by 0.2 percentage points, on average, while for 2016 they remained unchanged. According to respondents, **the factors that explain inflation expectations in September** are the geopolitical instability and the expectations of lower world prices of energy and food products.

1.6. Balance of Payments³⁶

In the second quarter of 2015, the deficit on the current and capital accounts of the balance of payments increased on a quarterly basis, amid a reduced surplus in the foreign trade of services and a higher trade deficit, which made a small contribution to the change. On the other hand, net inflows of private transfers registered quarterly increase, which indicates the relatively limited effects of the increased uncertainty in this period on the currency exchange market. On annual basis, the current and capital account deficit was lower due to better performances in the trade of services. The balance of secondary income deteriorated on an annual basis, almost entirely due to the decline in transfers in the "government" sector. Also, a higher deficit was

³⁴ Refers to the period September 2014 to August 2015. The percentage of responsiveness to the Survey conducted in September was 35.3%, which compared to the previous quarter, represents an increase of responsiveness. Analyzed by groups of respondents, the financial institutions' responsiveness is 61.6%, followed by economic analysts with 40.6% and companies with 27.2%.

³⁵ 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.

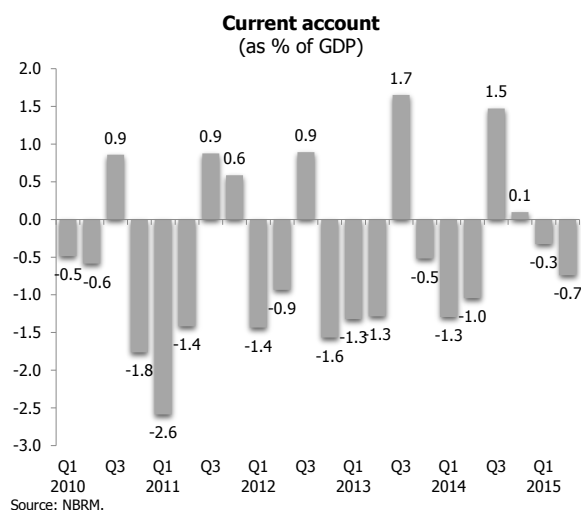
³⁶ Starting from the Quarterly Report, October 2014, the analysis of the movements in the balance of payments is based on data compiled under the Manual on the Balance of Payments and International Investment Position, sixth edition (IMF, 2009) (IMF, 1993). For more detailed information on the methodological changes, visit the NBRM website (http://nbrm.mk/WBStorage/Files/Statistika_Informacija_za_pomenite_vo_platniot_bilans_megunarodnata_investiciska_pozicija_i_nadvoresniot_dolg_koisto_proizleguvaat_od_primenata_na_novite_megunarodni_statisticki_standardi.pdf).



observed in primary income. In the second quarter of 2015, the financial account was characterized by small net inflows, insufficient to finance the current account deficit. Structurally speaking, net inflows from foreign direct investments and trade credits and advances supported the current transactions, while high net outflows were registered in currencies and deposits. Such movements of the individual components of the balance of payments in the second quarter of the year led to a further decline in the foreign reserves.

	2014				2015				2014				2015			
	Q1	Q2	July	I-VII	Q1	Q2	July	I-VII	Q1	Q2	July	I-VII	Q1	Q2	July	I-VII
	во милиони евра								% од БДП							
I. Current account	-111	-89	14	-186	-31	-67	32	-66	-1.3	-1.0	0.2	-2.2	-0.3	-0.7	0.4	-0.7
Goods and services	-367	-441	-135	-942	-304	-374	-118	-796	-4.3	-5.2	-1.6	-11.0	-3.4	-4.2	-1.3	-8.8
Credit	871	999	359	2,230	1,009	1,106	379	2,494	10.2	11.7	4.2	26.1	11.2	12.3	4.2	27.7
Debit	1,238	1,440	494	3,172	1,313	1,480	497	3,290	14.5	16.9	5.8	37.2	14.6	16.4	5.5	36.5
Goods	-471	-448	-180	-1,100	-419	-440	-172	-1,031	-5.5	-5.2	-2.1	-12.9	-4.7	-4.9	-1.9	-11.5
Services	105	7	45	157	116	66	54	235	1.2	0.1	0.5	1.8	1.3	0.7	0.6	2.6
Primary income	-40	-40	-12	-92	-53	-57	-18	-128	-0.5	-0.5	-0.1	-1.1	-0.6	-0.6	-0.2	-1.4
Secondary income	295	391	162	848	326	364	168	858	3.5	4.6	1.9	9.9	3.6	4.0	1.9	9.5
II. Capital account	1	0	-1	0	2	1	0	2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending (+) / net borrowing (-) (balance from current and capital account)	-110	-89	13	-186	-29	-66	32	-64	-1.3	-1.0	0.2	-2.2	-0.3	-0.7	0.4	-0.7
III. Financial account	-43	-7	-490	-540	161	-5	71	228	-0.5	-0.1	-5.7	-6.3	1.8	-0.1	0.8	2.5
Direct investment	-90	-15	-3	-108	-65	-45	-16	-126	-1.1	-0.2	0.0	-1.3	-0.7	-0.5	-0.2	-1.4
Portfolio investment	0	8	-492	-484	-12	9	-3	-6	0.0	0.1	-5.8	-5.7	-0.1	0.1	0.0	-0.1
Currency and deposits	44	55	23	122	65	71	45	182	0.5	0.6	0.3	1.4	0.7	0.8	0.5	2.0
Loans	-13	-58	13	-58	139	3	0	142	-0.2	-0.7	0.2	-0.7	1.5	0.0	0.0	1.6
Trade credit and advances	16	3	-31	-11	33	-43	45	36	0.2	0.0	-0.4	-0.1	0.4	-0.5	0.5	0.4
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
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
IV. Net errors and omissions	9	12	0	21	24	-1	-9	14	0.1	0.1	0.0	0.2	0.3	0.0	-0.1	0.2
V. Reserve assets	-59	-70	503	374	-167	-62	-48	-277	-0.7	-0.8	5.9	4.4	-1.8	-0.7	-0.5	-3.1

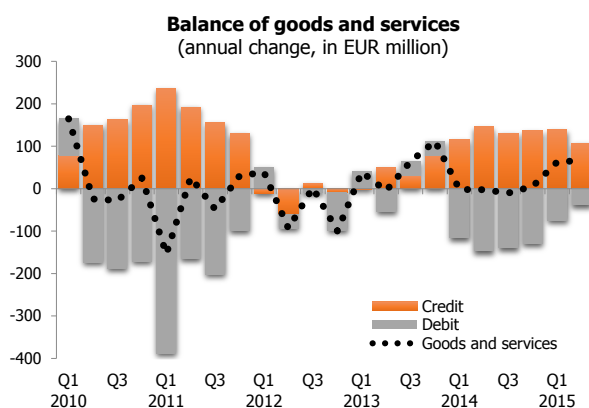
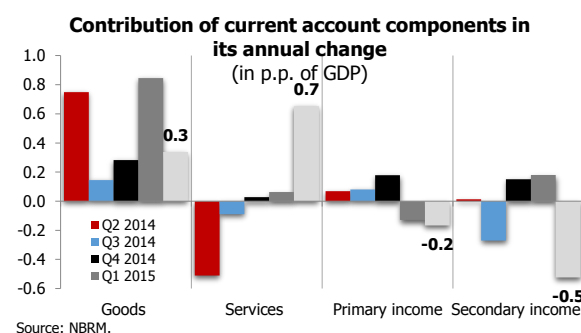
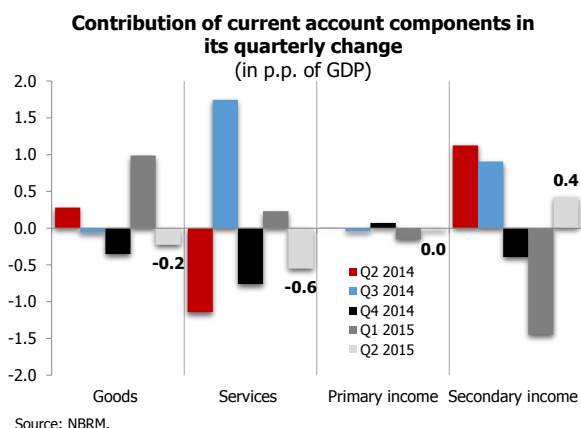
1.6.1. Current Account



In the second quarter of 2015, the current account deficit totaled Euro 66.9 million or 0.7% of GDP³⁷, which is a widening of 0.4 percentage points compared to the previous quarter. The quarterly change in the current balance is entirely due to the widening of the trade deficit in goods and services by 0.8 pp of GDP. Deteriorated balance of goods and services was mainly due to the lower surplus in the trade of services i.e. the narrowed surplus in production services of processing, coupled with a slight widening of the trade deficit. On the other hand, secondary income recorded positive movements, which are typical for this time of year. Achieving higher net inflows from private transfers compared to the previous quarter is due to the growth in foreign cash purchased on the currency exchange market³⁸, amid reduced official

³⁷ The calculations use the projected amount for the nominal GDP.

³⁸ Assessment of remittances in cash use the data on foreign cash purchased on the currency exchange market.



transfers. The deficit in primary income is virtually unchanged compared to the previous quarter.

The annual analysis of the current and capital account suggests improvement of the deficit by 0.3 percentage points of GDP as a result of the favorable trends in the balance of trade in goods and services.

The driving factor of the positive annual change is the growing surplus in the trade of services, which is largely explained by the significantly lower imports of construction services³⁹ (high comparison base) and to a lesser extent by the increased exports of transport services. Improved trade balance made an additional contribution to the narrowing of the current account deficit, given the faster growth of exports relative to imports. Contrary to these developments, the secondary income recorded lower net inflows, which almost fully reflected the drop in the transfers in the "government" sector. Namely, during the second quarter of the previous year there were higher inflows of funds from the IPA funds of the EU, which contributed to high official transfers in secondary income. At the same time, the deficit in primary income has registered a slight increase due to higher net outflows based on income from investments.

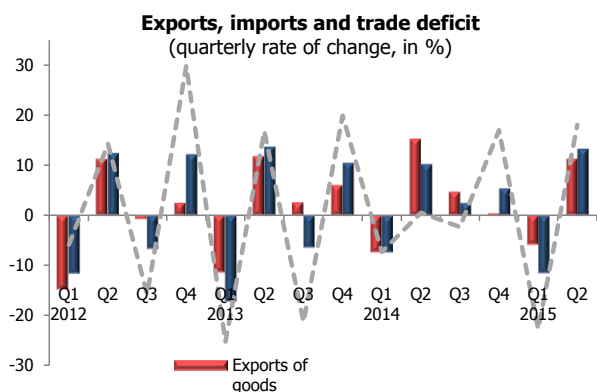
According to the latest data on the balance of payments, in July 2015 the current and capital account registered surplus of Euro 31.8 million, which is twice higher compared to the same month last year. These favorable developments in current transactions came as a result of almost all the individual components of the current account, with the exception of primary income. The largest contribution was that of the lower deficit in foreign trade in goods and services, followed by somewhat higher net inflows of secondary income.

³⁹ In April 2014, exceptionally high outflows for construction services were registered, which were acquired on the basis of advances for construction work on the highway construction projects. This transaction was simultaneously recorded in the financial account, as net-creation of liabilities on the basis of loans earmarked for financing road infrastructure, in the same amount as in the services, so that the net effect on the balance of payments in the respective period is neutral.

Box 2: Foreign trade of goods and movement of the Nominal and the Real Effective Exchange Rate (NEER and REER)⁴⁰

In the second quarter of the year, foreign trade of goods amounted to Euro 2,517 million (28.1% of GDP), registering growth of 12.5% compared to the previous quarter.

The quarterly increase was due to the growth in both the export and the import components. Relative

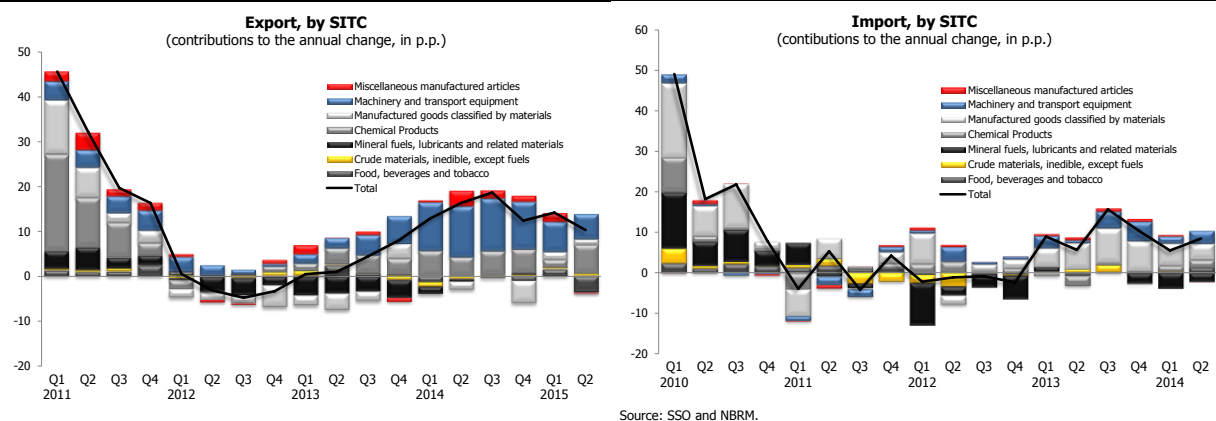


to the first quarter of the year, exports increased by 11.3%, with improved export performance of the new industrial facilities in the economy and increased exports of food, which is typical seasonal pattern for this quarter of the year. Realized quarterly import growth of 13.3% was driven by the higher investment import of equipment and machinery, and imports of raw materials for the two significant traditional industries, textiles and metalwork. The changes achieved in both components of foreign trade led to the expansion of the negative trade balance of 18.1% compared to the previous quarter, which was entirely due to the higher non-energy deficit.

The analysis on annual basis points to further growth of foreign trade in the second quarter (of 9.2%), driven by the growth in both components. **The export activity continued to grow in the second quarter of the year, recording an annual growth rate of 10.3%.** New export capacities remain the main engine of growth where more significant increase in exports compared to the same period last year was noted, with higher exports of chemical products and machinery and equipment. Export growth was also a result of the higher exports of the metal processing industry and export of ore, though with considerably less intensity. Reduced global demand for metals, particularly driven by deteriorating expectations for the Chinese economy, led to a significant decline in the prices of nickel⁴¹ and copper, causing downward pressure on export prices and the Macedonian metal processing and mining sectors. Unfavorable conditions for trade were offset by higher volumes exported, providing a moderate annual growth in the exports of these sectors. On the other hand, the export activity of the other traditional export branches, tobacco and textiles, decreased in comparison to the second quarter last year. Export performances were reflected on the **import side, where growth of 8.4% annually was registered.** Raw materials component of new foreign companies in the economy is a pivotal factor in the growth of imports, creating higher import pressures in equipment and machinery and nonferrous metals. Increase in investment imports in machinery and equipment was registered also in the other economic entities. In the second quarter of the year there was an annual increase also in the import of food, as well as further growth of imports of raw materials for the metal industry, in accordance with the performances on the export side. Higher imports of food are driven by the growth of imported quantities, in conditions when world food prices have reached their lowest level in the past five years. The downward trend in global stock prices had a significant effect on the imports of energy. The prolonged decline in the price of crude oil is reflected by further reduction of energy imports on an annual basis. The price effect is particularly evident in oil derivatives, where reduced import pressures reflect lower prices and simultaneous smaller quantity of imports. **Changes in both components of trade compared to the second quarter of the previous year caused a moderate widening of the deficit in the trade of goods of 4.2%,** entirely driven by the non-energy balance in circumstances of narrowing energy deficit on an annual basis.

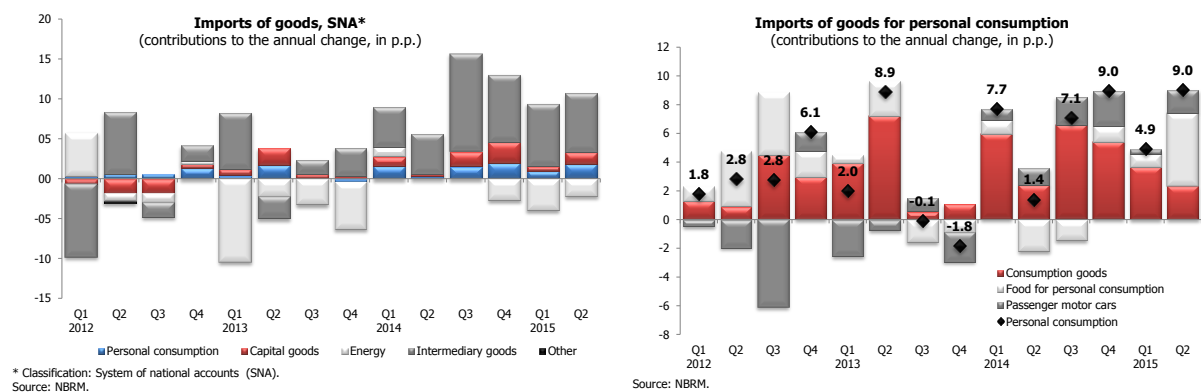
⁴⁰ According to the Foreign Trade Methodology, data on the export of goods are published on a f.o.b. basis, and on the import of goods, on a c.i.f. basis.

⁴¹ In the second quarter of the year, stock market prices of nickel reached the lowest value in the past six years.



The analysis of the import of goods under the System of National Accounts (SNA) indicates that in the second quarter of 2015, the intermediate products remain a category with dominant contribution to the annual growth of imports. Further growth was recorded also in the import of goods for personal consumption and import of capital goods, while the reduction in the energy imports acted in the opposite direction. The analysis of individual components of imports for personal consumption indicates the dominant contribution of the import of food for personal consumption to the growth of this component, coupled with more moderate import pressures from consumer goods and passenger vehicles. Overall, the annual growth in imports for personal consumption remains moderate, despite the acceleration compared to the previous quarter, indicating absence of significant pressures on imports through this channel.

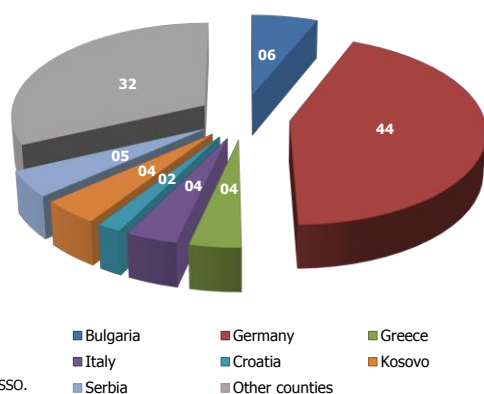
The latest available data on foreign trade for July and August indicate a certain slowdown in both components annually. Exports of goods grew by 1.4%, predominantly driven by the favorable export performances of the new capacities in the economy, amid an annual decline in the exports of traditional sectors. Slowdown in the annual growth is evident also on the import side (to 0.7%), amid more intense import of raw materials for the new companies and a further decline in energy imports.



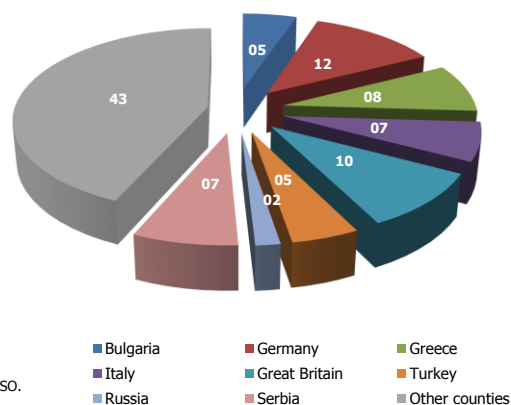
The analysis of foreign trade by individual trading partners indicates that the European Union remains our most important trading partner also in the second quarter of 2015, recording a share of 68.6% in the total foreign trade. Observing the export component, exports to Germany, as a market to which most of the export activity of new industrial capacity in the domestic economy is targeted, remain the dominant driver of the annual growth. Favorable export performances of these companies led to higher exports also to Spain and Romania, while a decline was registered in the exports to two traditionally important trading partners from the EU, Italy and Greece. The reduced sale of the metal processing sector to European markets, particularly evident in the case of Italy, was compensated by an increase in the exports to Asian economies, China and Taiwan. The annual import

growth is due to the increase of imported raw materials for the new facilities, reflected mostly by the higher imports from the South African Republic⁴² and Germany. In addition, more moderate increase in the imports of goods for the needs of foreign companies in the domestic economy was registered from the Netherlands, Russia and Romania, as opposed to the smaller import of non-ferrous metals from the UK. In terms of balances, the largest contribution to the widening of the trade deficit on an annual basis is that of the increased trade deficit with the South African Republic and Russia, while in the trade with the European Union and China a decline in the negative trade balance was registered. The further increase in the surplus with Germany and the reduced deficit with the UK contributed to the improved position in the foreign trade with the EU.

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

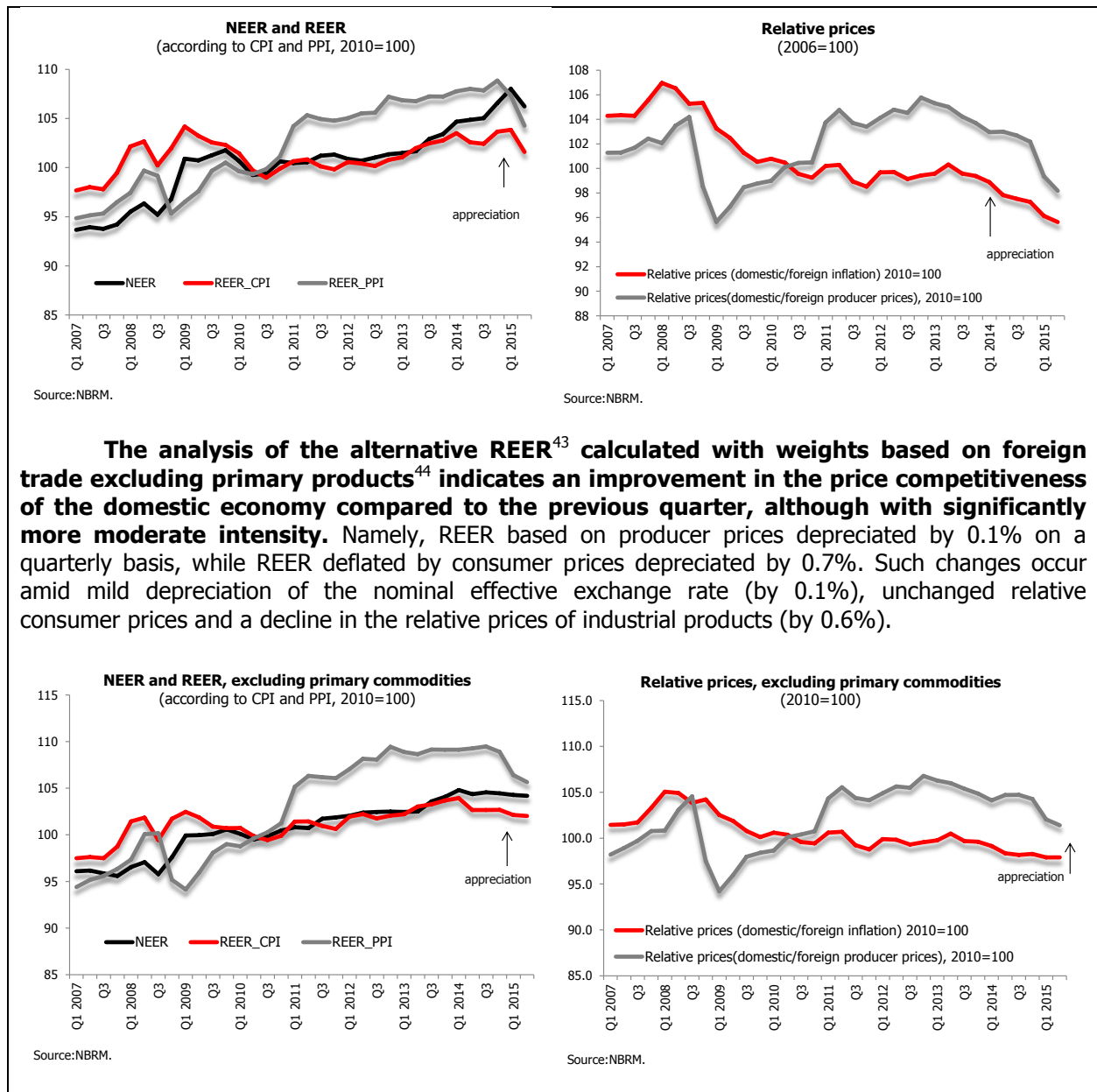


Import of goods, by countries in the second quarter of 2015 (share, in %)



The export performances of the domestic sector in the past period have been supported by the improvement observed in the indicators for measuring the competitiveness of the domestic economy by the consumer prices and by the producer prices. Namely, after a longer period of appreciation in these indicators, favorable movements in relative prices in the past year contributed to generally downward trends in the overall indices by creating conditions for depreciation. Consequently, **the movement of the indicators of price competitiveness in the second quarter recorded an improvement in the competitiveness of the domestic economy compared to the previous quarter.** The REER deflated by consumer prices depreciated by 2.2%, while the REER deflated by producer prices depreciated by 2.8% on a quarterly basis. These positive results, beside the favorable developments in the nominal effective exchange rate, which dropped by 1.7%, mainly due to the appreciation of the Russian ruble relative to the denar, reflect the favorable price ratio between domestic and foreign prices. Namely, the relative consumer prices registered a decline of 0.5% on a quarterly basis, while the relative costs of industrial products depreciated by 1.2%.

⁴² Higher imports from the South African Republic were entirely due to imported platinum. Namely, this economy is the largest world producer, with nearly 80% of the world production of this precious metal in 2014.



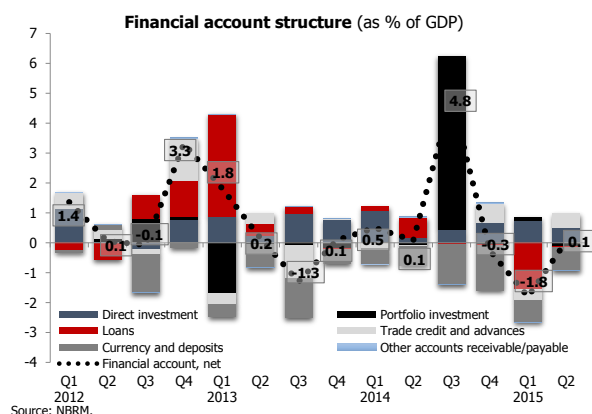
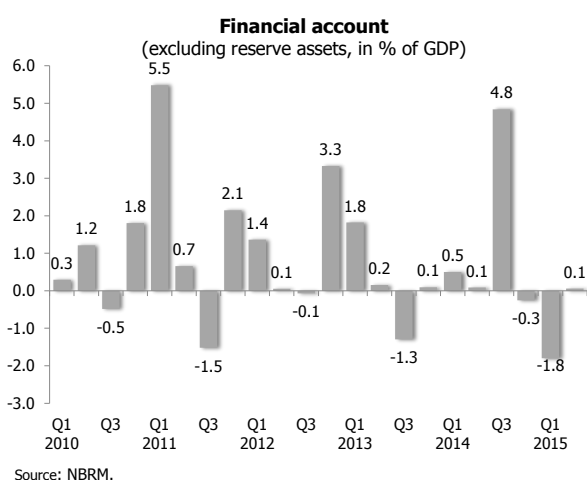
⁴³ Pronounced depreciation of the Russian ruble in 2014, which was caused by factors that are not only economic, points out some problems in analyzing the indicators of price competitiveness of the domestic economy by including volatile currencies such as the ruble. Therefore, it is more appropriate to analyze the price competitiveness indicators through the real effective exchange rate indices calculated by using weights based on the foreign trade without primary products. In this way some volatilities related to changes in currencies sensitive to trends in world stock prices are eliminated and appropriate focus is put on structural factors that encourage competitiveness of the economy.

⁴⁴ Primary products that are not included in the calculation are: oil and oil derivatives, iron and steel, ores and imported raw materials for the new industrial facilities in the free economic zones. For more detailed information on the methodology for calculating the real effective exchange rate visit: http://nbrm.mk/WBStorage/Files/Statistika_REDK_Informacija_za_promenite_na_metodologijata_za_presmetuvanje_na_realni_ot_efektiven_devizen_kurs_na_denarot_mak.pdf3

The latest data for July and August indicate mild quarterly appreciation of the REER indices. The index deflated by consumer prices appreciated by 0.9% and the index calculated by the prices of producers of industrial products registered an appreciation of 1.2%, driven by the appreciation of the nominal effective exchange rate. On the other hand, the REER calculated by using weights based on foreign trade without primary products registered diverging trends, due to the different directions of change in relative prices amid mild appreciation of the nominal exchange rate (by 0.3%). Namely, the index calculated on the basis of the consumer prices remained unchanged as a result of the favorable changes in relative prices, while the index deflated by producer prices recorded a slight appreciation, amid further decline of foreign over domestic prices.

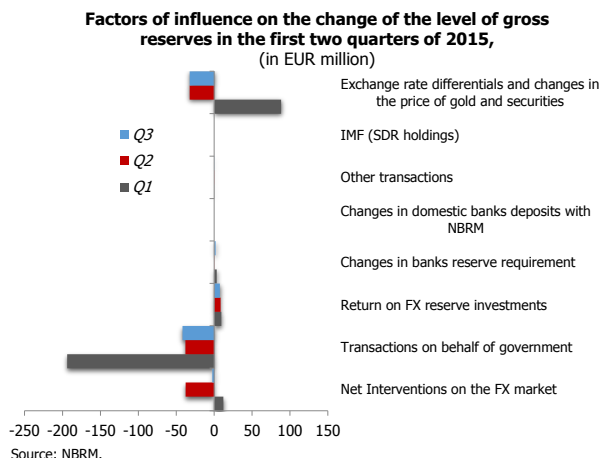
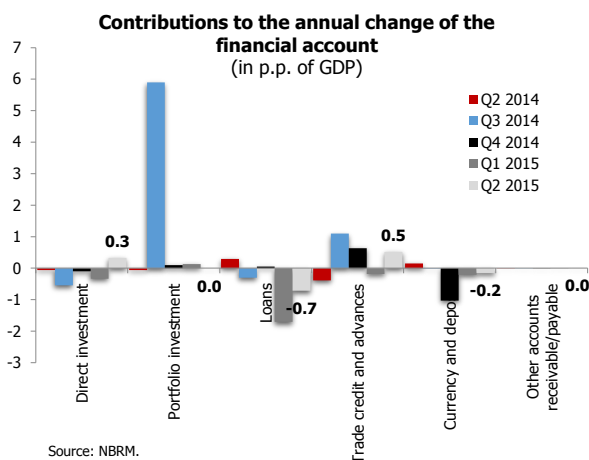
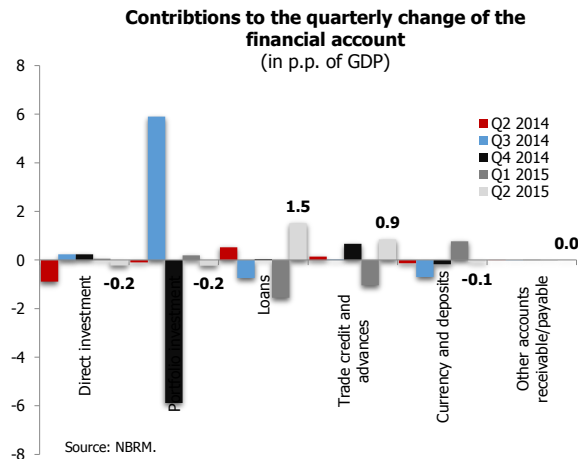
1.6.2. Financial account

In the second quarter of 2015, the financial account registered marginal inflows of Euro 5.1 million or 0.1% of GDP on a net basis⁴⁵. In the analyzed period, foreign direct investments and trade credits were the main sources of financial net inflows. These flows were largely offset by the net outflows in all other components, mainly currency and deposits. After a long time, the structure of foreign direct investments registered predominantly non-debt flows i.e. net inflows of equity capital and reinvested earnings, with significantly smaller share of the debt component. At the same time, trade credits and advances positively affected the financial account. The trend of negative flows in the category currency and deposits continued also in the second quarter of the year. High net outflows generated in other sectors were partially mitigated by the withdrawal of deposits from foreign banks in the domestic economy with depository institutions. *The quarterly analysis points to realized positive financial flows, as opposed to the extremely high net outflows recorded in the previous quarter.* This improvement stems from the significantly lower net repayments on the basis of government loans (in the previous quarter the early repayment of the remaining part of the PCL to the IMF was made) and the simultaneous net inflows on the basis of trade credits and advances as opposed to the net outflows in this category in the first quarter of 2015.



In terms of the annual changes, realized financial net inflows were almost unchanged compared to the same period last year. The movements in trade credits and advances, and foreign direct investments are more favorable,

⁴⁵ According to the new methodology for compilation of the balance of payments (BPM6), the terms net inflows and net outflows denote net incurrence of liabilities and net acquisition of financial assets, respectively.



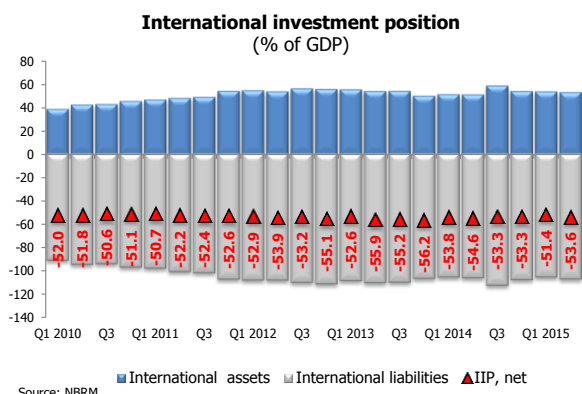
while loans and currency and deposits deteriorated. Thus, trade credits and advances registered net inflows, as opposed to the minimal net repayments made in the second quarter of 2014, while direct investments realized higher inflows due to the positive reinvested earnings, and higher inflows of equity capital. On the other hand, in this quarter the financial loans registered small repayments on a net basis, as opposed to the net borrowing in the second quarter last year. This movement is largely a result of the extremely high withdrawals in public companies in April 2014, which generate high comparison base. Further growth in net outflows realized in currency and deposits of other sectors also contributed to the less favorable position in the financial account on an annual basis.

In July 2015, the financial account of the balance of payments registered a net outflow of Euro 71.2 million on a net basis. Net outflows reflect the net repayments in trade credits and net outflows in the category currency and deposits, amid further favorable trends in foreign direct investments.

At the end of the second quarter of 2015, the gross foreign reserves were valued at Euro 2,254.8 million, which is a quarterly decline of Euro 100 million. The reduced level of foreign reserves is due to the net sales of foreign exchange by the NBRM, net outflows of funds on the basis of transactions on behalf of the government, in the absence of major inflows of foreign borrowing. During this period a decline in the market value of reserves was registered as a result of calculated negative price and currency differences, given the reduced price of gold and the depreciation of exchange rates on international financial markets. *According to the latest available data, at the end of September, the foreign reserves amounted to Euro 2,187.4 million, which is an additional decline of Euro 67.5 million relative to the end of the second quarter of 2015.* The reduction in foreign reserves was mostly due to transactions on behalf of the government, i.e. the regular servicing of the government liabilities - repayment of interest on the basis of the third Eurobond and reduced market value of the reserves as a result of calculated negative price and currency differences, amid lower gold price and depreciation of exchange rates on international financial markets. Regarding the NBRM interventions, it should be emphasized that after the sale of foreign currency in the first half of July, the foreign exchange market was stable, and

starting from the end of July and during August the NBRM intervened by purchasing foreign currencies. The analysis of foreign reserves adequacy indicators shows that they move within a safe zone.

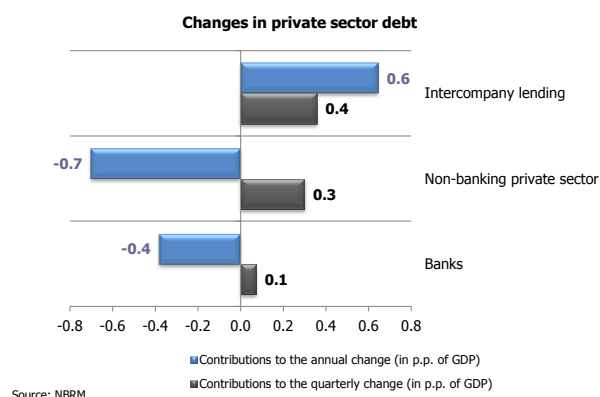
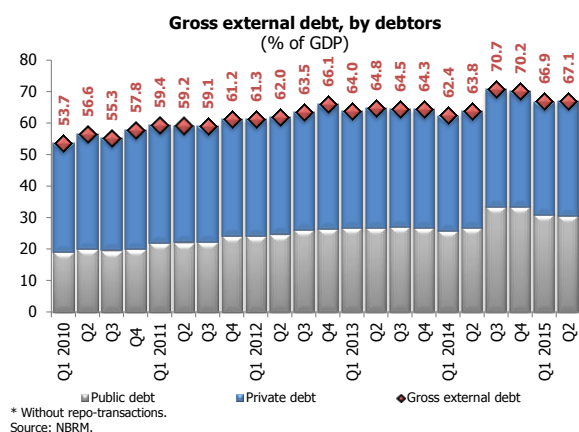
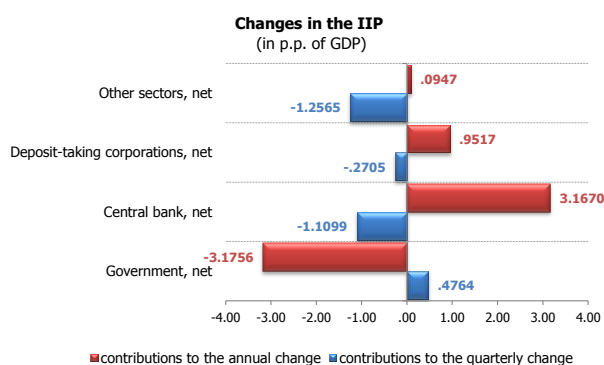
1.6.3. International investment position⁴⁶ and gross external debt



At the end of the second quarter of 2015, the **negative international investment position⁴⁷ of the Republic of Macedonia amounted to Euro 4,799.8 million or 53.6% of GDP**, which is a quarterly deterioration of 2.2 pp of GDP. The analysis of the nominal amounts reflects a deterioration of the international financial position of the country, amid reduction of international assets and faster growth of international liabilities. *The sector-by-sector analysis points to the fact that the quarterly increase was mostly due to the higher net liabilities in "other sectors of the economy" and the deteriorated position of the net assets of the central bank as a result of lower foreign reserves.* Additionally, growth was recorded also in the net liabilities of depository institutions. On the other hand, quarterly decrease was registered in the net government liabilities, as a result of reduced liabilities based on debt portfolio investment, and as a result of lower liabilities based on long-term loans.

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

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



On an annual basis, however, a decrease was registered in the net liabilities to the rest of the world by 1 percentage point of GDP, due to the intensive growth of international assets, and the slight reduction in international liabilities⁴⁸. The analysis by individual sectors indicates improvement mainly in the central bank and the depository institutions. Positive developments in the central bank arise from the annual increase in net assets due to higher foreign reserves, mainly due to the inflows from the third Eurobond issued in July 2014. Also, a positive annual change was registered in the position of depository institutions, where the lower net liabilities mainly resulted from the growth of net-assets in the form of currency and deposits. In contrast, changes in the "government" sector acted towards deterioration, which is caused by the growth of liabilities based on debt portfolio investments.

As of the end of the second quarter of 2015, the gross external debt stood at Euro 6,342.2 million, or 70.8% of GDP, which is an increase of 1.1 percentage points of GDP, on a quarterly basis. If the effect of the repo transactions of the central bank is excluded, the growth is more moderate and equals 0.3 p.p. of GDP⁴⁹. The quarterly growth of gross external debt arises from the higher private debt, as opposed to the declining public sector debt. The higher private debt is primarily a result of higher liabilities to foreign direct investors, and the higher liabilities based on trade credits and advances and short-term loans to the non-banking sector. In terms of the public debt, a decrease of long-term liabilities based on debt securities and loans to the central government was registered.

Annually, the gross external debt, excluding the repo transactions, grew by 10.5% or 3.3 percentage points of GDP. The annual growth in gross debt is due to the higher public debt (by 3.8 percentage points of GDP), with a simultaneous annual decline in the private sector debt (of 0.4 percentage points of GDP). The fast growth in public debt is due to the increased external borrowing of the central government in the form of long-term debt securities, as well as the growing debt of public companies through long-term loans for support of

⁴⁸ The analysis of negative debt position in nominal terms indicates an annual growth of 3%.

⁴⁹ The overall analysis below relates to gross external debt without the central bank liabilities based on repo transactions.

road infrastructure⁵⁰. In terms of the private sector debt, a decline was registered in the non-banking and banking sectors, which is partially mitigated by the higher liabilities to foreign direct investors.

Generally, the external indebtedness indicators of the national economy still show that the gross external debt is in the safe zone. The only indicator that classifies the economy in the group of highly indebted countries is the share of the gross external debt in GDP. The analysis of the dynamics of external debt⁵¹ indicates unfavorable annual movements in almost all solvency indicators in the second quarter. On the other hand, liquidity indicators suggest a favorable external position, with significant annual improvement in all indicators and full coverage of liabilities based on short-term debt with residual maturity with the foreign reserves.

At the end of the second quarter of the year, net external debt, as an additional indicator of the external position of the economy, amounted to Euro 2,071.1 million or 23.1% of GDP, which is an annual growth of 2.1 percentage points of GDP. Slower growth of the net external debt relative to the growth of gross debt is due to the higher level of gross external claims (by 1.2 percentage points of GDP).

⁵⁰ In July 2014, the government issued the third Eurobond in the amount of Euro 500 million. This high inflow was partially offset by the early repayment of the debt to the IMF (Precautionary Credit Line) in February 2015.

⁵¹ The analysis of external indebtedness indicators uses balance of payments data in accordance with the Balance of Payments and International Investment Position Manual (BPM6) and data on gross external debt according to the External Debt Statistics (2013). The methodological changes caused no changes in the overall level of external debt, but only affected the maturity and sector structure of the debt. Accordingly, under the new methodology, the level of short-term debt is lower at the expense of the increase in long-term debt component, which caused changes in the liquidity indicators, i.e. their improvement relative to the analyses based on data from the previous methodological framework. On the other hand, the methodological changes in the export of goods and services and other inflows caused deterioration of the indicators for the share of export of goods and services and other inflows in the gross external debt and debt service in relation to export of goods and services and other inflows, compared with the indicators relevant prior to the methodological changes.



Indicators for external indebtedness	Solvency				Liquidity		
	Interest payments/ Export of goods and services and other inflows	Gross debt/ Export of goods and services and other inflows	Gross debt/ GDP	Debt servicing/ Export of goods and services and other inflows	Foreign reserves/ Short-term debt	Foreign reserves/ Short-term debt, with residual maturity	Short-term debt/ Overall debt
	in %				ratio	ratio	in %
31.12.2004	2.41	129.3	47.3	12.4	1.14	0.89	30.3
31.12.2005	2.66	147.0	54.2	11.06	1.67	1.04	26.7
31.12.2006	3.44	131.3	49.8	21.7	1.95	1.34	29.0
31.12.2007	2.78	119.3	51.3	19.4	1.35	1.08	39.8
31.12.2008	2.66	116.9	54.1	10.2	1.29	0.95	35.2
31.12.2009	2.43	131.0	57.8	11.8	1.29	0.94	32.9
31.12.2010	3.22	140.4	59.7	13.9	1.49	0.99	27.9
31.12.2011	3.12	148.4	64.6	16.8	1.78	1.18	25.2
31.12.2012	2.92	141.9	67.6	13.1	1.64	1.03	26.7
31.12.2013	2.51	137.3	67.4	15.8	1.64	1.08	23.3
31.03.2014	3.02	132.8	65.9	17.3	1.41	0.95	25.9
30.06.2014	3.02	135.7	67.4	17.3	1.33	0.90	25.8
30.09.2014	3.02	150.5	74.7	17.3	1.74	1.16	23.2
31.12.2014	3.02	149.4	74.2	17.3	1.82	1.13	22.3
31.03.2015	2.81	138.5	70.2	20.5	1.77	1.13	22.2
30.06.2015	2.81	139.0	70.5	20.5	1.66	1.07	22.7
Moderate indebtedness criterion	12 - 20%	165 - 275%	30 - 50%	18 - 30%		1.00	

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

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

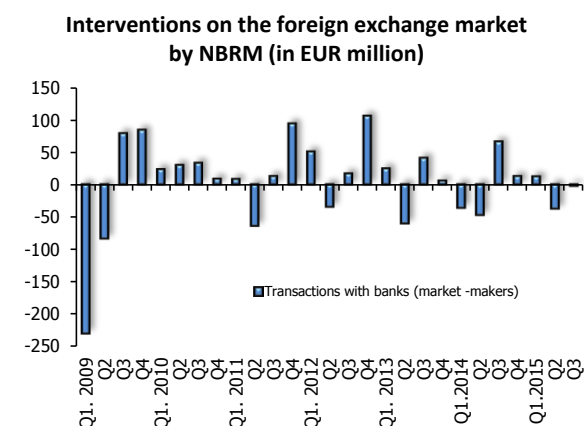
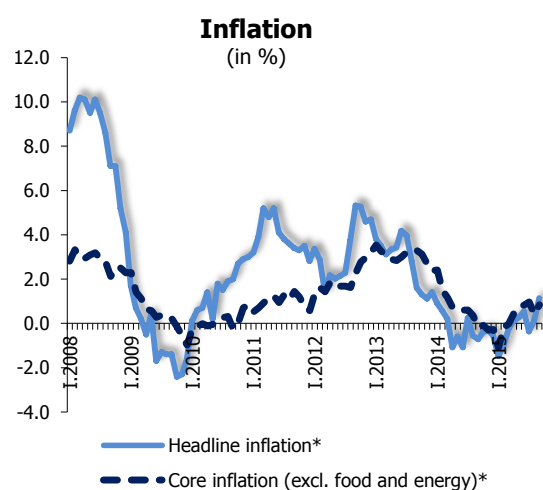
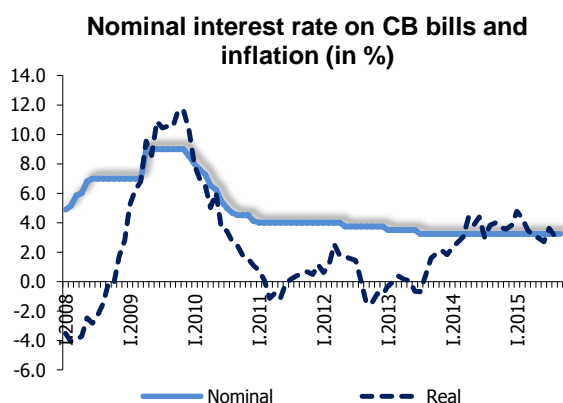
*According to the "Greenspan-Guidotti rule", a country should maintain full coverage of short-term debt at remaining maturity with gross foreign reserves.

Source: NBRM.

II. Monetary policy

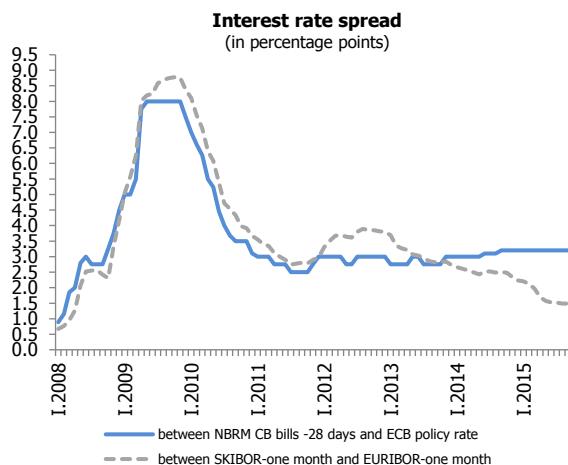
During the third quarter of 2015, the NBRM kept its policy rate unchanged at 3.25%. Besides the interest rate, the amount of CB bills that NBRM offers at the auctions was unchanged. This decision was based on the latest macroeconomic projections of April and the recent performances of the key macroeconomic and financial indicators. Analyses have shown that the economy continues to recover at a solid pace, without price pressures and amid further maintenance of an adequate level of foreign reserves. Such trends indicated existence of appropriate environment for sustained recovery of private sector, and it was again assessed that the domestic economy is sufficiently supported through the monetary policy measures. The risks for the domestic economy, associated with domestic political developments and economic and political developments in Greece during this period decreased, and their effects were assessed as limited and mainly realized through the expectations channel. Aimed at preserving the trend of deeuroisation and further support of the savings in domestic currency and in the long term, the NBRM in August made changes in the reserve requirement instrument setup, as well as in the mechanism of participation of banks in the auctions of CB bills, which are expected to support savings through greater supply of savings products in denars with stimulative interest rates. The NBRM will continue to monitor closely the situation in order to make timely and adequate accomodation of monetary policy.

Based on the regular assessment of the recent macroeconomic and financial developments, at the meetings held during



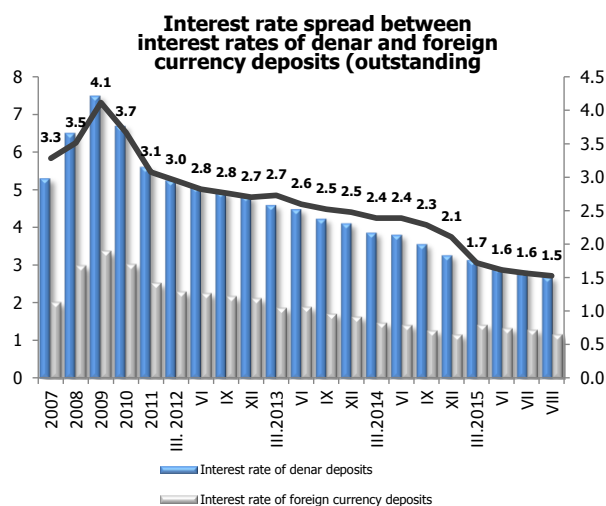
the third quarter⁵² of 2015, the NBRM Operational Monetary Policy Committee decided to keep CB bill interest rate at 3,25%. It was also decided to keep the amount of CB bills that NBRM offered at the auctions at the same level. The latest performances in key macroeconomic indicators pointed to no significant changes in the environment for conducting monetary policy compared to the previous estimates. In the third quarter the foreign reserves declined, due to regular settlement of external obligations of the state and negative currency and price changes. Foreign exchange market in the third quarter was basically balanced, with a small amount of interventions on a net basis. Seen dynamically, in the first half of July, the NBRM intervened with net sale of foreign currency on the foreign exchange market, followed by stabilization of the movements. Already by the end of July, with the beginning of the season of high foreign exchange inflows, the NBRM started to intervene by purchasing foreign currency, which continued during August. In September no transactions with market makers in the foreign exchange market were realized. The indicators of reserve adequacy, remained at an appropriate level, enough to cope with eventual shocks. In the third quarter, the annual rate of inflation decreased by 0.2% on average, as a result of lower energy prices, amid growth in food prices and core inflation. Core inflation annually averaged 0,7%. Inflation performances in this period registered a slight downward deviation compared to the April projection. The real sector performances remain solid. Available high frequency data during the quarter showed that growth in economic activity continued in the second quarter, which is confirmed by official data on GDP. Hence, the rise in GDP in the second quarter was within the projected, and recent short-term data pointed to a continuation of these trends during the third quarter. In terms of the credit market, in the third quarter of 2015 total loans recorded a slowdown, due to reduced lending to enterprises, while household loans continued to grow at a moderately slower pace. The changes in total loans may partly be due to seasonal factors, and may in part be a reflection of the uncertain domestic and global environment. The annual rate of growth of total loans in September was below the projection for the third quarter, indicating a

⁵² During the quarter, the NBRM's Operational Monetary Policy Committee held three sessions on 14 July 2015, 11 August 2015, and 15 September 2015, when it reassessed the monetary policy setup.



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

possible deviation from the projected dynamics. In terms of risks, achieving domestic political agreement and the conclusion of the third program of financial aid to Greece by international lenders have contributed to the stabilization of expectations and reduced the risks of non-economic factors for the domestic economy, following their peak in the second quarter. The effects of these developments remained limited during the third quarter, mainly realized through the expectations channel. However, although reduced, the uncertainty remains in the environment, not excluding the possibility of delayed effects in the next period. This statement is additionally supported by the latest information from the international environment, which indicates a moderate increase in the risks compared with April projections. This primarily relates to developments in the eurozone, where the latest ECB projections indicate weaker expectations about the GDP growth in the euro area in the forthcoming period in comparison to the June projections, primarily due to the slowdown in the emerging economies and economic and political developments in Greece. This situation imposes the need for continuous monitoring of performance and regular reassessment of the risks. **Leaving the zone of accommodative monetary policy in the next period will depend on the materialization of identified risks and the effects on the external position of the economy and on foreign reserves.**

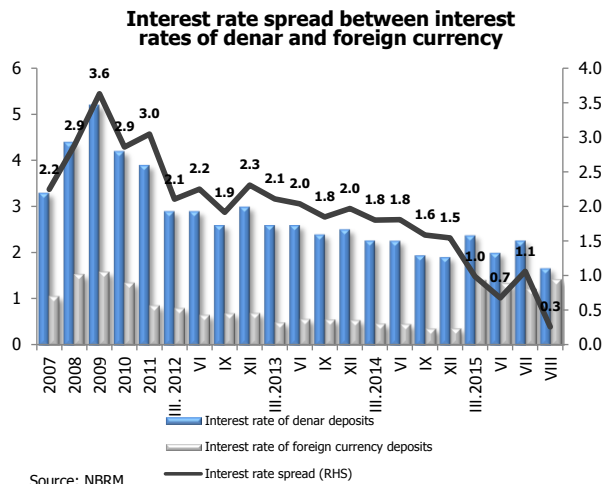


Source: NBRM

In the third quarter of 2015, the ECB kept its policy rate unchanged, after its last cut in September 2014 to a level of 0.05% and continued to further implement the program for purchase of securities. At the last meeting of the ECB⁵³ about the monetary policy, held in early September, the allowed amount that the ECB buys under the program for purchase of securities was increased from 25% to 33% of emissions of certain securities, which contributes to increasing the flexibility of the program. Thus, it maintained the accommodative nature of the monetary policy in the euro zone, whereby the ECB expressed readiness to take additional measures to ease monetary policy if the need arises for such a move in the next period. In such conditions, the interest rate spread between the interest rate on CB bills of NBRM and the key interest rate of the ECB in September remained at

53

<https://www.ecb.europa.eu/press/pressconf/2015/html/is150903.en.html>



3,2 percentage points, which is distinctive since September 2014. During the third quarter, the movements in short-term market interests on the European and the domestic financial market were relatively stable, with the interest rate spread between one-month SKIBOR⁵⁴ and one-month EURIBOR remaining at the same level as in the previous quarter and was 1,5 percentage points. Within the banking sector, in the newly received deposits, the interest rate on Denar deposits in August decreased compared to the end of the previous quarter, while interest rate on foreign currency deposits realized minimal growth. These developments contributed to narrowing of the interest rate spread between the Denar and foreign currency interest rate from 0,7 percentage points in June to 0,3 percentage points in August. However, it should be borne in mind that the interest rates on newly received deposits have characteristic volatile movements⁵⁵, which can result in frequent and temporary adjustments to the interest rate spread. The interest rate spread between interest rates on total denar and total foreign currency deposits was stable in August and amounted to 1,5 percentage points.

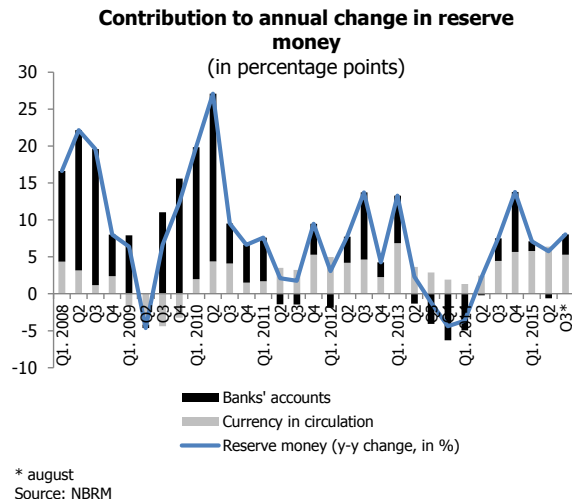
In order to encourage long-term savings of the households in domestic currency and create space to boost credit activity of banks, in August, the National Bank Council adopted a Decision amending the Decision on the reserve requirement. The amendments lower the reserve requirement ratio for banks' liabilities to natural persons in domestic currency with contractual maturity of over one year, from 8% to 0%, making these liabilities receive the same treatment as liabilities over two years, for which rate of 0% since 2012 is already applied. Given that with the amendment banks are exempt from the reserve requirement for deposits of natural persons in denars with maturities greater than one year, the measure is expected to contribute adequately to higher offer of savings products in denars with stimulative interest rates.

⁵⁴ Interbank interest rate on Denar deposits, calculated using quotations of reference banks.

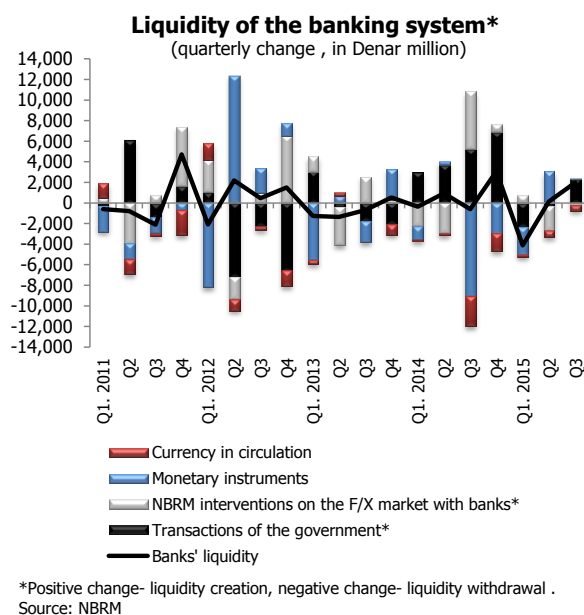
⁵⁵ Volatility of interest rate on newly accepted deposits results from the fact that they are driven by the volume of newly accepted deposits (which can vary from month to month) and their interest rate.

2.1. Banks' liquidity and interbank money market developments

During the third quarter of 2015, bank liquidity⁵⁶ increased by Denar 1.985 million, compared to the end of the second quarter. Thus, in September the balances of banks' accounts with the NBRM⁵⁷ stood at Denar 17.894 million. In August, reserve money⁵⁸ increased by 8% on an annual basis, compared to June 2015, when it increased by 5,8%.



During the third quarter of 2015, the autonomous factors, on a net basis, have contributed to creating liquidity in the banking system in the amount of Denar 1.890 million. The created liquidity almost entirely was achieved through government transactions, due to the reduction of government deposits with the NBRM. Currency in circulation in the third quarter acted towards withdrawing liquid assets (in the amount of Denar 575 million), and a small contribution in the same direction had foreign exchange transactions of the NBRM with market makers (amounting to Denar 159 million).



In the third quarter, the monetary instruments of the NBRM, on a net – basis had almost neutral impact on liquidity, that is they contributed to the creation of liquidity in the system in the amount of Denar 95 million. In addition, during this quarter, changes were registered in almost all monetary instruments. During the third quarter three CB bills auctions of NBRM were held, using a volume tender and fixed interest rate of 3.25%. Moreover, at the auctions a moderately lower demand compared to the supply was registered, resulting in lowering of the level of the bills. Following such developments, in the third quarter CB bills acted towards creating additional liquidity in the banking system (in the amount of Denar 251 million). Also in August, the NBRM Council adopted decision amending the Decision on CB bills, which adapts the mechanism of participation in the auction of CB bills of the National Bank, where the main criterion will be the participation of individual banks in total liabilities in

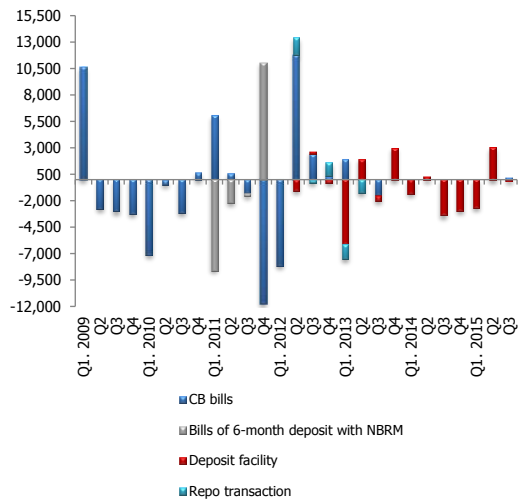
⁵⁶ Refers to the change in banks' account balances with the NBRM.

⁵⁷ Refers to Denar accounts of banks required to allocate reserve requirement.

⁵⁸ Includes reserve requirement in foreign currency.



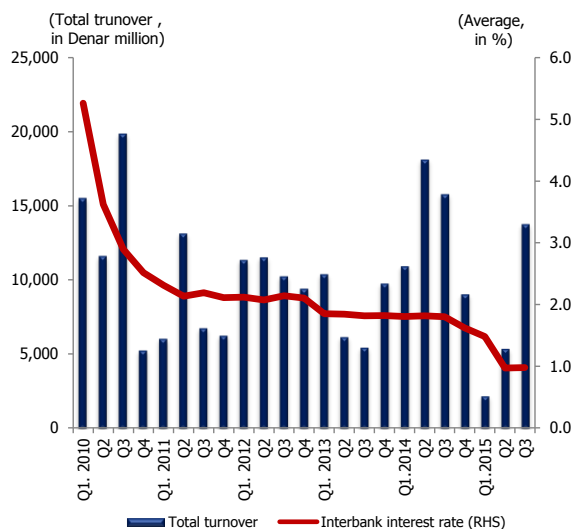
**Monetary policy instruments
(quarterly changes, in Denar million)***



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

domestic currency without FX clause⁵⁹. The changes are aimed at reinforcing the effectiveness of the measures in the system of reserve requirement aimed at further support of Denar savings in the long run. Available seven-day deposits and overnight deposits available, in the third quarter on a net basis were higher by Denar 75 million and Denar 81 million, respectively. Thus, through the deposit facility of the NBRM in the third quarter liquidity in total amount of Euro 156 million was withdrawn, on a net basis. During the quarter banks used repo auctions to provide liquidity in order to overcome short-term liquidity shortages. Matured funds were repaid in full, thus on a cumulative basis this instrument, had a neutral liquidity effect. In the third quarter of 2015, banks allocated surplus liquidity assets of 0,5% on average over the liability of the reserve requirement (in denars), which is almost at the average level of the previous quarter.

Interbank deposit market



Source: NBRM.

In the third quarter of 2015, the interbank deposit market (unsecured segment) reported a total turnover of Denar 13.764 million, which is 2.5 times more compared to the second quarter of 2015. The growth of activity on the interbank market is explained by the increased demand for liquidity assets by banks, especially in July, in circumstances where autonomous factors on a net basis acted towards withdrawing liquidity from the system. Compared with the third quarter of the previous year, the activity on the interbank money market in the third quarter of 2015 was lower by 12,8%. Analyzed by maturity buckets, in the third quarter, intraday transactions had a dominant share in the total turnover on the interbank deposit market, contributing with 69,3% to total realized transactions, followed by transactions with a maturity of seven days with share of 28,5%. After a year break, on the interbank deposit market transactions with a maturity of one month were realized, representing 2,2% of total turnover. The interbank interest rate for concluded overnight transactions (MKDONIA) in the third quarter remained relatively stable and averaged

⁵⁹ The current mechanism is implemented based on the decision of the NBRM adopted in March, according to which the formation of the bids of the banks in the auction of CB bills, when applying tender with a limited amount and fixed interest rate is taken into account the percentage share of the reserve requirement in denars of each bank in terms of reserve requirement in denars of the total banking system. Thus, according to this mechanism, the maximum amount of supply of each bank is calculated by applying its proper percentage share in the total supply of CB bills, decreased by the amount of past due CB bills of the Macedonian Bank for Development Promotion AD Skopje.

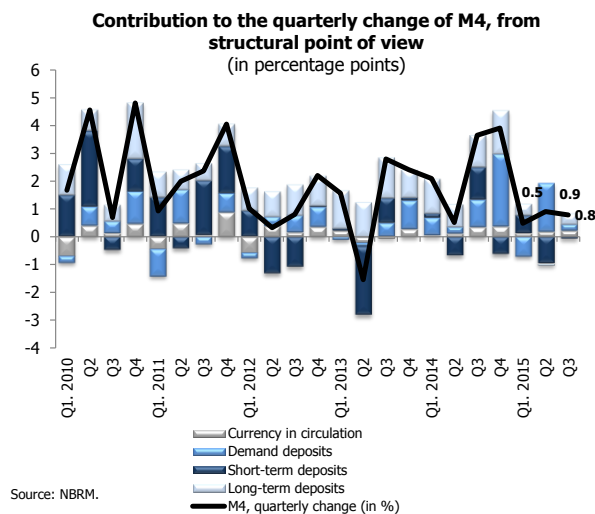
0,98% (0,97% on average in the second quarter). The interbank interest rate (MBKS) in the third quarter registered a moderate growth and averaged 1,08% (0,93% on average in the previous quarter) which is explained by increased trading with longer maturities of the interbank money market. In the third quarter of 2015, **on the secondary money market** transactions were executed for a total of Denar 2.928 million, mostly due to the concluded transactions in CB bills which accounted for 69,3% of total transactions. The CB bills traded on the secondary market had maturities of 7, 28 and 35 days and a yield of 1,3%, 1,75% and 2%, respectively. Second by trading were repo transactions (with a share of 20,5%) with a yield of 1,3% for transactions up to one week. In addition, transactions were concluded both in treasury bills and government bonds, which accounted for 4,4% and 5,8%, respectively, of the total transactions. The return was 1,25% for treasury bills with a residual maturity from 1 to 3 months, 1,4% for the treasury bills with a residual maturity from 6 to 12 months, 2,14% on average for the government bonds with residual maturity from 1 to 2 years and 5% for the government bonds with residual maturity from 5 to 10 years. The total turnover in the secondary market in the third quarter of 2015 is higher by almost 7 times on a quarterly basis.

2.2. Monetary and credit aggregates

Broad money M4 continued to grow during the third quarter of 2015 at a similar pace of growth as in the previous quarter. The money supply growth is due to the rise in almost all components from maturity and currency aspect, with the exception of short-term deposits, which registered a further decline. According to the sector analysis, household savings is the only driver in the deposit base, while corporate deposits decreased as opposed to the performances in the previous quarter. However, the monthly flows of household deposits and enterprises are still volatile (second consecutive quarter), suggesting potential effects on the savings from the shocks of domestic and external character, present in the past period. The credit market shows solid bank support to the "household" sector while corporate lending registered a quarterly decline, mainly influenced by seasonal factors. The favorable developments in the credit market in the third quarter as well as the expectations for their continuation in the last quarter of the year are supported by the answers of the banks in the last Lending Survey. Thus, banks point to positive shifts on the supply side and the demand for loans in the third quarter and keeping the stimulating effect on the credit activity of these two factors during the last quarter.



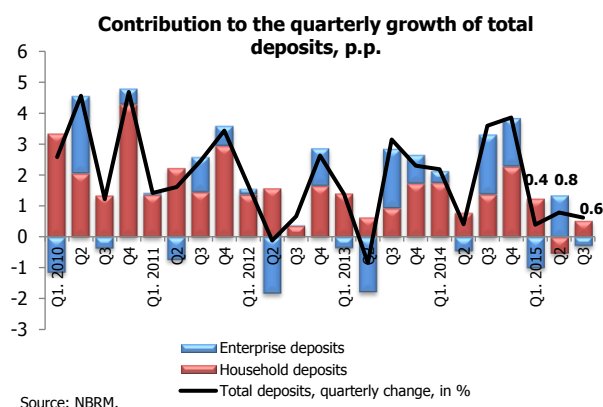
2.2.1. Monetary aggregates



During the third quarter of 2015 moderate widening of the broad money M4 was registered at a similar pace of growth as in the previous quarter (0,8% at the end of September compared to 0,9% at the end of June). However, the realized flows in the third quarter are weaker than the average quarterly increase in the money supply in 2013 and particularly in 2014, mainly resulting from lower realizations in the deposit base during this period. In conditions of solid performance of the domestic economy since the beginning of the year, the relatively weaker performance may in part be a reflection of the uncertain domestic and global environment. Structure analysis shows that the growth derives almost equally from the quarterly increase of the most liquid monetary aggregate M1 (currency in circulation and deposit money) and long-term deposits, while short-term deposits contributed to a slight decline in the money supply. These developments are accompanied by the maintenance of a relatively stable currency structure of the broadest monetary aggregate, with the share of foreign currency deposits in money supply as of September amounting to 37,7% (from 37,9% at the end of June). **On an annual basis**, the growth in monetary aggregate M4 in September slowed to 6,2% from 9,2% at the end of June.

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

Source: NBRM.



The total deposits of the banking sector at the end of September increased by 0,6% on a quarterly basis, compared to 0,8% at the end of June. Sectoral analysis indicates increase in total household deposits, amid realized decline in corporate deposits, as opposed to the performances of the previous quarter, when corporate deposits explained the overall quarterly growth. On a quarterly basis, total household deposits in September increased by 0,7%, compared to the decrease of 0,7% realized at the end of the second quarter. Analyzed on a monthly basis, the increase in total deposits was due to the performances in July and September, while in August total savings of households registered decline. These deposit movements indicate still volatile movements in the propensity of households to deposit assets in the banking sector the second consecutive quarter, in part perhaps due to the still present uncertainty related to domestic political developments and economic and political developments in Greece. On the other hand, the budget consumption provided support to the deposit growth during this period,



Household deposits

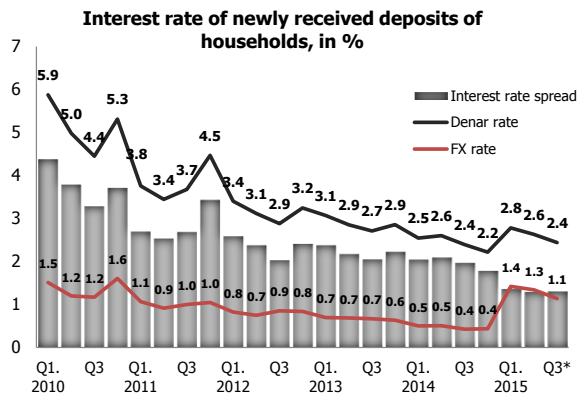
	2013				2014				2015		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
quarterly change, in %											
Total household deposits	2.0	0.9	1.3	2.4	2.4	1.1	1.9	3.2	1.8	-0.7	0.7
contribution to quarterly change of total deposits, in p.p.											
Deposit money	-0.1	0.2	-0.1	1.0	0.5	0.2	0.2	1.9	0.1	-0.2	0.3
Denar deposits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

Source: NBRM.

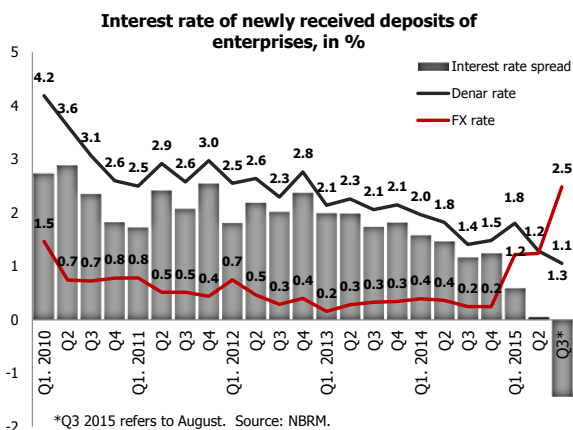
Enterprise deposits

	2013				2014				2015		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
квартални промени, во %											
Total household deposits	-1.5	-7.8	9.1	4.1	1.7	-2.0	8.8	6.8	-4.2	5.9	-1.2
contribution to quarterly change of total deposits, in p.p.											
Deposit money	-1.4	1.3	2.9	1.9	1.1	0.2	3.3	7.6	-4.3	8.1	0.6
Denar deposits	0.1	-1.3	2.6	1.6	0.2	-1.8	2.8	1.3	-1.7	-2.6	-0.4
FX deposits	-0.3	-7.8	3.5	0.7	0.4	-0.4	2.7	-2.1	1.8	0.5	-1.4
Short-term deposits	-1.5	-9.4	5.0	2.1	0.3	-2.0	4.8	-2.4	-1.1	-1.6	-1.2
Long-term deposits	1.4	0.3	1.1	0.2	0.3	-0.2	0.6	1.5	1.2	-0.6	-0.6

Source: NBRM.



*Q3 2015 refers to August.
Source: NBRM.



*Q3 2015 refers to August. Source: NBRM.

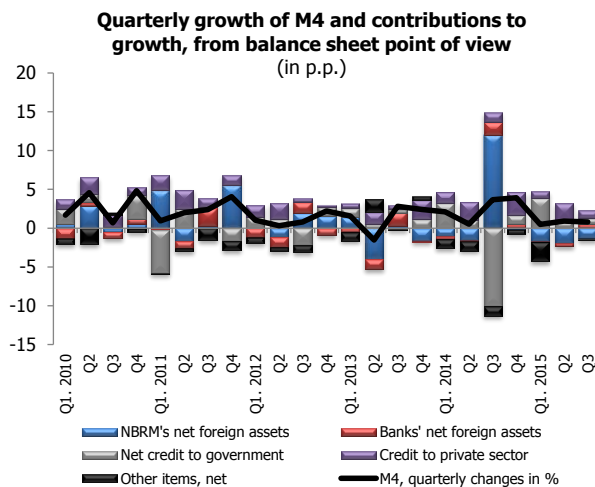
mainly through the payment of subsidies and flood damages as well as the payment of increased social and permanent financial assistance⁶⁰. Structure analysis of the realized increase indicates a positive contribution to all components of household savings by maturity and currency aspect, with higher contribution from long term deposits and foreign currency deposits. **Annually**, in September the growth of household deposits slowed to 5,0% from 6,2% in June.

The total corporate deposits in the third quarter of 2015 registered a quarterly decrease of 1,2% as opposed to the growth of 5,9% in the second quarter. According to the analysis on a monthly basis, the moderate reduction stems from the weaker performances in July and September, while in August a significant increase is registered on the deposit base. Such volatile monthly flows of corporate deposits are characteristic as of the end of 2014 and largely determined by changes in demand deposits which is probably explained by the need of the enterprises for liquid assets in order to carry out regular business activities. In this period, reduction of the credit support from banks to this sector of the economy is registered which further contributes to reduced capacity of enterprises for new savings. Structure analysis of the quarterly growth from the maturity aspect suggests further decline in short and long-term deposits. From currency aspect, the decline was primarily due to the foreign currency deposits, while the Denar deposits registered a small growth on a quarterly basis. **Annually**, in September corporate deposits increased by 7,1%, which represents a significant slowdown compared to the annual growth rate registered in June (17,8%).

According to the analysis of the yields from the new savings,⁶¹ the household sector shows a further decline in the Denar and foreign currency interest rates by 0,2 percentage points, thus at the end of August they amounted to 2,4% and 1,1%, respectively. In newly received Denar and foreign currency corporate deposits, movements are divergent. Thus, compared to June, the interest rate on Denar deposits

⁶⁰ In July 2015, the government increased social payments and permanent financial assistance for socially vulnerable groups by 10%, and the increased compensation to families hosting orphans by 25%.

⁶¹ As of January 2015, interest rate data of banks and savings houses have been collected under the new interest rate methodology, while data for the previous period were collected under the old methodology. For more detailed information see Quarterly Report, May 2015, p 53.



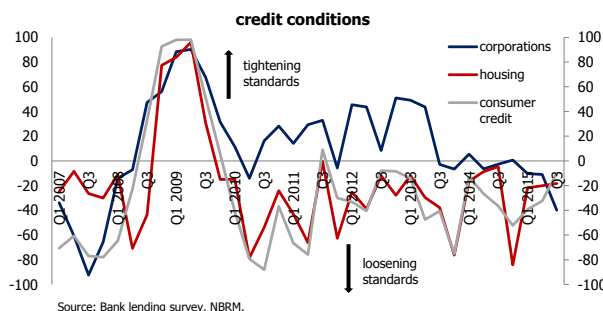
decreased by 0,2 percentage points while the foreign currency interest rate is higher by 1,2 percentage points. In such conditions, interest rates on newly received Denar and foreign currency corporate deposits in August amounted to 1,1% and 2,5%, respectively. In terms of total household deposits in August interest rates on Denar and foreign currency deposits amounted to 2,7% and 1,2% respectively, while for enterprises, Denar and foreign currency interest rates amounted to 2,4% and 1,6%, respectively.

According to the analysis of money supply from balance sheet perspective, the monetary growth in the third quarter is primarily determined by the growth of loans to the private sector followed by net loans of the government and the net foreign assets of banks. On the other hand, the net foreign assets of the NBRM contribute to reducing the broadest monetary aggregate.

2.2.2. Lending activity

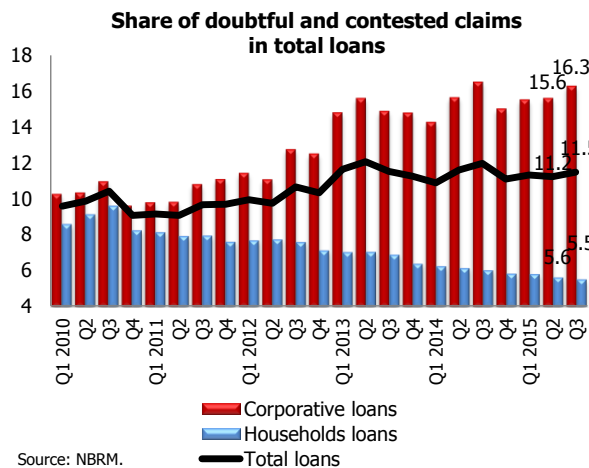
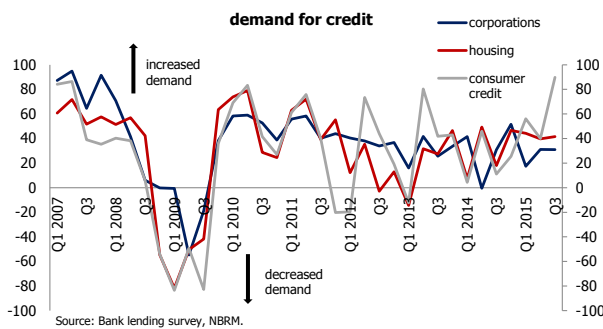
Total credits of private sector	2013				2014				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	
	quarterly change, in %											
Total credits of private sector	0.7	1.9	0.6	3.0	1.8	2.9	1.4	3.6	1.1	2.7	1.2	
Contribution in quarterly change of total credits (in p.p.)												
Denar credits	0.4	1.6	1.4	2.9	1.6	2.7	1.3	3.1	0.7	3.2	1.6	
Foreign currency credits	0.3	0.3	-0.8	0.1	0.2	0.1	0.1	0.5	0.4	-0.5	-0.3	
Short-term credits	-0.1	0.6	-0.4	0.7	0.7	0.4	0.0	1.7	-0.5	0.0	-0.4	
Long-term credits	-0.6	0.6	1.6	2.3	1.2	1.3	0.9	2.4	1.2	2.5	1.2	
Households	0.4	1.4	1.0	1.2	0.9	1.6	1.2	1.0	1.0	1.8	1.4	
Corporations	0.3	0.5	-0.4	1.9	0.9	1.2	0.2	2.6	0.1	0.9	-0.2	

Source: NBRM.



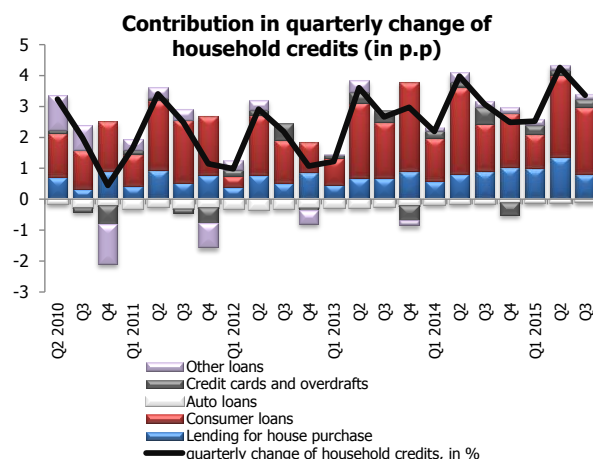
The total lending activity continued to grow during the third quarter of 2015 but at a slower pace compared with the previous quarter. Thus, the quarterly growth rate of total loans at the end of September amounted to 1,2% from 2,7% in June. Further favorable developments in the credit market result from the continued strong support of banks to the "household" sector, while corporate loans register a moderate decline on a quarterly basis. Such changes in corporate lending may partly be due to seasonal factors, taking into account the historical achievements of often weaker lending to this sector in July and August. Such assessment is supported by the results of the latest Lending Activity Survey⁶² which signals positive changes on the supply side and the demand side of the credits from the private sector during the third quarter. Also in August NBRM made changes in the reserve requirement instrument setup, which is expected to contribute to encouraging long-term savings of households in domestic currency and to release liquidity, which opens space for greater lending activity of the banks. In the period from July to August, certain deterioration of the credit portfolio of banks is registered especially in the corporate sector, which contributes to moderate growth in the share of

⁶² More detailed information is available within Lending Activity Survey:
<http://nbrm.mk/?ItemID=F7AC78DEE498764FBAF39049F726CE3C>.



Total credits of households											
	2013				2014				2015		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
	quarterly change, in %										
Total credits of households	1.1	3.4	2.5	2.8	2.1	3.9	2.9	2.4	2.4	4.2	3.3
	Contribution in quarterly change of household credits (in p.p)										
Denar credits	1.2	3.6	2.6	2.8	2.1	3.9	3.0	2.3	2.3	3.9	3.2
Foreign currency credits	-0.1	-0.1	-0.1	0.0	0.0	0.1	0.0	0.1	0.1	0.2	0.1
Short-term credits	0.1	0.4	0.3	-0.6	0.2	0.3	0.4	-0.4	0.2	0.2	0.2
Long-term credits	0.9	2.7	2.1	3.8	1.8	3.5	2.5	2.8	2.0	3.9	3.0

Source: NBRM.



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

doubtful and contested loans to total loans to 11,5% in September from 11,2% in June. These developments are in part explained by the slowing lending activity in this period, while the share of doubtful and contested claims in total loans continues to gravitate around the average for the previous two years, which is approximately 11,6%.

Structure analysis of the realized growth from maturity and currency perspective indicates retention of the trends from the previous quarter. Thus, long-term and Denar loans fully explain the realized quarterly increase in total loans, while short-term loans and credits in foreign currency registered a quarterly decrease. **On an annual basis**, total loans in September increased by 8,8% (9% at the end of June).

In the third quarter, the utilization of the deposit potential for lending to the private sector increased third consecutive quarter as a result of more intensive pace of growth of total loans compared to the moderate increase in the deposit base. Thus, at the end of September the ratio loan / deposit⁶³ amounted to 92,2% from 91,7% at the end of June.

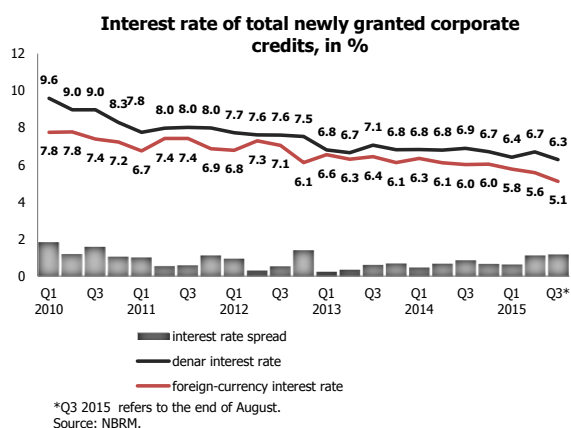
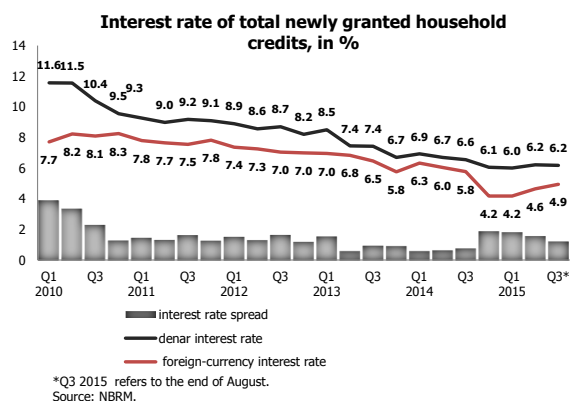
The solid growth of loans to the household sector continued in the third quarter of 2015, but at a slightly slower pace compared to the previous quarter (quarterly growth of 3,3% in September, compared to 4,2% at the end of June). The achieved growth largely remains due to the increase in consumer loans, followed by housing loans. Such performances, according to results of the latest Lending Survey, in large part are determined by favorable movements on the side of the demand for loans, with higher demand registered primarily in consumer loans followed by housing loans. In terms of credit conditions, banks indicate a moderate net easing of credit terms, but with lower intensity compared to the previous Survey. Structure analysis of the realized growth from maturity and currency perspective indicates that similar to the previous two quarters, in the third quarter households were dominantly indebted in the long term and in domestic currency, amid a small positive contribution of short-term loans and loans in foreign currency. **On an annual basis**, total loans to households at the end of September increased by 12,8% (12,4% at the end of June).

⁶³ According to monetary statistics data


Total credits of corporations

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

Source: NBRM.



Loans to the corporate sector in the third quarter registered a quarterly decline of 0,4%, compared to the growth of 1,6% in the previous period. The reduction in total loans was conducted during July and August while in September corporate loans register solid monthly increase. Such trends in the third quarter have been common for the past few years suggesting probably seasonal adjustment of the credit activity directed towards this sector. The temporary character of the adjustment of corporate loans in this period is additionally supported by the results of the Lending Activity Survey. Namely, according to the responses of the banks, in the third quarter certain improvements are registered on the supply side and on the demand side of loans. Thus, the number of banks that indicate a net easing of loan conditions increases, with a simultaneous increase in demand for corporate loans. Within the non-standard measure to encourage lending activity for net exporters and producers of electricity in the third quarter a decline in new loans was registered, which was entirely due to the relatively high monthly drop in the banks' loans approved to net exporters during July⁶⁴. Analyzing the maturity structure, there was a simultaneous decrease in the short and long-term loans. In terms of currency structure, similar to the previous quarter, Denar loans continue to grow while loans in foreign currency decreased. **On an annual basis**, at the end of September, loans to enterprises increased by 6% from 6,7% at the end of June.

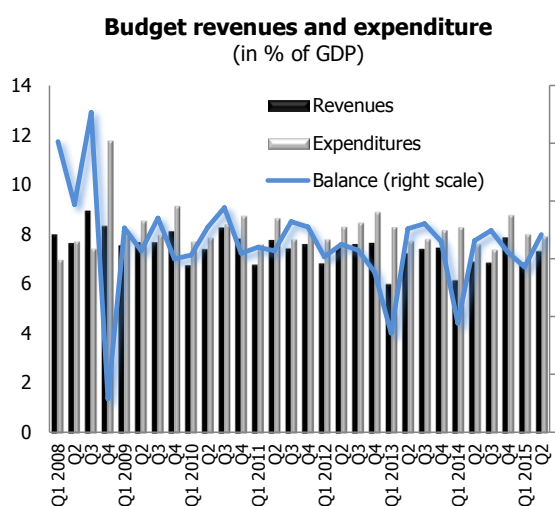
The analysis of the conditions of lending indicates divergent movements in interest rates⁶⁵ on the two most important sectors of the economy. Thus, households have seen a stabilization of the Denar interest rates on *newly approved* loans amid growth in foreign interest rates by 0,3 percentage points. On the other hand, the corporate loans as of August recent data indicate easing of the interest conditions by reducing the Denar and foreign currency interest rates on *newly approved* loans by 0,4 p.p and 0,5 p.p, respectively. Interest rates on *total* loans to households and enterprises in August did not register more significant changes compared to June, stabilizing at 7% and 6,6%, respectively.

⁶⁴ In July, loans to net exporters declined by Denar 1.169 million, followed by moderate growth in August and September. On a quarterly basis, loans to net exporters were lower by Denar 478 million.

⁶⁵ As of January 2015, interest rate data of banks and savings houses have been collected under the new interest rate methodology, while data for the previous period were collected under the old methodology. For more detailed information see Quarterly Report, May 2015, p 53.

III. Public finances

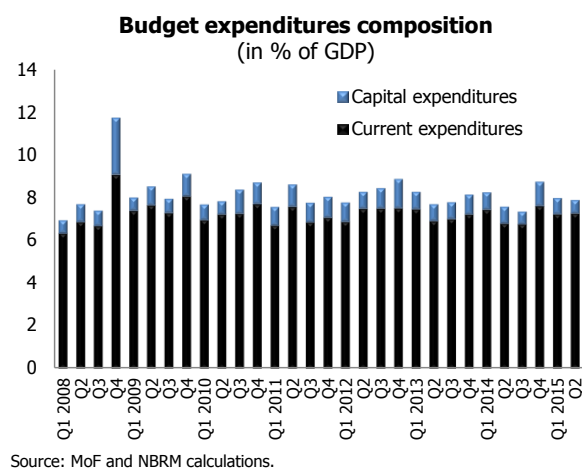
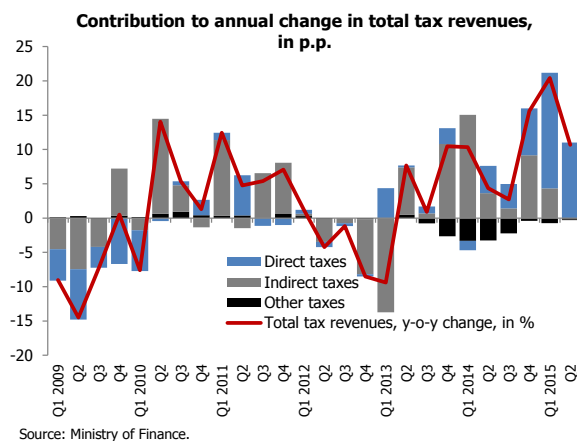
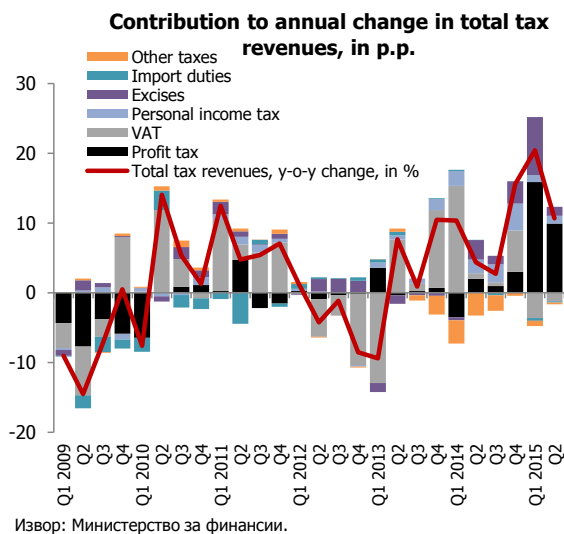
The growth of budget revenues continued during the second quarter of 2015. On an annual basis, revenues in the Budget (central budget and budgets of funds) increased by 11,3%, compared to 17% as was the growth in the previous quarter. The significant increase in revenues is greatly due to the recent tax changes which mean abolition of the anti-crisis measure that exempted retained earnings of the companies from taxation. This is confirmed by the dynamics of income tax revenues, which as of June exceeded the original plan for the entire year by around 49%, contributing to the better performance of total revenues compared to the plan for this time of the year. Budget expenditures have continued to realize the projected pace in the second quarter and they were higher by 9,3% on an annual basis, as opposed to 1,5% annual growth in the first quarter. However, on a quarterly basis budget expenditures declined moderately, which in terms of revenue growth contributed to a narrowing of the negative gap between revenues and expenditures in the budget. Consequently, the budget deficit in the second quarter was lower and amounted to 0,6% of GDP (1,1% of GDP in the first quarter) and was financed from domestic sources. Given the better performances in tax revenues compared to the plan and due to the appropriate adjustment of expenditures in order to achieve set goals and policies by the end of the year, Supplementary Budget for 2015 was proposed in July, and adopted in August. With the Supplementary Budget an upward correction of the revenue and the expenditure side was made, with an anticipated realization of somewhat higher budget deficit of 3,6% of GDP (3,4% of GDP according to the original plan). Total budget revenues and expenditures continued to grow in the period from July to August when they were higher by 11,7% and 14,8%, respectively, on an annual basis.



Source: Ministry of Finance

During the second quarter of 2015, total revenues in the Budget⁶⁶ on an annual basis increased by 11,3%, compared to 17% in the previous quarter. Seen as a share of GDP, total revenues in the second quarter amounted to 7,3%, which is higher compared to the previous quarter (6,8%) and compared to the same quarter of 2014 (6,9%). These shifts indicate further strong realization of revenues, despite the slowing growth rate, which is largely explained by changes in tax policy since the beginning of 2015, which abolished the anti-crisis measure (adopted in 2009) in which companies are exempted from taxation on undistributed earnings. Thus, tax revenues were the main driver of growth in total revenues also during the second quarter (an annual rate of 10,7%), driven by the growing realization of direct taxes and primarily profit tax within their framework. However, the pace of growth of revenues from profit tax slowed down in the second quarter, which is explained by high realization of this tax in March when the gaps

⁶⁶ Central budget and budgets of funds.

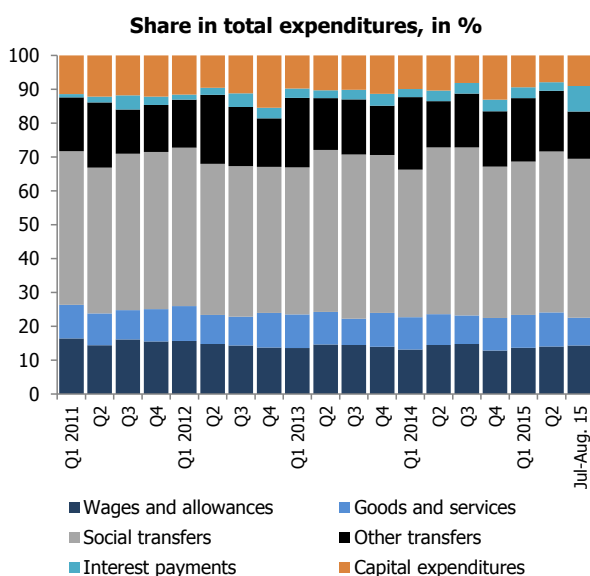
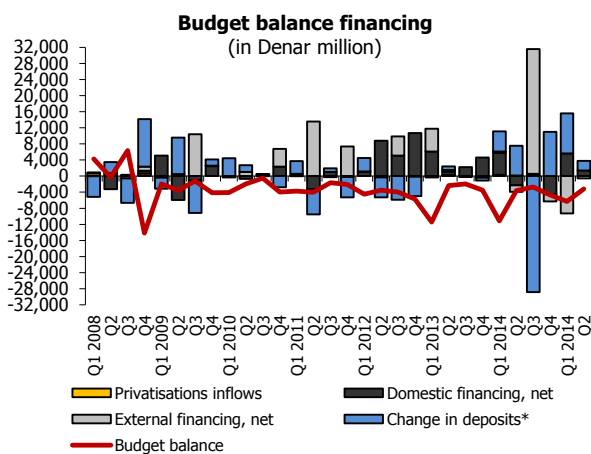
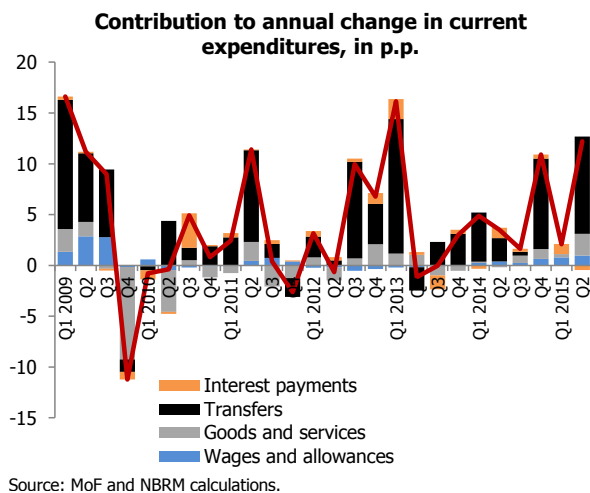


are paid between the advance payments in the previous year for the realized profit in tax balances in the final account. Growth has also been registered in the collection of personal income tax, whose rate of growth accelerated moderately on an annual basis, supported by favorable labor market movements, where since the beginning of the year an increase in the number of employees on annual basis is registered, followed with the growth of nominal gross wages. Indirect taxes had almost neutral contribution to the growth of tax revenues in the second quarter, which is primarily explained by the normalization of excise revenues, after the high growth registered in the first quarter⁶⁷. Changes in revenues from VAT and import duties have registered further reduction on an annual basis, but at a slower pace compared to the previous quarter. Downward movements in VAT revenues are characteristic since the beginning of this year, which in conditions of registered growth in private consumption, is probably in part due to the negative effects of the drastic reduction in oil prices during this period. Total social contributions continued to grow at an accelerated pace compared to the previous quarter (9,3% versus 7,1% annually in the first quarter), amid more intensive increase of collection in all subcategories. The evident increase in contributions for pension and disability insurance, and health insurance is probably due to the legislative amendments introduced earlier this year that require payment of benefits for work performed on the basis of copyright contracts⁶⁸, and in part stems from the further growth of the number of employees. Non-tax revenues in the second quarter on an annual basis were higher by 9,7% and had a moderate contribution to the growth of total revenues in this period.

In the second quarter of the year, the growth in total expenditure accelerated on an annual basis and equaled 9,3% versus 1,5% in the first quarter. Thus, total expenditures had a share of 7,9% of GDP, which is higher compared to the same quarter of the previous year (7,6% of GDP), but is at a level similar to the performance in

⁶⁷ During the first quarter of 2015, revenues from excise taxes on an annual basis increased by 49,1% higher, which is probably a combination of multiple factors such as lower base effect, introduction of new excise duty on oil coke, transferred effect of last year's increase in excise duty on cigarettes per piece, and regular growth of the amount of the excise duty early this year.

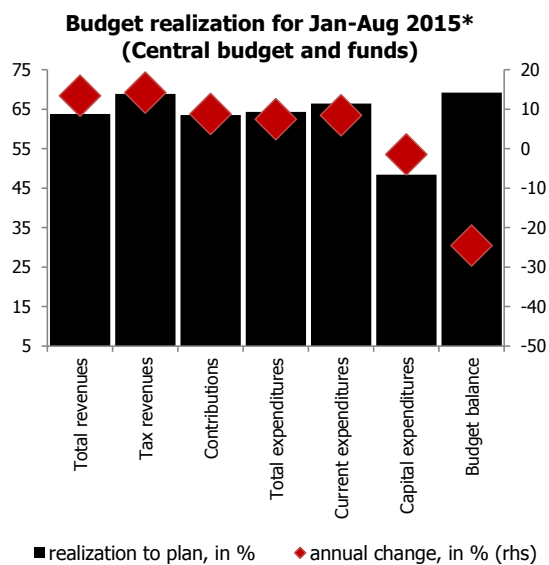
⁶⁸ These amendments were effective as of July. As of 1 August the obligation to contribute to the work on the basis of copyright agreements was abolished.



the first quarter (8% of GDP). Observed from individual categories of expenditure, the accelerated growth of expenditures was entirely due to the higher realization of the **current expenditures** (with an annual growth of 12,2%), of which the largest contribution was made by the increased realization of the expenditures for transfers. Total transfers in the second quarter registered double-digit growth rate of 13,6% annually, driven by the growth in the category "other transfers", after their decline in the first quarter. Such shifts in "other transfers" are probably driven by payments of subsidies to farmers. The growth of social transfers was at a similar rate as in the previous quarter. In the second quarter, increased realization was recorded also in the expenditures for goods and services, while the rise in the cost of wages and benefits moderately accelerated annually and had a steady contribution to the growth of current expenditures in this period. Changes in **capital expenditures** in the second quarter were of a declining nature on an annual basis (decline of 16,3% versus 3,8% in the first quarter), which contributed to the decline in the share of capital expenditures in GDP at 0,6% in the second quarter (compared to 0,7% of GDP in the previous and 0,8% of GDP in the second quarter of 2014).

Contrary to the intensified growth on an annual basis, on a quarterly basis budget expenditures declined moderately, which amid revenue growth contributed to a narrowing of the negative gap between revenues and expenditures in the budget. Thus, the budget deficit in the second quarter amounted to Denar 3.220 million, or 0,6% of GDP, compared to 1,1% of GDP in the first quarter. In terms of financing, during the second quarter budget deficit and liabilities based on domestic and external debt were almost entirely financed from domestic sources, through withdrawal of deposits from the government account with the NBRM and the issuance of government securities in the domestic market. Regarding foreign financing, small gross inflows were realized which cover about 7% of the total budget financing needs in the second quarter.

Growth of total budget revenues continued in the period from July to August at an annual rate of 11,7%, which is still driven by growth in tax revenues. Moreover, in this period certain changes are characteristic in the structure of growth in tax revenues compared to the previous quarter in the direction of



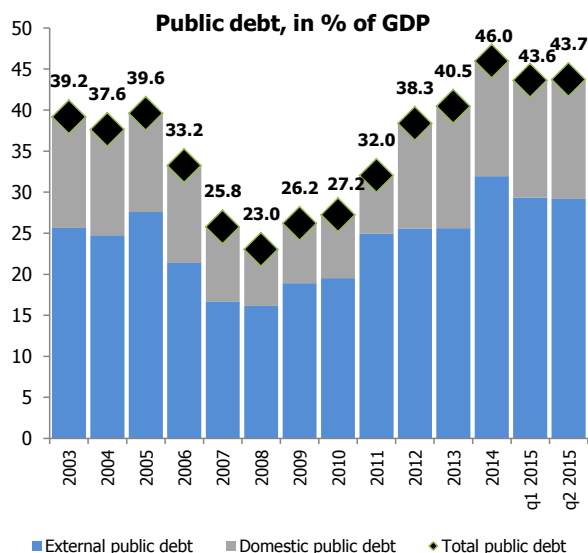
* With respect to the Supplementary Budget for 2015.
Source: Ministry of Finance.

increasing importance of indirect taxes. Thus, after the registered decline since the beginning of the year, revenues from VAT in the period July-August registered growth, amid revenues growth from import duties, which also had a negative impact in the previous two quarters. Amid such shifts and retaining of the growth of revenues from excise, indirect taxes in the period July-August had a greater contribution to the growth of tax revenues. On the other hand, the growth of direct taxes in this period decelerated, which is mostly due to the decelerated growth of revenues from profit tax, indicating gradual depletion of the effects of the tax changes in this area since the beginning of the year. In terms of other income categories, social contributions continued to grow at an accelerated pace compared with the second quarter, amid registered growth in all types of contributions. **In parallel with the growth in revenues, in the period from July to August growth of budget expenditures was registered, which on an annual basis were higher by 14,8%.** The growth of total expenditures in this period in more significant part was conditioned by the increased execution of the current expenditures in the form of transfers (social and other transfers) and interest payments. However, in the first two months of the third quarter positive trends in capital expenditures are evident, which after the registered decline in the first and especially the second quarter, now realized high growth of 34,8%. Such changes indicate a possibility of an increased concentration of capital expenditures in the second half of the year. In the period from July to August was realized budget deficit of Denar 3.283 million. Budget financing needs again in dominant part were provided through domestic sources - withdrawal of deposits from the account with the NBRM and issuance of government securities in the domestic market.

The dynamics in the realization of the budget from the beginning of the year pointed to a better performance of budget revenues compared to the initial plan, due to which, together with the need for certain budget allocations of the expenditure side a Supplementary Budget of the Republic of Macedonia was adopted for 2015. The Supplementary Budget was adopted in August and provides an upward correction of the revenue and the expenditure side and slightly higher budget deficit of 3,6% of GDP (3,4% of GDP with the original plan)⁶⁹. Compared to the Supplementary

⁶⁹ For more details on the Supplementary Budget for 2015 see within Appendix 1.

Budget, the realization of total budget revenues in the period January-August amounted to 62,4%, with almost the same pace of execution of the budget expenditures (62,5%). The budget deficit for the period January-August amounted to 2,3% of GDP, representing 63,6% of the projected budget deficit for the year under the Supplementary Budget.



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

According to the latest available data, the total public debt⁷⁰ as of 30 June 2015 година amounted to 43,7% of GDP⁷¹, which compared to the first quarter represents a slight increase of 0,1 percentage points of GDP. Observed by components, a small increase was registered in the domestic debt, which as of the end of June amounted to 14,5% of GDP (compared to 14,3% of GDP in the first quarter), while external debt registered a slight decrease on a quarterly basis and at the end of the second quarter amounted to 29,2% of GDP (29,3% of GDP at the end of the first quarter). Total government debt⁷² as of the end of the second quarter amounted to 36,1% of GDP (36% of GDP as of the end of the first quarter), while the debt of public institutions⁷³ was maintained at the level of the previous quarter and amounted to 7,6% of GDP.

⁷⁰ The public debt is defined under the Law on Public Debt (Official Gazette of the Republic of Macedonia No.165/14), according to which it is the sum of the government debt and the debt of public enterprises established by the state or municipalities within the city of Skopje and the city of Skopje, and companies that are wholly or predominantly owned by the state or by the municipalities, the municipalities within the city of Skopje and the city of Skopje, for which the Government has issued a state guarantee.

⁷¹ In the calculations the October projection of NBRM was used for the nominal GDP for 2015.

⁷² Government debt is defined as a sum of debts of the central and the local government.

⁷³ It refers to the guaranteed debt of public enterprises and joint stock companies owned by the state, according to the definition of the public debt of the Public Debt Law (Official Gazette of RM No. 165/14).

Budget of Republic of Macedonia (Central budget and budgets of funds) □

	Budget for 2015	Supplementary budget for 2015	Q1	Q2	Jul-Aug	Y-o-y changes, 2015 period over the same period from the previous year, in %			Contribution to y-o-y changes, 2015 period over the same period from the previous year, in p.p.		
	planned, in Denar million	planned, in Denar million	realized, in Denar million			Q1	Q2	Jul-Aug	Q1	Q2	Jul-Aug
TOTAL BUDGET REVENUES	163,280	166,842	37,779	40,352	25,995	17.0	11.3	11.7	17.0	11.3	11.7
Revenues base on taxes and contri	137,672	142,527	33,326	35,378	23,512	16.1	10.3	10.7	14.3	9.1	9.8
Tax revenues	87,465	93,516	21,935	23,119	15,194	20.4	10.7	11.1	11.5	6.2	6.5
Contributions	48,717	47,189	10,932	11,900	8,105	7.1	9.3	10.3	2.2	2.8	3.2
Non-tax revenues	17,078	16,433	3,240	2,672	1,790	24.7	9.7	17.8	2.0	0.7	1.2
Capital revenues	4,152	2,880	350	1,286	261	101.1	23.5	26.1	0.5	0.7	0.2
Donations from abroad	3,578	4,202	784	846	398	28.1	58.4	48.5	0.5	0.9	0.6
Revenues of recovered loans	800	800	79	170	34	-61.1	3.0	-22.7	-0.4	0.0	0.0
TOTAL BUDGET EXPENDITURES	181,777	186,981	44,080	43,572	29,278	1.5	9.3	14.8	1.5	9.3	14.8
Current expenditures	160,569	164,747	39,936	40,106	26,618	2.1	12.2	13.2	1.9	11.0	12.1
Capital expenditures	21,208	22,234	4,144	3,466	2,660	-3.8	-16.3	34.8	-0.4	-1.7	2.7
BUDGET DEFICIT / SURPLUS	-18,497	-20,139	-6,301	-3,220	-3,283						
Financing	18,497	20,139	6,301	3,220	3,283						
Inflow	44,667	48,958	16,709	5,142	6,940						
Revenues based on privatisation	0	0	0	0	0						
Foreign loans	16,159	4,339	1,018	362	408						
Deposits	23,321	20,973	9,928	2,414	3,693						
Treasury bills	5,137	23,596	5,762	2,356	2,837						
Sale of shares	50	50	1	10	2						
Outflow	26,170	28,819	10,408	1,922	3,657						
Repayment of principal	26,170	28,819	10,408	1,922	3,657						
External debt	20,001	22,664	10,276	923	518						
Domestic debt	6,169	6,155	132	999	3,139						

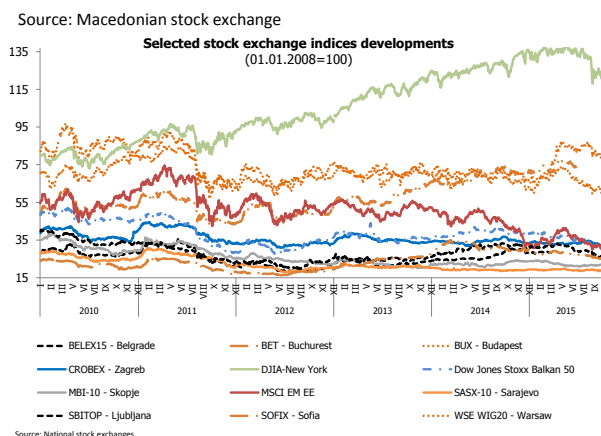
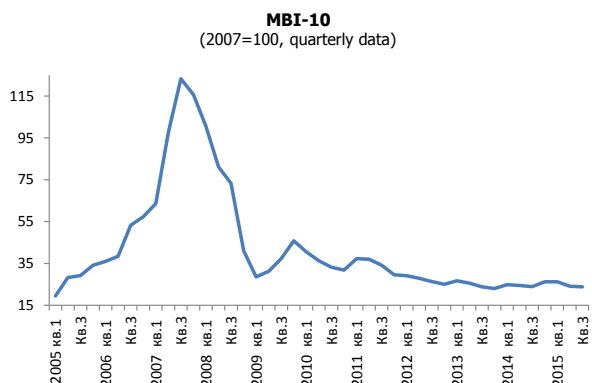
Source: Ministry of Finance and NBRM calculations.

IV. Stock exchange indices and real estate prices

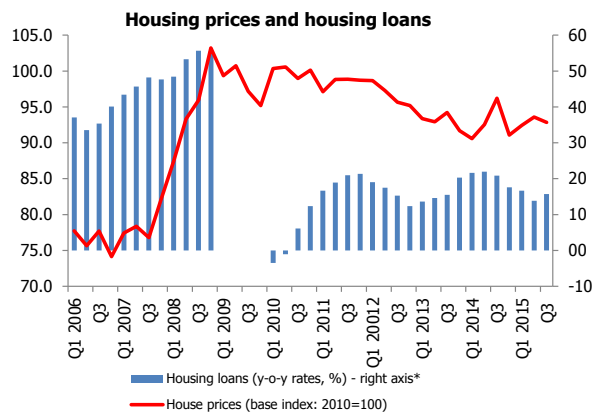
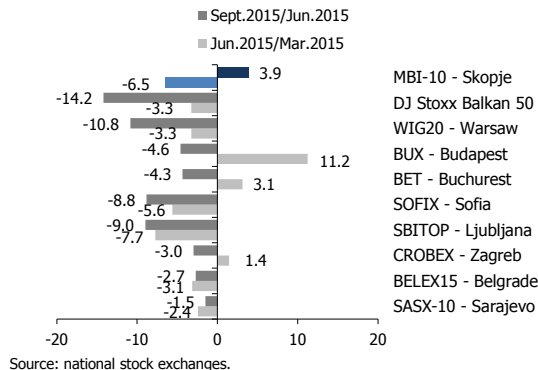
In the third quarter of 2015, the Macedonian MBI-10 increased, and an upward trend was registered also in the OMB index. Contrary to the favorable developments of the MSE, all regional stock indexes decreased in value, which in conditions of low degree of financial integration of the region with the world's financial markets (especially the Chinese economy whose deceleration is cited as the main reason for the fall in the stock markets global) is probably due to specific local factors. Real estate prices in the domestic market, after the growth in the first half of the year, in the third quarter decreased, which corresponds to fluctuations in the supply and demand for real estate.



During the third quarter of 2015, the value of the Macedonian MBI-10 increased by 3,9%, thus stopping the downward trend of its value which started at the beginning of the year. Analyzing the dynamics of movement, during the third quarter, consistently increasing of the value of the stock index was registered and at the end of the quarter the same was positioned on 1704,46 (compared to 1644,33 as it was at the beginning of the quarter). Favorable developments in the market correspond with the good economic performances and expectations for their extension until the end of the year, and stabilization of the uncertain political situation had a further positive impact. However, taking into account historical data indicating the sensitivity of the index, in



Changes of the regional stock exchange indices, eop September 2015/eop June 2015 and eop June 2015/ eop



conditions of insufficient interest of domestic investors and absence of foreign institutional investors, it is still difficult to determine whether this movement of the stock exchange index will continue, or it is a temporary movement. The total stock exchange turnover decreased by 41,3% compared to the previous quarter, mostly due to the lower turnover based on conventional trading. The decrease is mainly due to the high comparison base of the previous quarter when it was registered high growth in turnover in bonds associated with the release of a new issue of denationalisation bonds. The OMB index at the end of September 2015, compared to the end of June 2015, increased by 1,5% (compared to the decline at the end of the second quarter by 1,5%).

At the end of the third quarter of 2015 the values of all regional stock indices decreased. In global terms, the downward movements and increased volatility in stock markets are mostly associated with the increased uncertainty in the external environment, mostly due to the deceleration of the Chinese economy⁷⁴. However, at a low level of financial integration of regional economies with the Chinese economy, the downward movement of the indices in the region is probably the result of specific local factors.

After the deceleration in the pace of growth in the second quarter, in the third quarter of 2015, the index of apartment prices dropped. Thus, the index of apartment prices⁷⁵ in the period July-September 2015 dropped by 0,8% on a quarterly basis (as opposed to growth of 1,2% in the second quarter) and a decline of 3,5% on an annual basis (compared to the annual growth of 1,1% in the second quarter). This price movement corresponds to the estimates for the temporary character of the increase registered in the previous two quarters amid continued growth in the supply of real estate market in the past few years. Namely, the cumulative value of the buildings constructed in the period 2011 - 2015 (second quarter of the year) is higher by 68,4% than the value in the period 2007-2010, and data show similar dynamics in building permits. In terms of demand for apartments, the permanent solid growth in home

⁷⁴ <http://www.belex.rs/trgovanje/sentiment>

⁷⁵ Hedonic index of housing prices, prepared by the NBRM on the basis of the notices of sale in the capital city, and published by the agencies dealing with trade in real estate. The price of the apartment is a function arising from the size of the apartment, the neighborhood in which it is located, the floor, whether the apartment has central heating and whether the apartment is new.

loans continued in the third quarter of 2015, which suggests further strengthening of demand.

V. Macroeconomic forecasts and risks

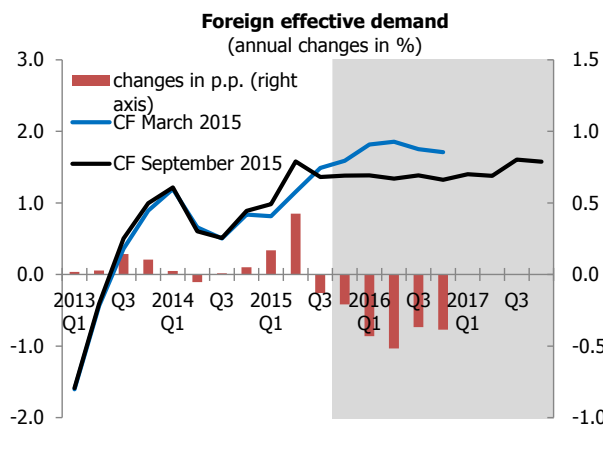
The realization of the economic growth in the first half of 2015 is in line with the expectations. However, amid unfavorable assessments for the global environment, especially significantly worsened situation on the metals market and higher risks in the domestic environment, it is estimated that there is no possibility for the economy to grow in the following period with the dynamics expected in April projection. Despite such changes, the economic recovery is expected to continue by registering solid growth rates. **Thus, the latest estimation for the economic growth for 2015 equals 3.2%, while for 2016, moderate growth acceleration is expected again, which shall equal 3.5% (compared to the projected growth of 4.1% and 4.5%, respectively in April). Further growth intensification of the economy, which will equal about 4%, is expected for 2017.** Larger changes regarding the structure of the growth generators are not anticipated. It is still expected that the largest contribution to the growth will account to both exports and investments, with the positive effect being also expected from the private consumption. The larger utilization of the existing export-oriented facilities, assumptions for new investments in this sector, in combination with the anticipated recovery of the foreign demand, is expected to underpin the exports growth. The intensified export activity and the announcements for investments in new foreign facilities, together with the fiscal stimulus in the infrastructure, will contribute to higher investments in the following two years. Such developments should have positive effect also on the labour market, which will contribute to increased household consumption. The domestic consumption is expected to be additionally supported by the lending activity, as well. According to this projection, solid growth in both lending and deposit potential of the banking system is still expected, although with slower pace compared to April projections. **The projections of the current account deficit have been revised downwards, amid better estimations for the balances of all its components (deficit of 0.5% and 1.9% of GDP for 2015 and 2016, compared to April projections for a deficit of 1.6% and 3.1% of GDP, respectively). From the viewpoint of the dynamics, in 2015 narrowing in the current account deficit is anticipated, compared to the preceding year, which arises from the improvement in the balance of goods and services, mostly due to the significantly reduced energy deficit. On the other hand, in 2016 and 2017, the current transactions deficit is expected to widen and to reach 1.9%, i.e. 2.4% of GDP, respectively.** The sources of financing the current account gap in this and in the next two years is expected to be a combination of debt and non-debt flows, with the projections for the foreign reserves showing their constant maintenance at an adequate level. Regarding the inflation, slightly lower performances than expected, together with the downward correction of the estimations for the future dynamics of the import prices resulted in downward revision of the projected inflation. **Thus the recent estimations indicate an inflation of approximately 0% in 2015, and about 1.5% in 2016, (0.5% and 2% in 2015 and 2016, respectively in the previous projection), while for 2017, inflation rate of 1.6% is expected.**

5.1. Assumptions in the external environment forecast⁷⁶

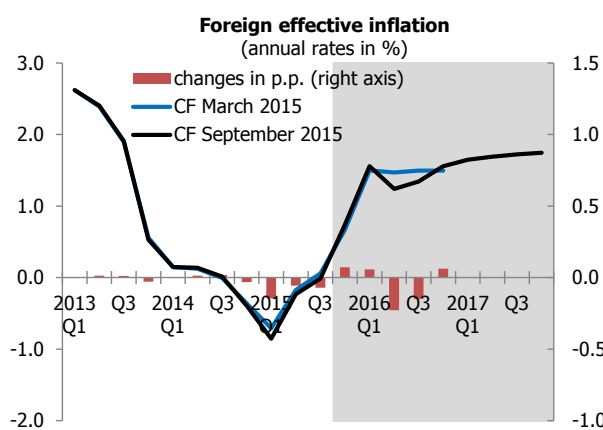
The growth of the global economy in the first half of 2015 decelerated, reflecting

⁷⁶ 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.

the further slowdown of the economic activity in the emerging economies and the slower recovery of the economies in developed countries. However, the expectations for intensified global activity in 2016 remained, amid growth intensification in both developing and developed countries. However, as a result of the performances, downward revision of the global growth for the entire 2015 was made, with lower growth also being projected for 2016. Specifically, it is now envisaged global growth of 3.1% for 2015 and 3.6% for 2016, contrary to the expectations for an increase of 3.5% and 3.8%, respectively in April⁷⁷. Having in mind the downward revisions, the global economic environment acts less favorable on the projections for the domestic economy compared to April cycle.



According to the latest estimations, the foreign effective demand is expected to register annual rise of 1.3% in 2015, which is in line with the April projection. In contrast, in 2016, the projection was revised downwards, now envisaging an increase of 1.4%, contrary to April projection of 1.8%. The main factor for deteriorated estimations is the significantly downward revised projections for Greece, where now a decrease in the economic activity is projected instead of increase. In 2017, intensified foreign demand is expected, envisaging growth of 1.5%

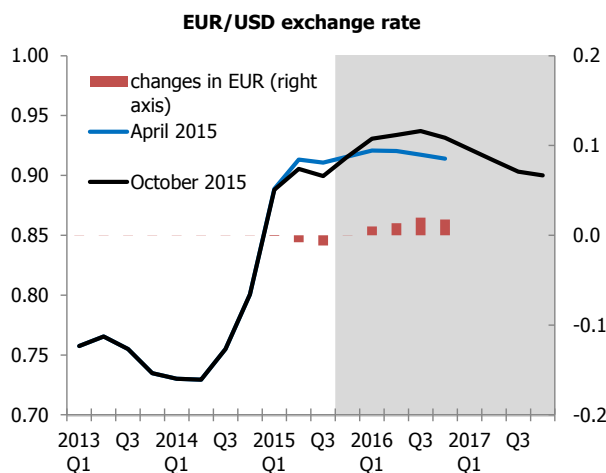


Compared to April, the projection of the foreign effective inflation has minimally been revised downwards during the current and the following year. Thus as a result of the current estimations that indicate negative price changes in Bulgaria and Slovenia, it is now assessed that the foreign inflation in 2015 will equal -0.1% instead of 0% as projected in April. Similarly, downward adjustment was made also to the expected foreign inflation for 2016, which is now projected at 1.4%, instead of the previous estimation of 1.5%, mainly due to the lower inflation projection⁷⁸ in Serbia. In 2017, it is expected that foreign effective demand will increase moderately and reach 1.7%.

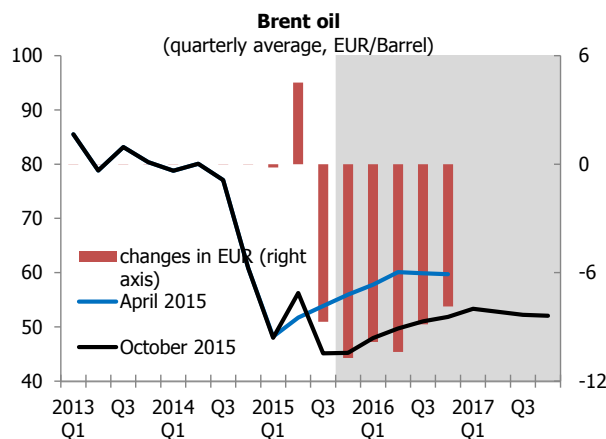
Regarding the projection of the foreign exchange rate US Dollar/Euro in 2015, there are no larger deviations compared to April projection, i.e. it is still expected that US Dollar will register the historically

⁷⁷ World Economic Outlook, IMF, October 2015.

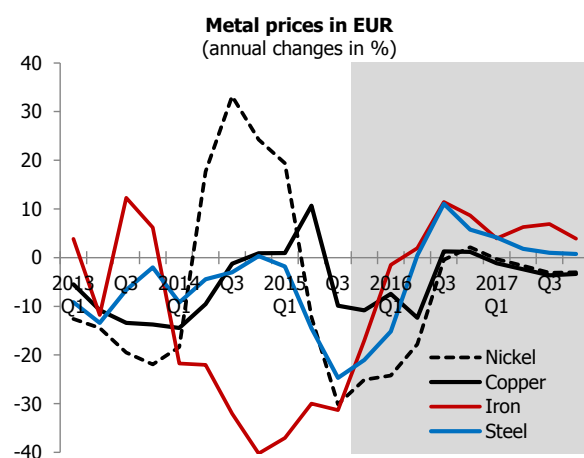
⁷⁸ Inflation corrected by the effects of the foreign exchange rate.



highest appreciation of 19.7% (20.4% in April). Such changes in the value of the US currency mainly refer to the quantitative easing measures implemented by the ECB, which have negative influence on the yields from the euro-denominated assets, with the solid growth of the US economy this year also being an additional factor. In 2016, additional rise in the value of the US Dollar is envisaged, which will be higher than in April projection (3.4% compared to 1.2%), on the backdrop of further divergence of the US and the euro area monetary policies. The trend of US Dollar strengthening is expected to cease in 2017, when depreciation of 2.6% is envisaged.



In the third quarter of 2015, the oil price registered larger drop than in April projection, a trend that will continue also in the last quarter of the year. As a result of such developments, it is estimated that in 2015 the price drop will be more severe than expected in April projection. Such an estimation is a reflection of factors on the supply side (high production in the OPEC countries and growing inventories), as well as to factors on demand side, among which the deceleration of the Chinese economic activity is pronounced the most. The excess supply of oil on the global market is expected to exhaust gradually from 2016, which will result in higher oil prices. However, the rise in the oil price is envisaged to be lower than in April projection. This moderate upward trend of the oil price is expected to last also in 2017. In nominal amounts, it is projected that the oil price will equal Euro 48.6 per barrel in 2015, Euro 50.1 in 2016 and Euro 52.6 in 2017.

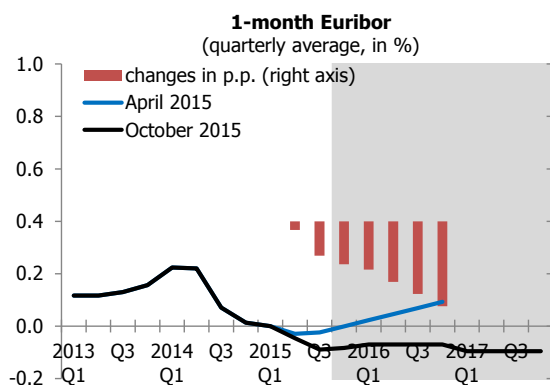
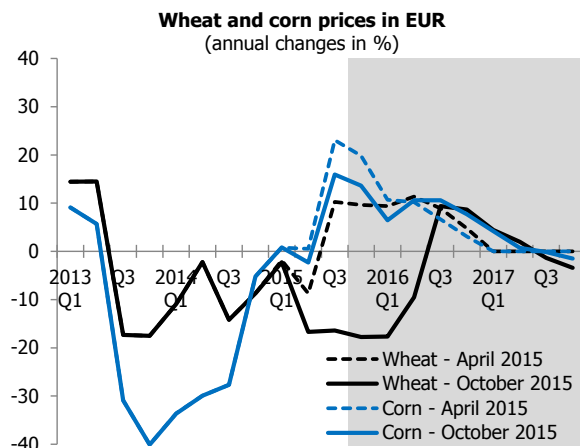


In the third quarter of 2015, the metal prices registered more evident drop in comparison with the April projections, due to growth deceleration in China and Yuan devaluation, as well as continuously higher supply in global terms. Having in mind that the unfavorable movements in the metals prices are expected to continue also in the fourth quarter in the October projection they were revised downwards for the entire 2015 compared to April. By individual metals, larger fall in the price of nickel and iron has been projected, as well as drop instead of rise in the price of copper and steel in conditions of solid inventories and lower demand from China. Having in mind the projections for further deceleration of the Chinese economy and maintaining the favorable perceptions on the supply side for most of the metals, in 2016 the prices of nickel, copper and steel have been

revised downwards, expecting to range in the zone of negative changes. The only upward revision was made in the price of iron, which, according to the current expectations, will surge, instead of the decrease envisaged in April.

Changes in the expectations for the prices of primary food products are generally downward.

Thus, compared to the April projections, for 2015, the prices of wheat and corn were revised downwards. Having in mind that the registered yields exceed the expectations, especially in EU, Russia and Ukraine, and improved perspectives for the production in south hemisphere, it is projected that the wheat prices will drop significantly, contrary to the projected growth in April. It is also predicted that the price of corn will rise less intensively than the April projection, largely due to expectations of higher production in the USA, the world's largest exporter of corn. In 2016, it is expected that the price of wheat will continue to decrease, compared to the growth projected in April, contrary to the price of corn which is envisaged to register a slightly higher growth than in April. The difference in projections stems from the different situation in terms of production expectations and stocks of wheat and corn the next year. On the other hand, it is estimated that the prices of these agricultural products will be in the zone of positive changes during 2017. The risks with respect to these projections are usually associated with variability in terms of weather conditions in the following period.

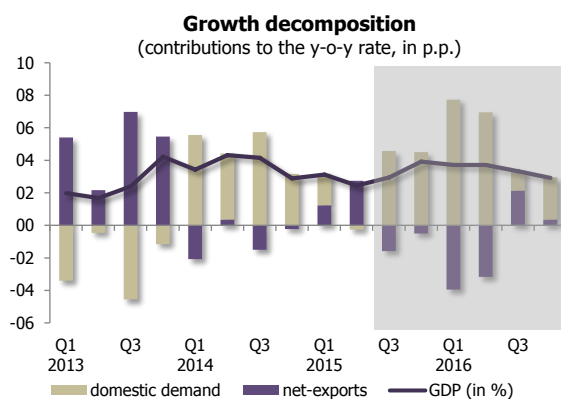


The **one-month EURIBOR** rate has been revised downwards minimally compared to the April projection, and unlike earlier, it is now projected that it will remain in the negative zone throughout the entire period of the projections. The negative foreign interest rates are directly related to the policy of quantitative easing by the ECB, whereas changes in dynamics are due to the possibility of the bank to extend the period of implementation of these measures beyond September 2016, or to intensify the purchase of government securities, which would act towards increasing liquidity in the euro area.

5.2. Forecast and effects on monetary policy

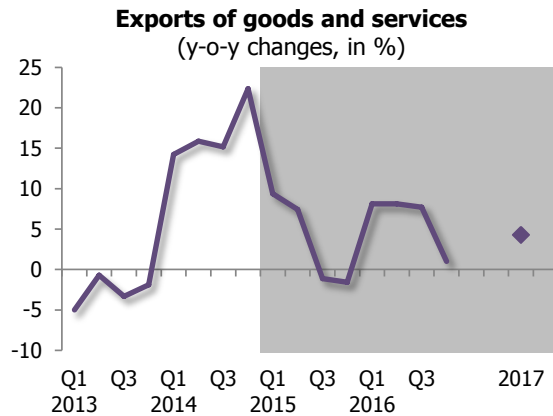
The latest projections suggest somewhat less favorable macroeconomic environment and increased risks from external and domestic environment. However, the basic macroeconomic scenario

indicates a stable external position of the economy and foreign reserves, which in the next period will be maintained at an appropriate level. The estimations for the recovery of the economy will create certain import pressures, but not so strong to disrupt external balance. For the next two-year period, direct investment and borrowing are expected to be the main sources of covering the needs for external financing, in a volume sufficient to further maintain the foreign reserves at an adequate level. **In light of the foreign interest, which is an important factor for the domestic monetary policy, there are no major changes in this projection either.** Amid expectations of maintaining a low inflation rate in the euro area and slow credit growth, continuation of the stimulating monetary policy of the ECB until at least September 2016 is expected. Hence, the latest estimations indicate that the interest rate of the one-month EURIBOR will remain negative until the end of 2015 and stay at that level also in the following period, contrary to the April projections, when minimal increase in the interest rates was anticipated. The key unfavorable **risks to the baseline macroeconomic scenario are similar to those of the April projection cycle, but more pronounced.** On the backdrop of further uncertainty about the recovery of the global economy and the continuous revisions of the foreign effective demand, and increased volatility on the global financial markets, there are unfavorable risks for the external position of the economy. These risks are now more pronounced compared to the April projection. This largely relates to expectations of slower recovery of the euro area, less favorable expectations for the emerging economies, especially China, and increased risk aversion amid volatility on global financial markets. In terms of domestic risks, important point is the uncertainty related to political developments and the possibility it spills over into the economy due to greater restraint on domestic and foreign entities. These risks point to the need for continuous monitoring of possible changes in the domestic and external economic conditions in the future and taking prompt and appropriate measures.

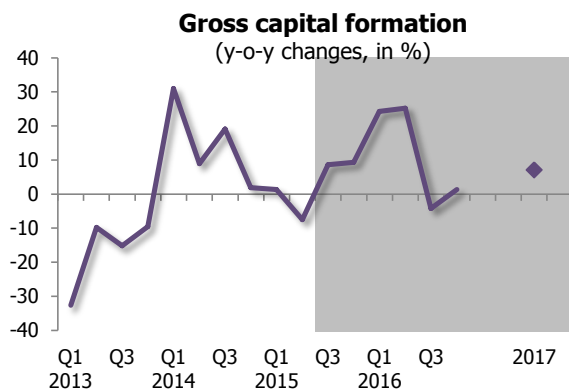


In the first half of 2015, the growth of economic activity continued, but at slightly slower pace. Exports, although with slower growth, is a factor with the largest contribution to overall economic growth, with positive contribution also accounting to both household and public consumption. According to available data, it is

estimated that solid GDP growth rates will resume also in the second half of 2015, generated mainly from the investment growth. Furthermore, **on average, for the entire 2015, GDP growth of 3.2% is expected, which will further accelerate to 3.5% and 4% in 2016 and 2017, respectively.**

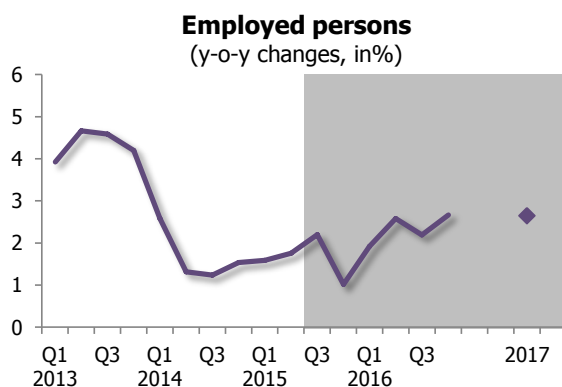
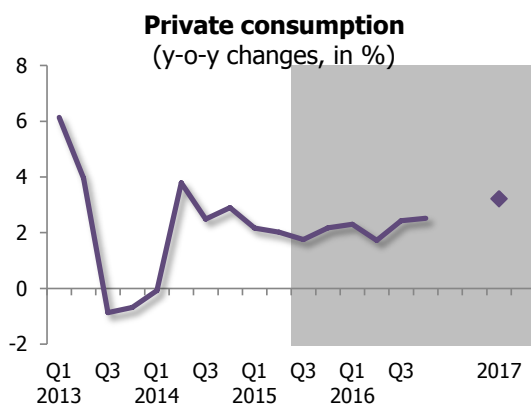


In 2015, slowdown in the **growth rate of the real export of goods and services is expected**, which is partially due to the base effect of the previous year, when the high export became more markedly driven by the new production capacities. Despite the deceleration, in 2015 it is still expected that the export sector will register the highest individual contribution to the total economic growth. In the following two years, it is assessed maintenance of the solid rates of the export growth, underpinned by the export activity of the new export-oriented facilities, the expectations for the new facilities in the export sector, as well as the recovery of the foreign demand, as a result of which the **export will remain one of the main generators of the total economic growth.**



Positive contribution to the GDP growth in 2015 is also expected by the total domestic demand. Until the end of the year, positive movements in all components of the domestic demand are expected. Namely, in expectation of further positive movements with the disposable income components, as well as with the credit activity, the growth trend of the private consumption is expected to continue until the end of the year with the same dynamics as in the first half. The public consumption is also expected to have a significant positive contribution, which is in line with the Budget Revision for 2015, which envisages larger expenditures in some of the public consumption components. After the fall in the first half of the year, most probably due to the inventories, it is expected that the gross investments will rise until the end of the year and have positive contribution to the growth for the entire 2015. These developments in the second half of the year are in line with the expectations for continued growth in construction, mainly associated with the current infrastructure projects, and investment in equipment and machinery in accordance with expectations of increased export activity in the future.

Domestic demand will continue to grow during 2016, amid high investment growth and rapid increase in private consumption.



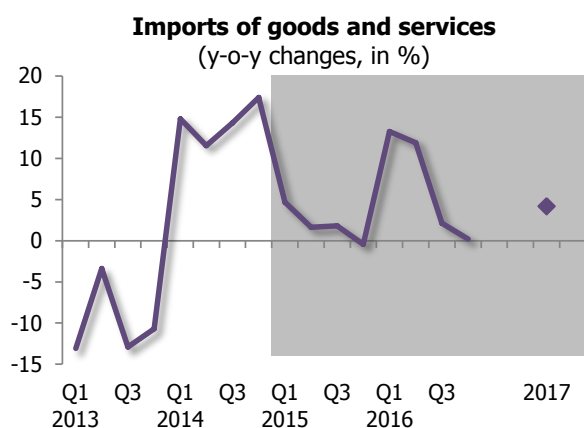
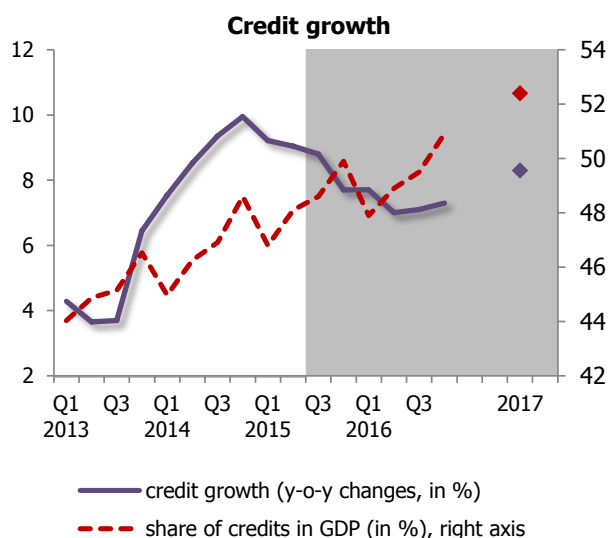
It is expected that **gross investment will be a major factor in the projected growth in domestic demand.** Namely, in 2016 intensification of the construction work related to government investments in road infrastructure is expected, as well as growth in private investment given the announcement for foreign investments in new facilities, favorable expectations among domestic enterprises and increased lending activity. Therefore, the investment activity will arise primarily from factors that relate to the domestic economy, contrary to the anemic recovery of global demand. **In 2016, the pace of growth of private consumption is expected to accelerate moderately.** The announcements for new foreign facilities and the expected intensification of overall economic activity will also affect the labor market positively in terms of intensified increase in the number of employees, and small growth in real wages. Namely, in 2016 nominal wages are expected to grow at the same pace as in 2015, which in terms of the increased price level will mean small growth in real wages. Consequently, increase in the wage bill, which will contribute to the higher disposable income, is expected. An additional contribution to the increase in disposable income is expected also from the increase in pensions, which includes the announced increase of pensions by 5% starting with the payment in October 2016, and the real growth of private transfers. In addition, the increase in the private consumption will be supported by further credit activity by domestic banks directed to the household sector. **The growth of domestic demand will continue during 2017, as well, with stronger growth rates in private consumption and moderately slower growth with gross investments, compared to 2016.** The household consumption is expected to have positive contribution to the overall economic growth, which again will continue to be supported by favorable trends in the labor market, in accordance with the transmission effects of investment and export activity on the number of employees and wages. Additional contribution is expected also from the increase in pensions and stronger credit activity. The increase in investments is expected to result primarily from the public investment stimulus in road infrastructure, taking into account the long-term nature of infrastructure projects. An additional effect is expected from investments in new facilities with foreign capital and higher export activity. **Also, positive but moderate growth rates are expected in public consumption in**



2016 and 2017, thus having minor positive contribution to GDP growth.

The estimations for continuing economic growth and stabilization of the banks' risk perceptions will contribute to prolonged solid credit growth in the forthcoming period. Namely, it is estimated that

at the end of 2015, credit growth will be 7.7%, while in 2016, the credit activity is expected to grow further (7.3%) and to accelerate moderately in 2017 (8.3%). Such projected credit growth reflects the factors on the side of both supply and demand. Namely, the positive achievements and expectations for the continuation of favorable trends on the labor market, and the projected solid growth in investment activity will contribute to stable demand for loans in the following two years. On the supply side, further positive contribution is expected from the increase in the deposit base, as well as the banks' stable risk perceptions. In addition, favorable effects on the credit activity are still expected, from the standard and non-standard measures undertaken by the NBRM so far. In terms of deposit potential, **significant slowdown in the deposits growth is expected in 2015, which partly reflects the higher uncertainty in the economy, which affects the confidence and expectations of economic agents. In the next two years, amid further economic growth and stabilization in the expectations, higher deposit growth is anticipated.** Thus, given the previous performances, at the end of 2015 deposit growth of about 4% is expected, and in the following two years, according to the economic growth intensification, accelerated increase in the deposit base by 6.8% and 9.1% is expected in 2016 and 2017, respectively. Downward risks around the projection of the credit and deposit growth are still present. Possibly weaker economic recovery than expected and continuing uncertainty about the domestic risk factors can lead to greater restraint for saving, limited sources of funding for banks, exacerbation of risk perceptions and reduced willingness for borrowing by the private sector.



In 2015, the import demand is expected to rise, but at a slower pace, reflecting primarily the slower export activity and the domestic demand, as well. However, the latest estimations for 2015 show slight positive contribution of the net export to the total growth. **In the next two years the imports growth is expected to continue**, especially in 2016, when



acceleration of growth in exports, investment and private consumption is expected. **As a result of these movements, the contribution of the net export on the growth in the following two years will be negative.**

Balance of Payment Forecast (% of GDP)

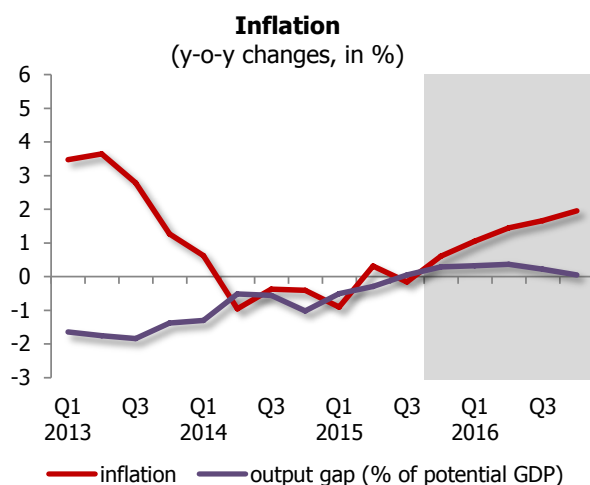
	2012	2013	2014	2015	2016	2017
Current account	-3.2	-1.7	-0.8	-0.5	-1.9	-2.4
Balance of goods & services	-22.4	-18.3	-17.5	-15.8	-16.5	-16.2
Goods, net	-26.5	-23.0	-21.7	-20.4	-20.8	-20.9
Services, net	4.1	4.6	4.2	4.6	4.3	4.7
Primary income, net	-2.2	-2.4	-1.9	-2.4	-2.6	-3.1
Secondary income, net	21.4	19.1	18.6	17.7	17.2	16.9
Private sector, net	20.6	18.2	17.3	17.1	16.6	16.3
Capital account	0.1	0.2	0.0	0.0	0.0	0.0
Financial account	-4.7	-0.8	-5.2	0.6	-1.8	-4.1
FDI, net	-1.7	-2.8	-2.3	-2.6	-2.8	-3.0
Portfolio Investment, net	-1.0	2.0	-5.7	-2.3	-0.1	-0.1
Other Investment, net	-1.9	0.1	2.8	5.5	1.1	-1.0

According to the latest estimates for 2015, the deficit on the balance of payments' current account is expected to reduce by 0.3 p.p. of GDP annually, and accordingly, at the end of the year it would equal 0.5% of GDP. The improvement in the deficit in the current transactions fully arises from the favorable developments with the foreign trade of goods and services. Thus the deficit in the trade of goods and services would equal 15.8% of GDP, compared to 17.5% of GDP in 2014. Namely, the low prices of energy on the international stock exchanges resulted in significant narrowing of the energy deficit and consequently in narrowing of the total trade deficit. Positive effects on the trade balance are expected also from the new export facilities, compared to the traditional export sector, the performances of which are less favorable. On the other hand, the secondary income is still expected to deliver solid net inflows based on current transfers of 17.7% of GDP, but slightly lower than in 2014 (mainly within the government sector, due to a high comparison base, and in smaller part within the private sector), with a simultaneous increase in the deficit in primary income, annually. **By contrast, in 2016, the current account deficit is expected to deteriorate by 1.4 p.p. of GDP and equal 1.9% of GDP.** This change is largely driven by the deepening of the deficit in the balance of goods and services, which in 2016 is expected to be 16.5% of GDP (i.e. annual growth of 0.7 percentage points of GDP). The higher trade deficit is expected to arise primarily from further import of raw materials by the new facilities, as well as investments and energy imports. An important part of this deficit will further be funded by the secondary income, which is expected to remain relatively high. Regarding the dynamics, its share in GDP is expected to reduce gradually, which will further contribute to the deterioration of the current account deficit. In 2017 further worsening of the current account deficit is expected, to 2.4% of GDP. This change is expected to be driven by further steady fall in the surplus in the secondary income and increase in the deficit in the primary income. By contrast, the balance of goods and services is anticipated to narrow, amid improved global environment and

expected further favorable effects of export-oriented facilities.

It is expected that the largest portion of the current account in the period 2015-2017 will be financed through foreign direct investment and long-term foreign borrowings of the public sector. The direct investments are expected to gradually increase from 2.6% of GDP in 2015 to 2.8% of GDP in 2016 and reach 3% in 2017. **The main risks** to the external position of the economy in this period still come from the global recovery pace and the movements of the world prices, and thus the domestic economic growth and their impact on the investors' perceptions.

In 2015-2017 period, the current account deficit is expected to be fully covered by financial flows, which will provide further accumulation of foreign reserves in this and in the following two years. Thus, during the entire period of projections, the foreign reserves adequacy indicators are maintained in a safe zone.



In 2015, the inflation rate is expected to be around 0%. Such unchanged price level compared to the previous year is due to the negative changes in the prices of energy, amid small increase in food and core inflation. **In 2016, the average annual increase in the prices of around 1.5% is expected.** The rise in domestic prices is in line with the movement in import prices, on the backdrop of the expected inflation intensification in trade partners, while in the second half of 2016, higher pressures also with food and energy components are expected, in line with expectations for growth in world oil and wheat prices. To a smaller extent, effects on inflation are expected also from the further growth of domestic demand and increase in core inflation. The risks to the projected inflation path in 2016 is mainly related to the volatility of world prices of primary products and the uncertainty about their future movements. **In 2017 the inflation is expected to stabilize at 1.6% amid further recovery of domestic demand, growth in the foreign effective inflation and a slight increase in import prices of food and energy.**

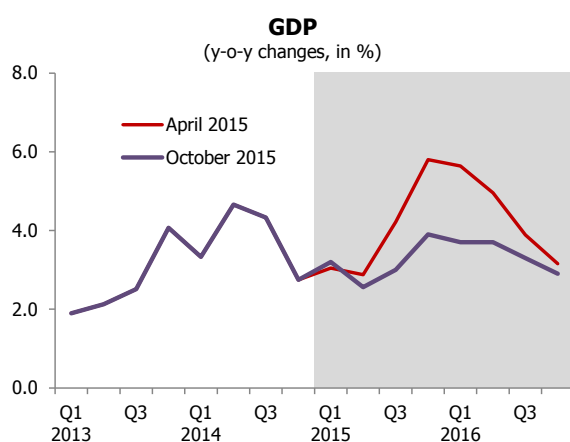
5.3. Comparison with the previous forecast

Amid a less favorable external and domestic environment, the projections for the growth of the domestic economy in 2015 and 2016 has been revised downwards compared to the

Forecast of selected macroeconomic variables

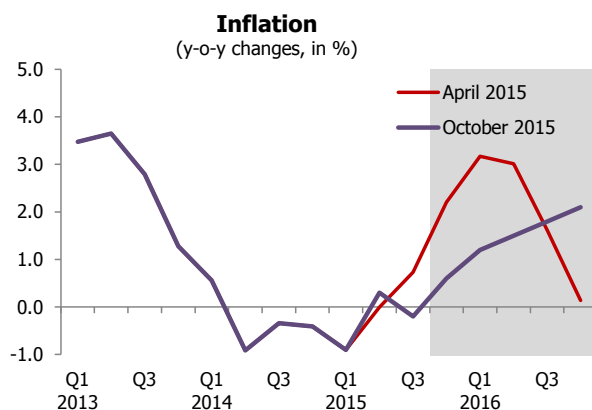
annual rates of change (in %)	2015 forecast		2016 forecast		2017 for.
	Oct.	Apr.	Oct.	Apr.	Oct.
GDP	3.2	4.1	3.5	4.5	4.0
Private consumption	1.9	3.1	2.2	3.0	3.2
Gross capital formation	2.7	10.0	10.4	10.1	7.1
Public consumption	4.0	1.3	1.4	1.4	1.3
Exports of goods and services	3.4	5.9	6.2	6.5	4.3
Imports of goods and services	1.9	6.3	6.8	6.2	4.2
Inflation	0.0	0.5	1.5	2.0	1.6
Current account deficit (% of GDP)	-0.5	-1.6	-1.9	-3.1	-2.4

April estimations. In terms of price movements, the latest estimates also indicate a lower inflation rate in the current and the following year, mainly due to lower import prices than expected. In this forecasting round, assessments point to smaller current account deficit in 2015 and 2016. On the other hand, the financial flows expected lower inflows on cumulative basis over the period 2015 - 2016, compared to April projections. Given the worsened macroeconomic environment, the projected credit growth for the 2015-2016 period has also been revised downwards relative to the April projections.

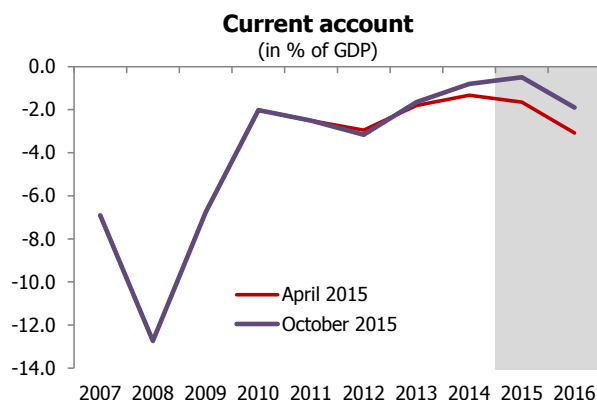


Despite solid performance in the first half of the year, which is almost in line with expectations, the deteriorated external environment and increased domestic political turmoil cause the downward adjustments in expectations for the economic growth. **Thus the projection for GDP growth in 2015 was revised downwards, which is now projected at 3.2%, compared to the April forecast of 4.1%.** Regarding the growth structure, larger changes were not made. Namely, observed by individual components, the exports remain a major driver of the growth, with the estimations for the growth of the individual components of domestic demand being preserved. However, compared to the April forecasts, the contribution of the total *domestic demand* is smaller. Such changes are largely related to the changes in the projection of gross investments, which are now estimated to register significantly lower growth compared to the April projection. Moreover, it is likely that the drop in investments results from changes in their volatile component (inventories), which should be temporary. Furthermore, the expected rise in the private consumption is lower, which is influenced by the general political environment in the country and changes in the expectations about the trends on the labor market, as well as the downward revision of the credit growth, which could influence towards greater restraint of the households for consumption of goods until the end of the year. Another important difference with the April projection is that it is now expected a significant positive contribution to GDP growth that will come from public consumption, according to the Budget revision. Less favorable external environment led to slight downward correction to estimations of the export growth. However, the downward revision of the real import relative to real export of goods and services is higher, now expecting small positive contribution of the net exports in 2015, compared to the previous

projection, when it was envisaged that it would adversely affect the economic growth. **Less favorable external economic environment and the impact of domestic economic factors have resulted in a downward revision of the forecast for the GDP growth in 2016 from 4.5% to 3.5%.** However, the growth structure remained almost unchanged. Thus, the assessments about the economic growth driven by exports and investment were maintained, the latter stimulated largely by government investments in infrastructure. Regarding the increase in the public consumption, no changes relative to April were made, thus expecting this component to maintain the minimum positive contribution to the overall growth in 2016. Larger downward change was made in private consumption, as a prolonged effect of the less favorable assessments about the domestic and external environment and downward change in the assessments for the credit support to this sector of the domestic banking system. In terms of domestic demand and net exports, the current assessments show a slightly smaller positive contribution of the domestic demand and higher negative contribution of net exports.



The realization with the inflation in the first three quarters indicate downward deviations compared to April projections. However, the deviations are due to energy and food component, while the core inflation was in line with the assessment in April. Taking this into account, and amid expectations for further pronounced downward movements in market energy and food prices compared to the previous projection, **a downward revision in the inflation rate in 2015 and 2016 was made.** Thus, it is now forecasted that in 2015, the inflation will equal about 0%, unlike the April assessment for 0.5% inflation, while in 2016, the inflation will be around 1.5%, versus the expected 2% in April.



According to recent estimates, the current account deficit is expected to improve relative to the April cycle of projections. **By the end of 2015, it is expected that the deficit will be 0.5% of GDP, instead of the previously expected 1.6% of GDP.** The downward correction of the current account deficit, mainly results from lower deficit in primary income (due to lower estimated amount of reinvested gain and lower interest payments) and lower negative gap in the foreign trade of goods and services. At the same time, the position of secondary income has



also registered a slight upward change.

Almost identical downward correction in the current account deficit is expected in 2016, when it is expected to reach 1.9% of GDP, compared to 3.1% of GDP according to the April projection. The smaller current account deficit is again a consequence of the lower deficit in goods. Thus, compared with the April projection, the improved balance is due primarily to lower non-energy deficit, i.e. smaller import pressures from raw materials and investment imports, as well as more favorable energy balance. At the same time, it expected higher surplus in secondary income and a lower deficit in primary income.

From the viewpoint of financial flows, cumulatively in 2015 and 2016, lower inflows compared to the April 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, %)		
		2015	2016	2017	2015	2016	2017
IMF	October 2015	3.2	3.2	3.3	0.1	1.3	1.8
World Bank	September 2015	3.2	3.4	3.7	-	-	-
European Commission	November 2015	3.2	3.5	3.5	0.2	1.0	1.7
EBRD	November 2015	3.5	3.5	-	-	-	-
Consensus Forecast	October 2015	3.3	4.0	-	0.3	1.8	-
National Bank of Greece	October 2015	3.2	3.4	-	-	-	-
Ministry of Finance of the Rep. of Macedonia	September 2015	3.5	4.0	-	0.7	2.0	-
National Bank of the Republic of Macedonia	October 2015	3.2	3.5	4.0	0.0	1.5	1.6

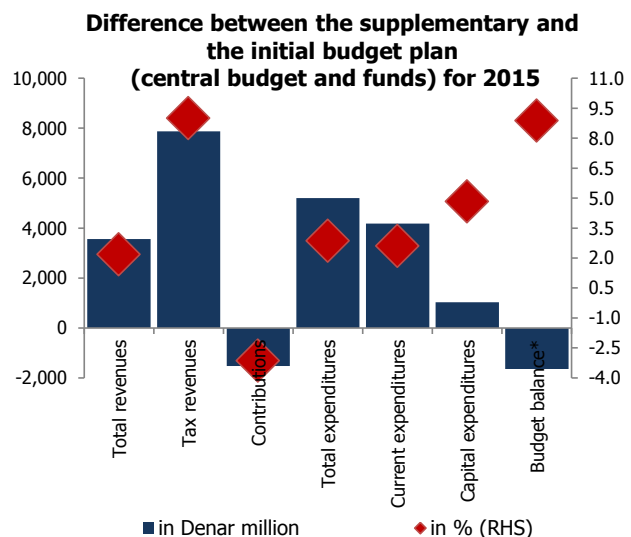
Source: IMF World Economic Outlook, October 2015; World Bank SEE Regular Economic Report No.8, September 2015; European Commission European Economic Forecast, November 2015; EBRD Regional Economic Prospects, November 2015; Consensus Forecast, October 2015; NBG Southeastern Europe and Mediterranean Emerging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

VI. Analytical appendices

Box 1: Budget Revision of the Republic of Macedonia for 2015

In August 2015, Amendments to the Budget for 2015 were adopted, which envisage an increase in the total budget revenues and expenditures compared to the initial plan and realization of a higher budget deficit of 3.6% of GDP (3.4% of GDP in the initial Budget). Thus, in circumstances of improved realization of budget revenues since the beginning of the year (as of June, about 48% of the budget revenues projected with the initial plan were realized), **the budget revenues projected with the revision are higher by 2.2% compared to the initial plan.** The upward correction of the budget revenues is connected primarily to the expected higher growth in tax revenues, which intensified from the beginning of the year, primarily driven by increased collection of profit tax. Thus, as of June, revenues from the profit tax surpassed the plan for the entire year by about 49%, which is largely explained by the tax changes in the area of taxation of profits, which became effective from the beginning of the year⁷⁹. Solid performance was registered in other tax categories whose rate of execution of the initial plan as of June ranged from 42% for import duties, up to 53% of revenues from excise and personal income tax.

The Revision envisages changes also in the amount and the structure of the total expenditures in order to harmonize the budget funds with the realization dynamics of planned projects and successful realization of the goals and policies by the end of the year. In that context, it is now envisaged **higher budget expenditures by 2.9% compared to the initial plan, with larger upward correction being made within the scope of the current, and less in the area of capital expenditures.** Such changes on the expenditure side include reallocation of funds among budget users within the ensured salary amount and provide additional funds for the planned increase in the salaries of security forces; providing additional resources to overcome the consequences of natural disasters in the municipalities; providing additional funds for co-finance of the IPA funded projects, TAIB 2011 funds⁸⁰ and regional development operational program, within which until the end of the 2015 it is planned to sign contracts for the construction of wastewater treatment plants in several towns in the Republic of Macedonia - Radovis, Kicevo, Berovo, Kumanovo, Strumica; providing additional resources for social rights, according to the latest trends to achieve them, and further increase in social contributions since June this year; providing additional funds to the Pension and Disability Insurance Fund in order to enable smooth payment of pensions; providing additional resources to increase student and pupil scholarships, as well as funds for tablet vouchers for students; harmonization of budgetary allocations for interest and principal repayment with the executed transactions in the area of external and domestic debt according to the amortization plans; providing additional resources for the purpose of intensifying the construction of the national gasification system in Macedonia.



*Negative change in Denar million refers to higher budget deficit in the Supplementary Budget.
Source: Ministry of Finance.

⁷⁹ From the beginning of 2015, the anti-crisis measures (adopted in 2009), with which the companies were released from taxation on undistributed earnings, became void.

⁸⁰ First component of the Instrument for Pre-Accession Assistance (IPA) - Assistance in transition and institution building (TAIB).

According to the Revision, **the budget deficit in 2015 is expected to be 3.6% of GDP.** The budget needs to finance the deficit and liabilities based on domestic and external debt is planned to be covered through a combination of domestic and foreign sources in order to achieve the optimum combination in terms of financing costs. Compared with the original plan, the Revision provides increased reliance on domestic sources of financing by issuing government securities on the domestic market at the expense of reduced funding from abroad.

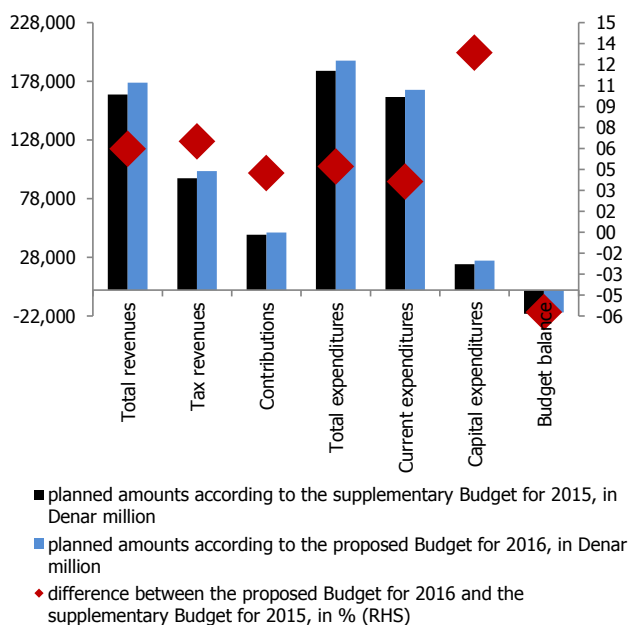
Box 2: Budget of the Republic of Macedonia for 2016

In September 2015, the Government of the Republic of Macedonia adopted the Draft Budget of the Republic of Macedonia for 2016. According to the Draft Budget, **the total revenues of the consolidated budget (central budget and budgets of funds) for 2016 were planned at the level of Denar 176,804 million**, which means an expectation to generate 6% higher revenues compared with 2015, according to the Budget Revision. **Total realized budget expenditures in 2016 are expected to be in the amount of Denar 195,788 million**, representing growth of 4.7% compared with the projection of the budget expenditures for 2015, according to the Budget Revision. Given such planned dynamics of total budget revenues and expenditures **for 2016, realized budget deficit is expected to be in the amount of Denar 18,984 million, or 3.2% of the GDP.** This Budget for 2016 is moderate consolidation of the public finance compared to 2015, for which the realization of the budget deficit of 3.6% of GDP is planned, according to the Budget Revision for 2015.

Within the structure of the budget revenues, the highest rate still accounts to tax revenues, where higher collection compared to 2015 is expected (6.5% compared to the Revision), driven by expectations of positive economic performance and dynamics of revenue collection in the current 2015

year. The structure of total budget expenditure is planned in function of supporting the domestic economy growth by investing in important infrastructure projects, maintaining social security and stability, and improve the economic situation and living standard of the population, primarily the most vulnerable categories of citizens. The Draft Budget retains the commitment to pursue a disciplined budget spending towards restrictive and rigorous control over less productive costs without disrupting the normal functioning of the budget users. The allocation of expenditures between current and capital expenditures is similar to the Budget Revision for 2015 (and the initial plan of the Budget for 2015), given planned share of current in the total budget expenditures at the level of about 87%. **In 2016, it is envisaged a higher realization of current expenditures compared to the Budget Revision for 2015 (by 3.6%),** which is expected to provide regular funding of the wages for the public sector employees, prompt and regular payment of pensions and social contributions, as well as payment of subsidies for agriculture. The Budget envisaged also an increase in pensions by 5% on average, starting with September pension, paid in October 2016 and welfare also by 5% for June, to be paid in July 2016. **The capital expenditures, which represent the development component of the fiscal policy in 2016**

Budget proposal for 2016 and supplementary Budget for 2015



Source: Ministry of Finance and NBRM calculations.

The capital expenditures, which represent the development component of the fiscal policy in 2016

should be in the amount of Denar 25,092 million, which exceeds the level envisaged in the Budget Revision for 2015 by 12.9%. In this framework, funds are envisaged for investments in the construction of the Corridor 10 highway and the railway infrastructure, energy and utility infrastructure, investments for managing technological and industrial zones, as well as capital investments aimed at improving the conditions in the health, educational and social system, agriculture, justice, in the area of public order and security, defense, culture and information technologies.

The funds for the projected deficit for 2016 and the debt repayment is planned to be provided through foreign borrowing by issuing a Eurobond on the international capital market, by borrowing on the domestic market of government securities and the disbursement of favorable loans from international financial institutions and credit lines for financing certain projects. In managing domestic debt, the Ministry of Finance will be oriented toward increasing the maturity of issued debt securities by issuing government bonds with longer maturity in order to optimize payments and reduce the risk of refinancing.

As stated in the Draft Budget, **such a designed projection of public finances for 2016, which assumes maintenance of a moderate level of deficit, in circumstances where significant funds are earmarked for infrastructure investment and providing an adequate level of social protection, will positively influence towards acceleration of the economic growth and maintenance of sound fiscal position.**

Box 3: Assessment of money demand with reference to the equilibrated level of money supply in the Republic of Macedonia

The models for the demand for money are one of the main tools for analyzing monetary developments in the economy. This is related to the fact that the informative value of the monetary aggregates in the monetary decision-making process is largely conditioned by the existence of a sound long-term function of the demand for money. Models for money demand is a solid framework for assessing the stability of demand for money by binding of the money supply with other macroeconomic variables such as income, the level of prices and interest rates. If well specified, they may represent a useful indicator of monitoring changes in the demand for money, identification of factors and evaluation of the nature of these changes, in terms of whether they are a fundamental macro economically driven changes, or a temporary adjustment of the demand for money influenced by specific factors. As such, the analysis of money demand can be an important input in the process of making monetary decisions.

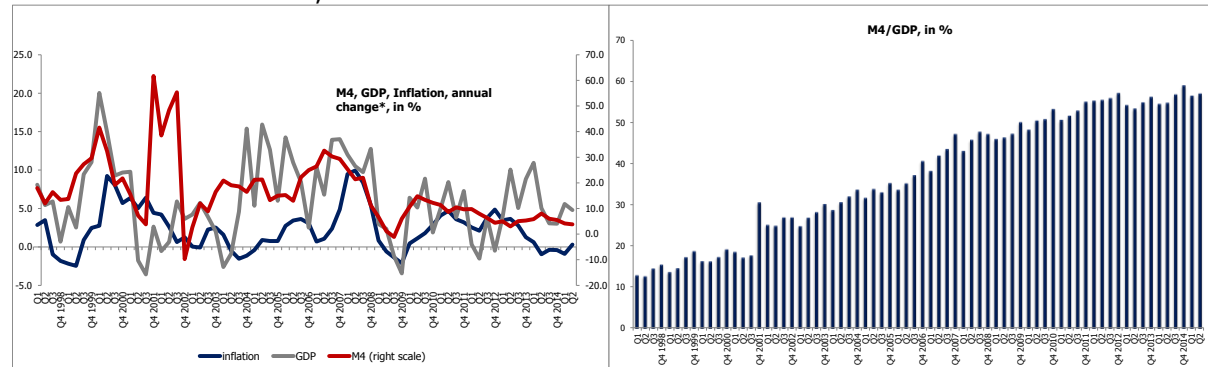
This brief analysis shows the results of the evaluation of the demand for money in the country. The analysis focuses on examining the long-run relationship between demand for money and long-term growth of the economy. In that context, the classical function of the demand for money is presented through the following formulas:

$$\log(\text{rm4sa}) = c_0 + b_1 * \log(\text{rgdpsa}) + b_2 * \log(\text{cpi}) \quad (1)$$

where $\log(\text{rm4sa})$ is a logarithm of the broadest money supply M4, real, i.e. deflated by the consumer price index; $\log(\text{rgdpsa})$ is a logarithm of the real GDP; while $\log(\text{cpi})$ is a logarithm of the consumer price index. The ratios b_1 and b_2 represents the elasticities of the money supply of the real GDP and the inflation, respectively. The evaluation was made by using quarterly data for the period from the first quarter of 1997 as of the second quarter of 2015. The data are seasonally adjusted. The selection of the M4 money supply as monetary aggregate according to which the money demand is evaluated, is bound by the fact that it is the broadest definition of the money supply that provides the highest coverage of total volume of transactions in the economy. The real GDP and the consumer price index in the equation have the role of the relevant income and price variable in terms of assessing demand money. The model includes an artificial variable for 2001 in order to control the euro conversion process. The evaluation was made by using co-integration analysis techniques, i.e.

Johansen (1988) co-integration technique, which is based on the ECM (error correction method)⁸¹.

Chart 1 Movements of M4, GDP and Inflation



*it refers to the changes compared to the same period of the previous year.

Source: NBRM and SSO.

The main result of the analysis is to find a long-term bond between real money supply M4 and real GDP and inflation. The results of the co-integration bond of VEC model with the estimated coefficients are presented in the following equation:

$$\begin{aligned} \log(\text{rm4sa}) &= 22,7 + 2,7 * \log(\text{rgdpsa}) + 2 * \log(\text{cpi}) \\ \text{t-stat} &= \quad \quad [-10.4749] \quad \quad [-2.40836] \end{aligned} \quad (2)$$

As it can be seen from the equation, there is a strong statistically significant long-term connection between GDP and money supply M4. Sign before the coefficient is positive, which is consistent with the theory, based on the setting that the income growth should be supported by appropriate growth of the money supply and vice versa. The size of the coefficient indicates the elasticity of the money supply relative to GDP, i.e. in case of 1% GDP growth, money supply increases by 2.7%. According to the theory, the elasticity of the money supply of GDP is expected to be about 1, which implies growth of the money supply, which is approximately proportional to GDP growth, in order to provide adequate support to the volume of total transactions in the economy. However, it is often expected to obtain a long-term elasticity of GDP which exceeds one, especially in the developing countries. This is associated with a relatively smaller development of financial systems in developing countries and the limited supply of financial instruments, with the most of the transactions in the economy is realized through some form of money supply. In such conditions, the increase in income causes more than proportionate increase in the money supply. In developed countries, according to diversified structure of financial institutions and instruments, GDP growth may be followed by growth of other forms of financial assets other than money supply, and thus the elasticity of the money supply would be priced in the range close to the one. The relatively lower financial integration of developing countries in the global market can also have an influence, with the growth in the money supply being kept within the economy, unlike developed countries where due to the high financial integration, outflows from the economy are possible. An additional factor that may contribute to the higher sensitivity of the money supply of the income in developing countries is the low initial position, i.e. the low level of savings in the first years of the transition, which was later reflected in faster growth of money supply relative to income as part the process of convergence towards the monetization levels characteristic for the developed countries.

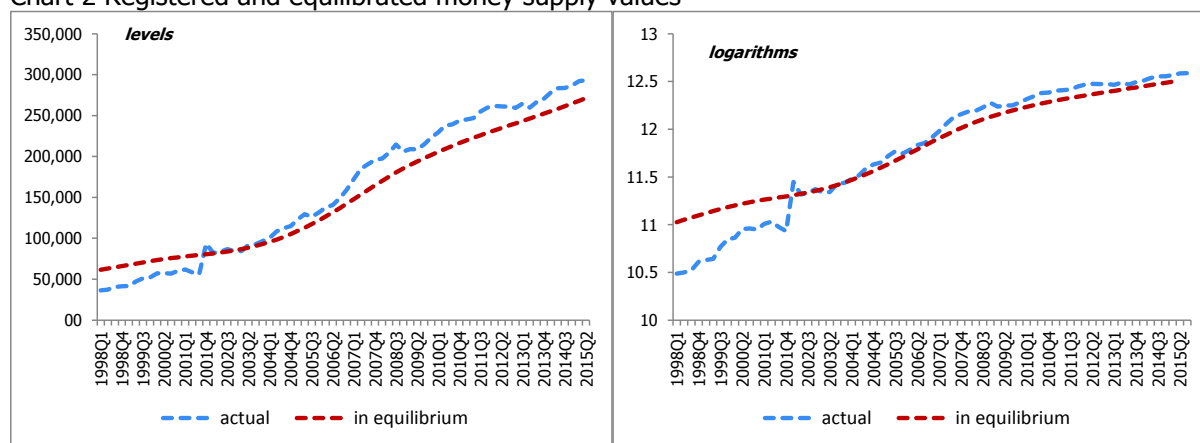
In terms of inflation, which in some specifications is used as a measure of the opportunity cost, the theory suggests a negative connection with the real money supply. The increase in the inflation is expected to increase the demand for real goods and to reduce the demand for money. The **findings** of our research of the sample from 1997 - 2015, **show a statistically significant, but positive ratio before the inflation**, indicating growth of the money supply M4 of 2% given an

⁸¹ According to the Trace co-integration test, there is a co-integration vector at the level of 0.05. Also, a significant Error Correction term is obtained.

increase in the price level of 1%. The positive ratio before inflation suggests the need for inclusion of additional variables in the function of money demand, such as interest rates, as better indicator of opportunity cost.

In addition to the analysis, we assess the equilibrated money supply level by using the obtained coefficients of the long-term relationship. It allows to determine the surplus/shortage of liquidity in the system which affects the primary objective of monetary policy - the price stability. One of the better concepts for determining the deviation of the actual equilibrated levels of money supply, i.e. excess liquidity that is pronounced is the so-called money overhang/shortfall approach. It is calculated as the difference between the realized actual values of certain monetary aggregate and the estimated long-term relationship of the demand for money. The advantage over other approaches for determining the excess liquidity (such as determining the difference of the actual with certain reference values) is that the long-term relationships also take into account the developments in the economy and structural changes that occur. To determine the reference level, the GDP actual values and inflation are taken into account (Polleit и Gerdesmeier 2005). The results are provided in Chart 2.

Chart 2 Registered and equilibrated money supply values



Source: NBRM calculations.

As can be seen from the chart, **the analysis shows no significant deviation of the realized from the estimated money supply. Thus, according to the analysis in the period from 1998 to 2001, moderate downward deviation is characteristic**, followed by approximately two-year period when the money supply is maintained at balanced level. **The period from 2003 onwards is characteristic for the maintenance of higher money supply than the balanced one. However, they are relatively small deviations going in both directions, especially evident in the growth rates, which leads to the conclusion that the increase in the money supply during the analyzed period was basically in line with the fundamentals that determine the money supply.**

In summary, the findings resulting from this study suggest the existence of a long-term relationship between the money supply and a standard set of explanatory variables used to determine the function of the demand for money. Such findings validate the usefulness of the information the monetary aggregates contain for the process of making monetary decisions. The analysis of the deviations of the money supply compared to the assessment of the analyzed period does not indicate significant imbalances in the supply of money, indicating money supply growth in line with the fundamentals of the economy.

Box 4: Indicators of the developments in the tourism sector in Macedonia

The tourism is one of the most dynamic economic sectors and as such can provide significant support to growth of the economic activity. Worldwide, the number of tourists

reached 1.135 million in 2014, which is higher by 4.4% than in 2013, thus completing the five-year period of continuing growth in this sector that started in 2010. According to projections of the World Tourism Organization (WTO), the expected number of tourists in the world to 2030 is 1.8 billion people. In addition, in its Annual Report for 2014, the WTO highlights the large resilience of this economic sector and its ability to adapt in terms of major macroeconomic turbulence and a high degree of uncertainty, such as the situation in the global economy in recent years. Namely, despite the slow recovery of the global economic activity, the achievements in the tourism sector go beyond the expectations for several years in a row. In 2013, the tourism-based inflows participated with about 30% in the world export of services and approximately 6% in the total exports⁸². Such performances prove the importance of tourism as a sector that could generate significant positive effects for long-term economic growth. There are several channels through which tourism stimulates the economic growth. According to *tourism-led growth hypothesis*⁸³ the tourism provides higher capital inflows, encourages investment in new facilities, enhances competitiveness, as well as positive spillover effects on other economic sectors and higher employment. Also, tourism can act positively on human capital as encourages transfer of new technology, knowledge and skills. Theoretical predictions in terms of the importance of tourism for economic growth are confirmed in a larger number of empirical studies, which find positive connection between the development of the tourism sector and the GDP growth (Dritsakis, 2004; Balaguer and Cantavella-Jorda, 2002; Barro and Sala-i-Martin, 1992⁸⁴).

When it comes to Macedonia, tourism is not a leading economic sector - in the period 2004 to 2013 the share of the tourism sector in Macedonia's GDP is only 1.3%, and it is relatively stable⁸⁵. In the same period, GDP registers a cumulative growth of 30%, while the growth of the tourism sector accounted for only 15% (cumulative contribution to GDP growth of only 0.2 percentage points). According to the data of the balance of payments, the tourism accounts for around 16.3% of services exports and 5.2% in exports of goods and services in the period 2003-2014. However, the potential positive effects that the tourism sector could generate on the long-term economic growth, is a motive for continuous efforts, in order to improve the quality of this type of services. This box analyses the developments of tourism sector in Macedonia⁸⁶. Namely, it is focused on the indicator tourist arrivals⁸⁷, which is discussed from the aspect of regional distribution of tourists, as well as from the viewpoint of the country of origin of the foreign tourists.

Historically, the number of tourists in Macedonia registers a long-term growth trend starting from 1959 until 1987, when it was around one million persons, i.e. increased by about 4 times compared to the beginning of the period. After 1987, parallel to the beginning of the transition and risen political and economic uncertainty in the region, drastic reduction in the number of arrivals of tourists in Macedonia has been registered. The fall is especially pronounced among foreign tourists (drop in the number of foreign tourists from 82% in 1997 vs. 1987, or 689 thousand persons in 1987 to only 121 thousand in 1997), while the number of domestic tourists is maintained relatively stable. After 1997, the situation stabilized and a slight upward trend was registered, that was interrupted in 2001 which corresponds to the period of the internal armed conflict in Macedonia. Since 2002 the number of tourists in the country has generally been growing (cumulative growth within 2002-2014

⁸² World Tourism Organization, Annual Report 2014.

⁸³ Balaguer, J. and M. Cantavell-Jorda, 2002, "Tourism as a Long-run Growth Factor: The Spanish Case," *Applied Economics*, 34, No. 7 (May 2002): 877-884.

⁸⁴ Dritsakis, Nikolas, 2004, "Tourism as a Long-run Economic Growth Factor: An Empirical Investigation for Greece," *Tourism Economics*, 10 (3), (September 2004):305-316; Balaguer, J. and M. Cantavell-Jorda, 2002, "Tourism as a Long-run Growth Factor: The Spanish Case," *Applied Economics*, 34, No. 7 (May 2002): 877-884; Barro, R. J. and X. Sala-i-Martin, 1992, "Convergence," *Journal of Political Economy*, 110: 223-251.

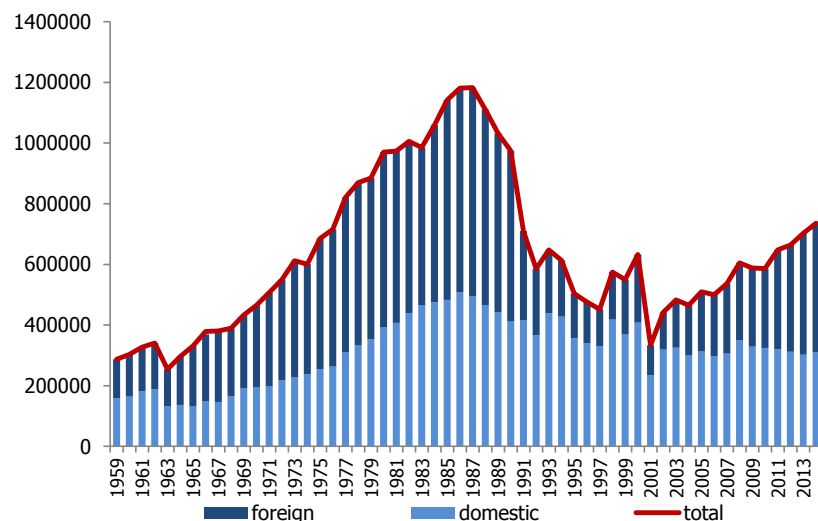
⁸⁵ The calculation of the share is according to the data on GDP according to ESA95, on the grounds that the ESA2010 methodology does not publish longer series of movements of value added in this sector at constant prices.

⁸⁶ Most of the data used in the analysis are of the publication "Tourism in the Republic of Macedonia 2010-2014", State Statistical Office of Macedonia.

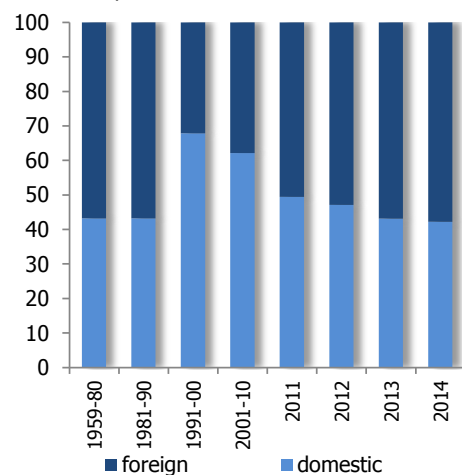
⁸⁷ The statistics registers the arrival of tourists, rather than just the number of tourists in order to avoid duplication, such as tourist to decide to change the place or the location of the stay. Thus the data are obtained on the basis of regular monthly reports of catering and other business entities that provide accommodation services to tourists (data derived from the books of guests under the legal regulations, these business agents are obliged to run). This ensures full coverage of tourists and overnight stays, with the exception of a number of tourists accommodated in private rooms, apartments, holiday homes and the like, which are not covered because they are not reported.

period of 66.5% or 293,938 persons), while the growth was entirely explained by the increased number of foreign tourists, while the number of domestic tourists has seen a slight decline. Such developments resulted in changes in the structure of tourists, i.e. increase in the share of foreign tourists (from 27.8% in 2002 to 57.8 in 2014) and a decrease in the share of domestic tourists (from 72.2% in 2002 to 42.2% in 2014). However, despite the growth in the last ten years the number of tourists is still below the peak level recorded in 1987 (the total number of tourists in 2014 versus 1987 is lower by 37.8%, 38.3% with the foreign tourists, while 37.2% with the domestic ones).

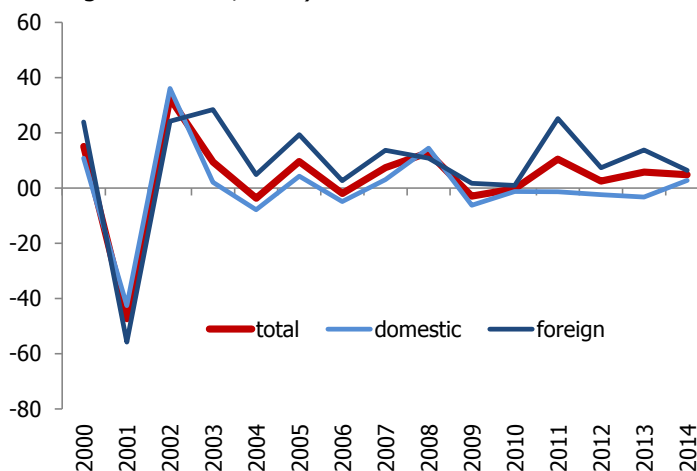
Chart 1
Tourist arrivals, 1959-2014



structure, in %



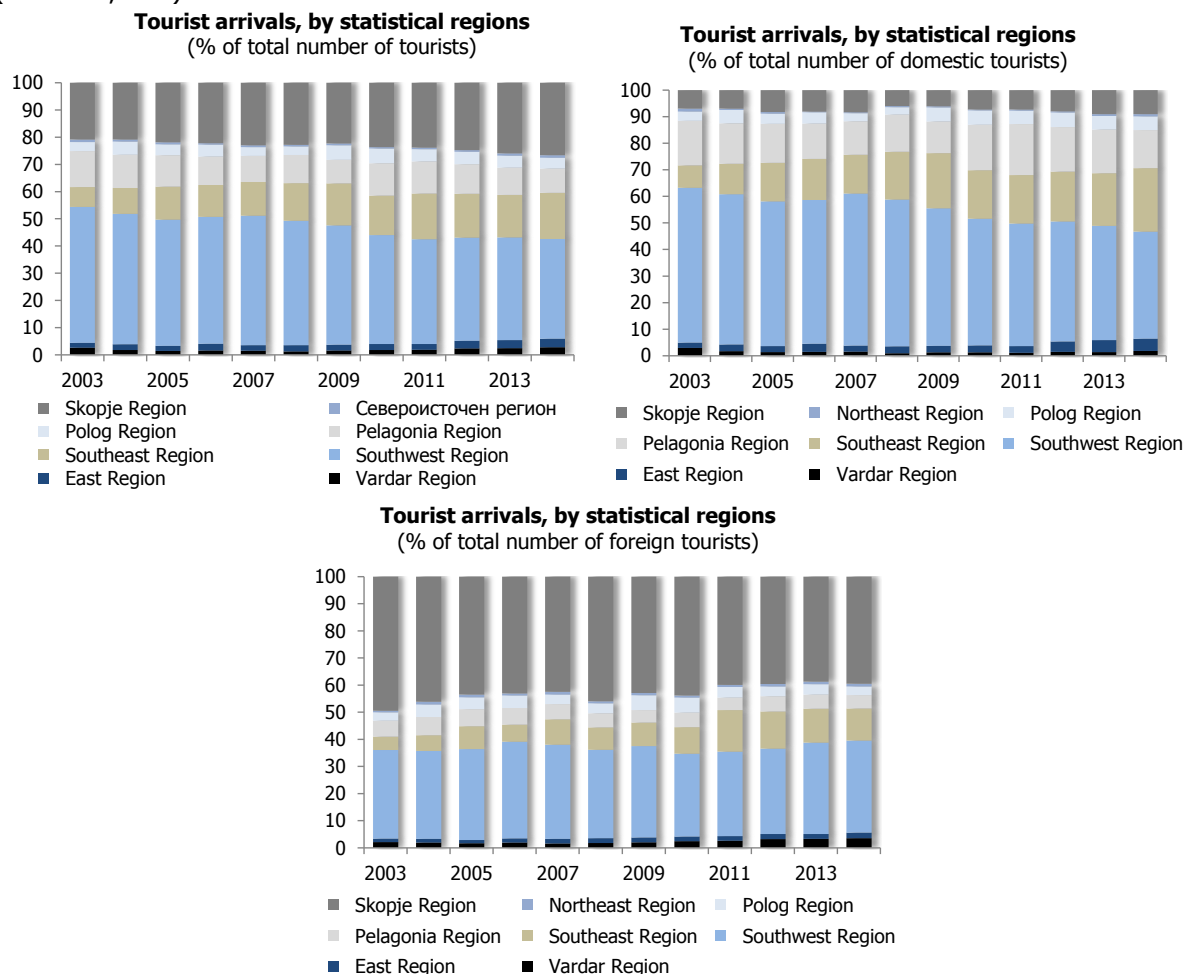
(annual growth rates, in %)



According to the data⁸⁸ on the tourist distribution by region in Macedonia, the most attractive are the Southwestern and Skopje Region. In fact, about 66% of the total number of tourists (domestic and foreign) in the period 2003-2014 stayed in these two regions. The most attractive, to domestic tourists, is the Southwestern Region (within 2003-2014 period, at an average of 51% of domestic tourists visited the region), followed by the Southeastern Region (with an average share of 17%) and Pelagonija Region (average share of 15%). On the other hand, the most attractive for foreign tourists is the Skopje Region (within 2003-2014 period, at an average of 43% of foreign tourists stayed in this region), followed by the Southwestern Region (with an average share of 33%).

⁸⁸ The data on the number of tourists by region, as well as by the country of origin are available since 2003.

Chart 2
Tourist arrivals, by statistical regions
(structure, in%)

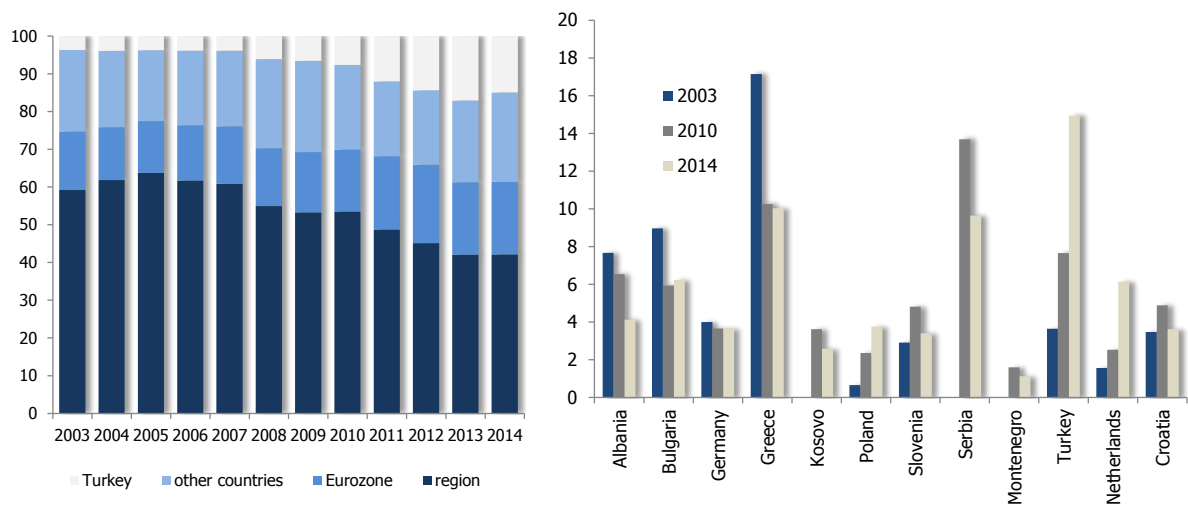


Analyzed by groups of countries, most of the foreign tourists in the 2003-2014 period come from countries in the region (average share for the period of about 54% in the total number of foreign tourists), Turkey (an average share of about 8.1% of the total number of foreign tourists) and the countries within the euro area⁸⁹ (an average share of about 16.6% in the total number of foreign tourists). Moreover, in the analyzed period, besides the tourists from Turkey, viewed by individual countries, the most numerous were the tourists from Serbia and Montenegro⁹⁰ (an average share of 15.7% of the total number of foreign tourists), Greece (an average share of 12.9% of the total number of foreign tourists) and Albania (average share of 6.51% of the total number of foreign tourists). According to the dynamics, trend of intensive increase in the number of tourists coming from Turkey (especially in 2008) and the Netherlands (especially after 2011) has been registered. On the other hand, during the period covered, continuous decrease in the share of tourists coming from most of the countries in the region has been registered, with the largest drop being recorded with the tourists from Serbia and Greece.

⁸⁹ With the exception of Slovenia and Greece, which are included in the region.

⁹⁰ Data on Serbia and Montenegro in the period 2003-2007 are maintained together (in the period until 2006 these two countries were one state), while after 2008 they are presented separately. During 2008-2014 period, the average share of Serbia is 12.4%, while the share of Montenegro is minimal and amounts to 1.1%.

Chart 3
Foreign tourists by the country of origin
(% in the total number of foreign tourists)



Continued growth in the number of tourist arrivals, especially foreign tourists indicates growth in demand for tourism services in the domestic economy. Moreover, the most attractive tourist regions are the Southwestern and the Skopje Region, while in terms of countries of origin of foreign tourists, the most numerous are tourists from the region and Turkey, as well as tourists coming from the Netherlands, from the EU countries. **The continuation of favorable trends in this sector, complemented by appropriate policies and measures to encourage its development, would ensure further growth of the tourism sector, and hence the positive effects on long-term economic growth of the country.**