

National Bank of the Republic of Macedonia



Quarterly Report April, 2013



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Introduction

In early 2013, NBRM reduced the key interest rate from 3.75% to 3.5%.

The analysis of the latest domestic and external macroeconomic and financial conditions at that time showed that the economic recovery is likely to be slow, which pointed to the absence of inflationary pressures from the domestic demand also in the forthcoming period. The latest information related to the movements in the prices of primary products in world markets indicated less pressure from import prices, which together with the initiated stabilization of the growth of domestic prices towards the end of 2012, was the reason for the NBRM to assess the risks to inflation as reduced expecting it to remain moderate in the medium term. In 2012, foreign reserves achieved higher growth than expected, and the latest estimates indicated no significant risks for the external sector in the next period. In these circumstances, NBRM assessed that the stability of the exchange rate and the price stability as an intermediate and ultimate monetary objective, could be achieved also in more relaxed monetary conditions. Since the beginning of 2013, changes in the reserve requirement came into force¹, which meant additional support for the credit growth. By the end of April, NBRM did not make changes in the monetary policy setup, expecting the occurrence, with a certain time lag, of stimulating effects on the economy from the monetary easing already conducted in 2012 and early 2013. The restraint from additional monetary changes in this period was underpinned by the presence of certain risks to monetary policy. It was estimated that potentially greater than expected pressures on foreign reserves in the future may come through the changes in currency preferences of domestic entities. Lowering of the interest rate of the NBRM was estimated to possibly influence the yields on Denar savings and the propensity to save in these instruments. Despite the lower inflation risks observed from a viewpoint of headline inflation, core inflation remains off track, indicating larger transmission effects from the increase in the prices of food and energy on other prices in the economy. Additional risk were the information regarding the deteriorated expectations about metal prices in the world market, which pointed to the risk of possibly worse export performance.

In between the two projections, macroeconomic developments in the domestic economy were largely in line with the January expectations. At the same time, there were no significant changes in the assumptions for the global setting, which resulted in retaining a similar macroeconomic scenario as in the January cycle. Thus now, same as in the January projection, GDP growth of 2.2% is expected in 2013, amid nearly balanced contribution of export and investment demand, supported by foreign and public investments. More significant recovery of exports is expected in 2014, which corresponds with the expectations for improved economic performance of the major trading partners, as well as estimates for the increased utilization of the new foreign facilities. These developments, along with the expectations for maintaining the positive investment cycle and the revival of private consumption are expected to contribute to GDP growth by around 3% in 2014, which is in line with the January expectations. Support for the economic growth in the next period is expected also from the banking sector, which is in line with the **expectations for accelerated lending to a level of about 7%, i.e. 8% annual**

¹ See more detail in the Quarterly Report, January, 2013 in the section on monetary policy.



growth in 2013 and 2014, respectively. Availability of healthy fundamentals, expressed through appropriate levels of capitalization and liquidity of the domestic banking sector, together with the relaxation of the monetary policy points to a room for more active lending to the private sector. At the same time, expectations for gradual improvement of the economic conditions in the country and abroad are expected to improve banks' perceptions of the level of credit risk with private entities, as a major limiting factor for increased lending activity in the previous period, which would also contribute to moderate activity on the credit market in the next period.

Despite the estimates for revival of the economic activity, the current macroeconomic scenario assumes the recovery to be slow, with expectation of closing the negative output gap in the second half of 2014. These developments suggest further retention of the assumptions about the absence of more significant pressures of the domestic demand on inflation also in the next period. On the other hand, the latest information on the expected dynamics of world food prices in the period ahead show reduced pressures from import prices, which together with the lower inflation achieved in the first quarter, compared with the January projection, resulted in a downward revision of the inflation rate for 2013. **Thus, now we assess the annual rate of inflation in 2013 to be 2.8% (3.2% in January), while in 2014 it is still expected to approximate its historical average, so it would equal 2.3% annually.**

Within the external sector, estimates for current account deficit of the balance of payments of around 4% of GDP in 2013 remained, and it is expected to be funded entirely from the anticipated capital flows, allowing moderate growth of the foreign reserves. Compared to the previous year, this projection means moderate expansion of the current account deficit, driven by the decline in the relative importance of private transfers in 2013. January forecast projected a little more intensive expansion of the current account deficit in 2013, but at estimates made at that time for lower deficit in 2012 compared to that realized. **For 2014, the current account deficit is estimated to expand to 6% of GDP (5.4% of GDP in the January projection),** amid estimates for major import pressures driven by the relatively strong investment growth, and further strengthened by the expected revival of private consumption. **However, also in 2014 it is estimated that the amount of generated capital inflows will be sufficient to ensure further growth of foreign reserves.** As in the previous projection, in both years, higher capital inflows are mainly expected from government external borrowing and foreign direct investment.

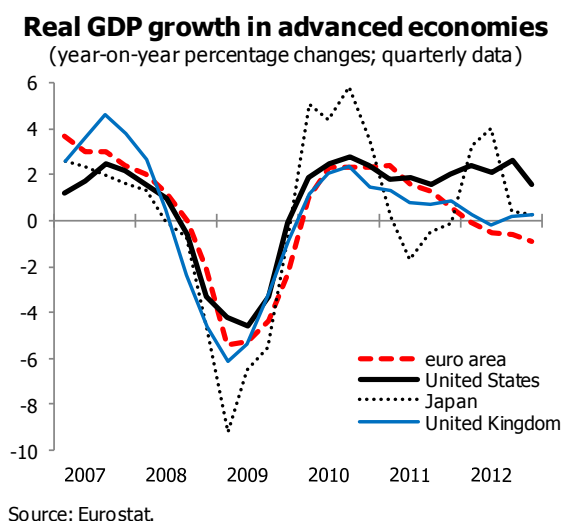
In summary, the new NBRM projections indicate a similar macroeconomic picture as in the January cycle, which envisages a gradual economic recovery and balance of payments position which enables further maintenance of foreign reserves at an adequate level. More significant change is that now lower inflationary pressures are expected compared with the January assessments. The risks around achieving this macroeconomic scenario continue to be predominantly of external nature and associated with possible changes in the dynamics of recovery of the global economic growth and fluctuations in the prices of primary products in the world markets.



I. Macroeconomic developments

1.1. International economic environment²

At the end of 2012, global economic activity continued to grow at a moderate pace, while signs of improvement, mainly in the emerging economies were registered also at the beginning of 2013. Although the global economic outlook has improved, differences in growth dynamics among the developed countries became more pronounced, with projected growth for 2013 of 1.9% for the USA and a negative rate of -0.3% for the Euro area. On the other hand, in most emerging and developing countries, after the major slowdown in mid-2012, economic activity accelerated again. Even though the policy measures in the Euro area and the USA have reduced the downward risks to global growth, it is estimated that these risks will continue to be dominant. The situation in the Euro area remains the greatest short-term threat to the global economy. In the medium term, key risks relate to the insufficient institutional reforms and continued stagnation in the Euro area, the absence of plans for fiscal consolidation in USA and Japan, the potential adverse medium term effects of the unconventional monetary measures in some of the developed economies and the possible economic overheating of some emerging economies. In the first two months of 2013, global inflation remained at the level achieved in the previous quarter, amid unchanged outlook for its movement in the coming period.

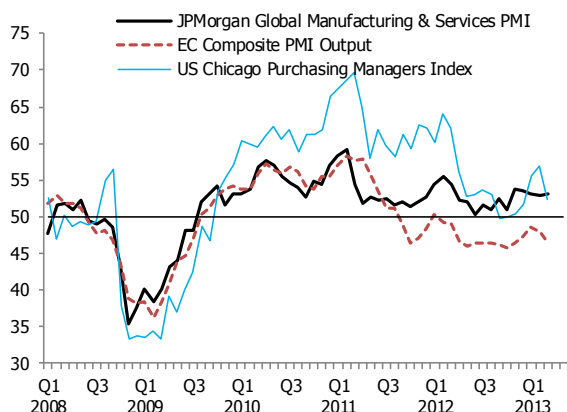


Globally, the outlook for the economic activity improved again, but the economic recovery of the developed countries is still accompanied by risks. In the past six months, policy makers in advanced countries successfully overcame the greatest immediate threats to world economic growth, the uncertainty about the future of the Euro area, and the tightening of fiscal policy in the USA caused by the "fiscal cliff" crisis. However, although the measures undertaken had a favorable impact on the condition of the financial markets, there was no significant positive

² The analysis is based on the ECB's monthly bulletin, February and March, 2012; updated "World Economic Outlook" of the IMF, January 2013, the "Forecast for the European Union" of the European Commission, February 2013, the "Quarterly Report on Employment and Social Structure in Europe" of the European Commission, March 2013, the reports of "Capital Economics" and press releases of "Markit Economics".



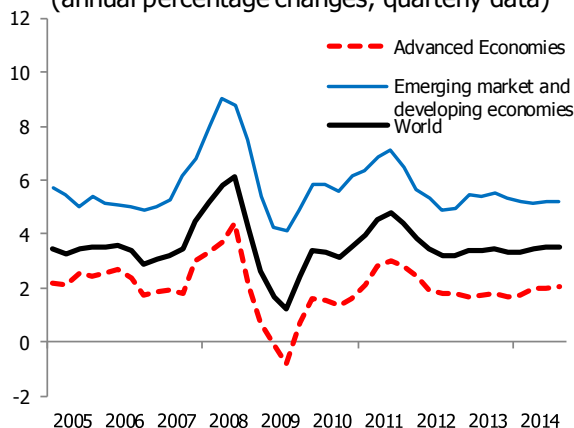
Global economic activity indicators
(monthly indices*)



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

Global inflation

(annual percentage changes, quarterly data)



Source: IMF.

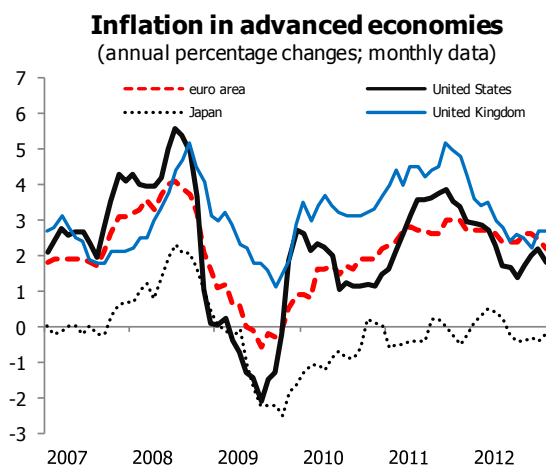
effect on the growth of developed economies. In most emerging and developing countries, stable domestic consumption, amid stimulating macroeconomic policies, and the recovery in exports led to a re-acceleration of economic activity, after the slowdown in mid-2012. Recent economic trends for the first quarter of the year indicate unchanged estimates measured by the leading indicators of economic activity - PMI. Global composite PMI registered minimal growth (of 0.1 percentage point) compared to the previous quarter, reaching 53.0 index points, with improved results in the manufacturing industry and the services sector. In terms of the expectations for the next period, the estimates in the **April IMF projections indicate that the global economy in 2013 will grow at a rate of 3.3%, which is a downward revision of 0.2 percentage points compared to the January projections.** In the short term, the greatest risks come from the Euro area and pertain to the uncertainty concerning the outcome of the Cyprus crisis, the situation in Italy and the difficulties the peripheral countries are facing. Long-term risks are related to growth prospects of the Euro area, fiscal policy in the USA and Japan, the medium-term effects of the previous relaxed monetary policy and the possible occurrence of major imbalances in emerging economies.

At the beginning of 2013, global inflation remained at the same level as in the fourth quarter. Worldwide, the average annual inflation rate³ for the first two months of 2013 was 3.5%. More significant acceleration in inflation was registered in the emerging and developing countries, where in January and February it

³ Data source is the International Financial Statistics database of the IMF.



averaged 6.7% (versus 6.1% in the previous quarter). In the developed countries, inflation rate continued to decline moderately, reaching 1.6%. According to IMF projections, in 2013, in most advanced economies inflation will continue to slow down, amid "controlled" inflationary pressures in emerging and developing countries.



Source: Eurostat and national statistical offices.

In the fourth quarter of 2012, the recession in the Euro area continued to deepen. The quarterly rate of decline in GDP was 0.6%, which contributed to the annual decline of GDP by 0.9%. A quarterly decline was registered in the four largest economies in the Euro area⁴. Despite the 0.6% decline caused by a reduction in net exports, only Germany among these countries had a positive growth rate of 0.9% during the year, with moderately favorable outlook for the future. The adverse developments in the real economy of the Euro area were inconsistent with the improving conditions in financial markets observed since the second half of last year. Namely, the measures implemented within the monetary union⁵, again increased the confidence and to a certain extent reduced the financial fragmentation⁶. Amid weak economic activity, developments in the labor market remained unfavorable. The

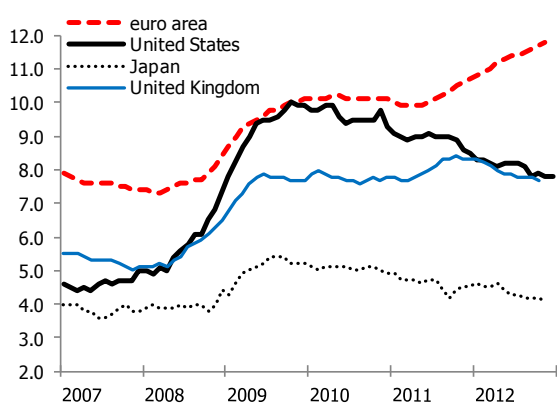
⁴ Germany, France, Spain and Italy.

⁵ The measures are related to the structural and fiscal reforms undertaken by the member states themselves, but also to the introduction of the Outright Monetary Transactions - OMT, the decision to introduce a Single Supervisory Mechanism - SSM as a first step towards the banking union, the establishment of the European Stability Mechanism - ESM and the strengthening of the institutional framework of EMU.

⁶ Financial fragmentation was manifested by a dramatic growth in the interest rate spreads between central and peripheral countries in the Euro area in some segments of the financial markets (government bonds and bank loans), threatening the monetary transmission and the implementation of the single monetary policy.



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



Source: Eurostat.

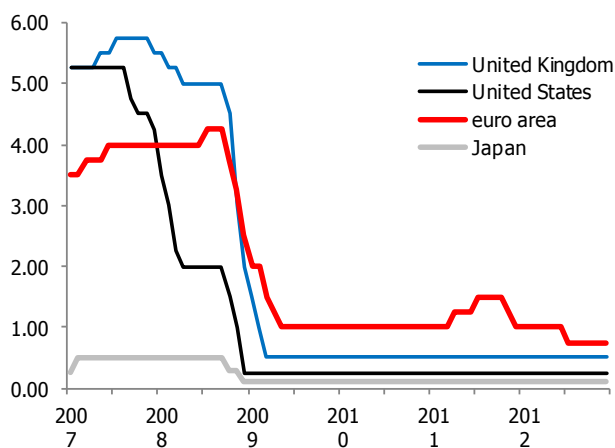
unemployment rate has increased continuously since April 2011, and in February it reached a new historic maximum of 12%, with prospects for its further increase in the short term. Analyzed by components, the changes in GDP recorded in the Euro area in the fourth quarter are due to the adverse movements in domestic demand and inventories, but also to the lower net exports. In fact, similar to the previous period, declining real disposable income, affected by inflation and unfavorable conditions in the labor market, adversely affected private consumption. Limited financing options, still high uncertainty and cross-sectoral adjustment⁷ are reasons that explain the decline in investment. Consistent with the fiscal adjustment efforts, public consumption registered minimal decline. Unlike the period since mid-2010, when net exports were the main driver of GDP growth, mainly due to limited imports, in the last quarter it had a neutral contribution to growth, with identical quarterly decline being registered in both components of the trade. In general, in 2012, the Euro area registered a decline in GDP of -0.6%. Net exports had a positive contribution to the rate of decline, amid growth in the exports and decline in the imports, while all components of the domestic demand registered an annual decline and thus had a negative contribution. **The annual growth in consumer prices in the Euro area continued to decelerate.** In the first quarter of 2013, the average annual inflation rate was 1.8%, which is within the defined inflation target of below, but close to 2% over the medium term. This is the first such inflation rate registered since

⁷ From a longer perspective, there are noticeable differences in performance among the sectors of the economy: in the fourth quarter, the value added in the construction sector was 20% lower than the maximum level reached in 2007, while the services sector is slightly above the maximum achieved in early 2008.



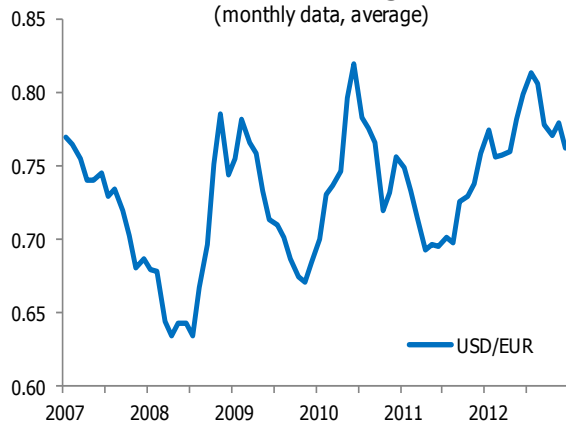
2010. The analysis of the consumer price index components indicates a significant slowdown of the energy component growth to a level of 3.2% (versus 6.3% in the fourth quarter last year). Also, a slight reduction in growth occurs in the price of food, which was reduced to 2.9%, from 3.1% registered in the previous quarter. Compared with the fourth quarter of 2012, core inflation in the January-February period moderately decreased and amounted to 1.5%.

Policy rates in advanced economies
(in %)



Source: Central banks.

USD/EUR Exchange rate
(monthly data, average)



Source: Eurostat.

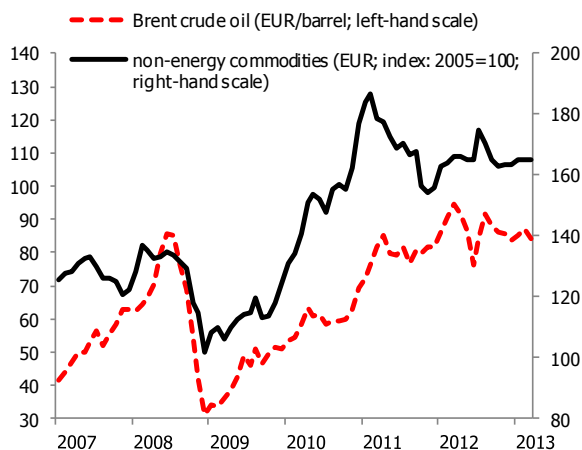
In the first quarter of 2013, the Fed, the Bank of England, and the ECB made changes in their interest rate policies and retained the policy rates at the level of 0-0.25%, 0.5% and 0.75%, respectively. Fed's Monetary Policy Committee decided to continue with the implementation of accommodative monetary policy in order to support economic growth and reduce the unemployment rate to the target level of 6.5%. In this sense, the Fed reiterated that it will continue to purchase long-term Treasury bonds and mortgage bonds until the prospects for the movements in the labor market significantly improve, without compromising price stability. The ECB made no changes in the monetary policy stance in this period.

During the first quarter of 2013, the nominal exchange rate of the Euro against the US Dollar was volatile, but on average, on a quarterly basis the Euro appreciated second quarter in a row. Thus, in January and February the Euro rose by 1.3% and 0.5%, respectively on a monthly basis, and reached a high level, last registered at the end of 2011. These upward movements were mainly due to the improved economic confidence and increased risk appetite of investors. In the same vein was the decision of the ECB to leave the key interest rate unchanged. On the other hand, in March, the precarious



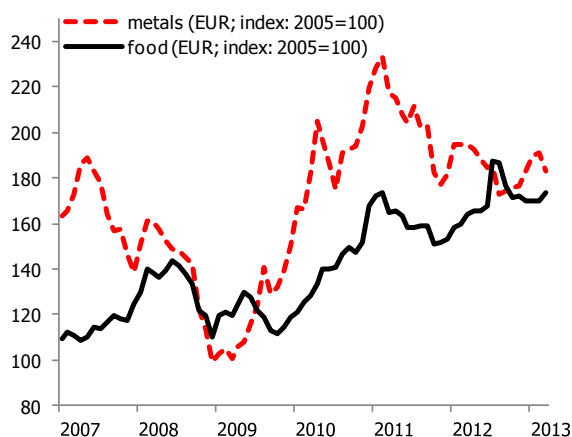
situation in the banking sector in Cyprus and the fears of market participants from deepening of the crisis despite the agreement with international creditors, contributed to the significant depreciation of the Euro by 3%. In March, the price of one Euro was 1.3 US Dollars, which is 1.2% lower than its value in December, but 0.8% higher than the average in 2012.

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



Source: IMF monthly database.

Prices of food and metals
(monthly data)



Source: IMF monthly database.

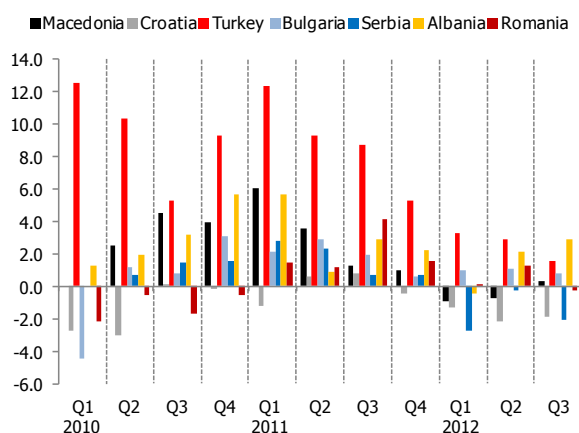
The prices of oil and non-energy primary products⁸ denominated in Euros increased in the first quarter of 2013, compared to the previous quarter. Thus, the average price of crude oil "Brent" in this period was 85.5 Euros per barrel, which is an increase of 0.4% compared with the last quarter of 2012. The increased optimism about the growth of the global economy and the increased demand due to the output growth in China and the USA, as well as the geopolitical situation in the Middle East, were the main reasons for the upward movement of oil prices. **The prices of non-energy products in the first quarter increased moderately compared to the previous quarter,** amid growth in metal prices of 5.3% and a decline in food prices of 0.7%. Within the food index, the prices of wheat and maize decreased as a result of the reduced demand and improved supply. On the other hand, the increase in metal prices, observed through the total index of metals, was due to the optimism about the recovery of the global manufacturing industry and expectations of stronger demand from China. The appreciation of the Dollar in these months had a downward impact on the price changes of primary products.

In the fourth quarter of 2012, the adverse economic developments

⁸ Price index of primary commodities includes: the prices of food, beverages, agricultural raw materials and metals.

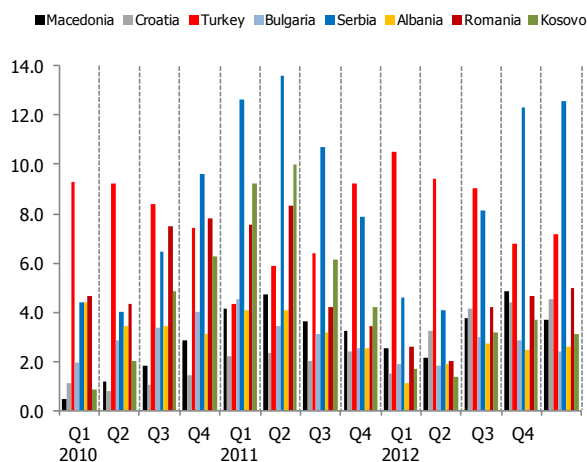


Real GDP growth in countries from the region
(annual percentage changes, quarterly data)



Source: Eurostat and national statistical offices.

Inflation in countries from the region
(annual percentage changes)



Source: Eurostat and national statistical offices.

continued in most countries of the region. Thus, on an annual basis, economic activity continued to shrink in Croatia and Serbia, while in Turkey and Bulgaria, further slowing of the economic growth was registered. After the decline in the third quarter, in the last quarter Romania registered slow economic growth, supported mainly by the growth of private consumption and improvement in net exports, while the drop in investment was a factor that influenced in the downward direction. In Croatia and Serbia, net export is the only component with a positive contribution to GDP while all other components showed negative change. Economic activity in Bulgaria slowed down for the second quarter in a row due to the decline in private consumption and investment in line with the deteriorated situation in the labor market and credit conditions, while in Turkey, the improved domestic consumption acted towards supporting the economic growth. Observed for the entire 2012, economic activity declined in Croatia and Serbia, while in the other countries in the region moderate positive growth was registered.

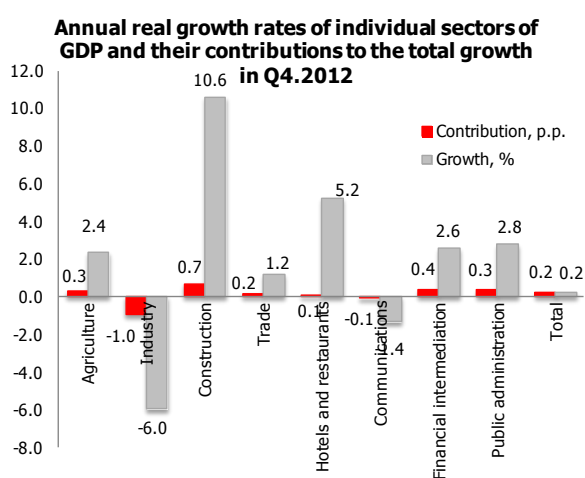
In the first two months of 2013, in most of the countries in the region moderate acceleration in the inflation rate was registered. Such movement in almost all countries is a consequence of the increase in food prices, while in Romania the increase in administrative prices and in the excise duty on petroleum and tobacco also acted in this direction. On the other hand, Croatia registered slower inflation rate due to the declining core inflation and lower effects of the imported inflation. Slowing inflation was registered also in Kosovo.

1.2. Domestic Supply

The recovery of the activity of the Macedonian economy continued in the last quarter of 2012. Given the positive quarterly movement, in the fourth quarter GDP registered an annual growth of 0.2%. With the



exception of the sectors "industry" and "transport and communication", the activity in all other sectors registered annual growth. As in the previous quarter, the largest positive contribution to the annual growth of the economy was that of the construction activity, supported by foreign and domestic investment. Moreover, growth was supported by the activity in agriculture and other services (financial intermediation, trade, public administration). Positive developments in the real sector had positive effects on the labor market, reflecting on wages and number of employees. Despite the slower decline, industrial activity had a negative impact on the domestic economy also in the fourth quarter. Transport also acted in this direction due to weaker performances in all components with the exception of telephony and passenger airtransport.



Source: State Statistical Office and NBRM.

In the last quarter of 2013, gross domestic product⁹ recorded quarterly growth of 0.7% (seasonally adjusted), which is a minimal intensification of the growth of 0.3% and 0.6% in the second and third quarters. On annual basis, this caused a small annual growth of domestic production by 0.2%. Improved quarterly dynamics in the fourth quarter, was mostly due to the growth of value added of the sector "financial intermediation", while construction, agriculture, trade and public administration had smaller and almost identical contributions. As for the annual dynamics, the largest contribution to the annual growth of domestic production was that of the double-digit growth of "**construction**", as well as the growth in financial intermediation, for the second consecutive quarter. Favorable dynamics was registered also in the value added of the sector "**trade**", whose growth increased for the second quarter in a row, after the annual decline in the first half of the year. Improved performance in the fourth quarter was registered in agriculture and other sectors of the domestic economy, with the exception of "**industry**" and "**transport and communications**". In fact, the decline in the industrial activity, which has been in the zone of negative

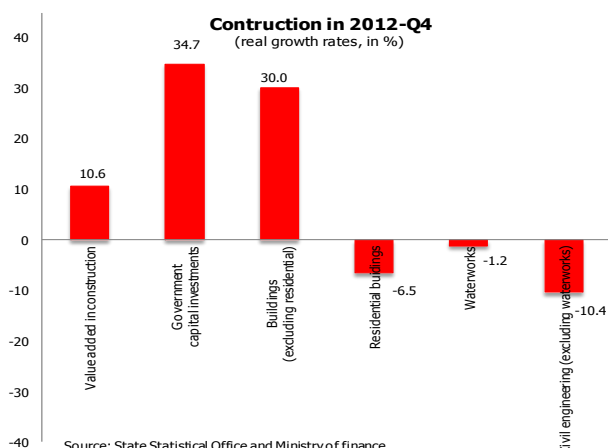
⁹ GDP data for 2011 and 2012 are estimated data of the SSO.



changes for five consecutive quarters, in the fourth quarter largely offset the growth of value added of other sectors of the domestic economy.

	annual growth rates, in %										contributions to GDP growth (in p.p.)									
	Q1 2011	Q2 2011	Q3 2011	Q4 2011	2011	Q1 2012	Q2 2012	Q3 2012	Q4 2012	2012	Q1 2011	Q2 2011	Q3 2011	Q4 2011	2011	Q1 2012	Q2 2012	Q3 2012	Q4 2012	2012
Agriculture	9.5	2.7	-9.1	6.0	1.4	-0.4	2.2	0.6	2.4	1.4	0.8	0.3	-1.1	0.7	0.1	0.0	0.2	0.1	0.3	0.1
Industry	16.5	6.5	0.5	-3.9	4.2	-8.7	-7.2	-7.6	-6.0	-7.4	2.9	1.1	0.1	-0.7	0.7	-1.6	-1.3	-1.3	-1.0	-1.3
Construction	20.1	20.6	8.0	6.8	12.3	-11.5	-6.0	16.7	10.6	4.6	0.7	1.0	0.4	0.4	0.6	-0.4	-0.3	0.9	0.7	0.2
Trade	2.9	14.4	0.9	2.0	5.0	-0.4	-2.3	0.8	1.2	-0.2	0.4	2.0	0.1	0.3	0.7	-0.1	-0.4	0.1	0.2	0.0
Hotels and restaurants	3.4	5.5	12.2	6.3	7.3	3.1	5.4	4.4	5.2	4.6	0.0	0.1	0.2	0.1	0.1	0.0	0.1	0.1	0.1	0.1
Communications	6.2	2.4	5.6	0.3	3.4	3.4	-1.9	2.0	-1.4	0.4	0.6	0.2	0.5	0.0	0.3	0.3	-0.2	0.2	-0.1	0.0
Financial intermediation	-0.3	0.9	0.0	3.2	1.0	3.4	4.0	1.8	2.6	2.9	0.0	0.2	0.0	0.5	0.2	0.6	0.6	0.3	0.4	0.5
Public administration	1.0	0.7	-0.8	-2.5	-0.4	0.3	1.0	1.6	2.8	1.4	0.1	0.1	-0.1	-0.3	-0.1	0.0	0.1	0.2	0.3	0.2
Value Added	6.6	5.7	0.2	0.6	3.1	-1.8	-1.6	0.3	0.6	-0.6	5.8	4.9	0.2	0.5	2.6	-1.6	-1.4	0.2	0.5	-0.5
Net taxes on products	2.2	-8.1	6.7	3.0	1.1	5.0	4.8	0.4	-1.3	1.7	0.3	-1.1	0.9	0.5	0.2	0.6	0.6	0.1	-0.2	0.2
Gross Domestic Product	6.1	3.6	1.3	1.0	2.8	-0.9	-0.7	0.3	0.2	-0.3	6.1	3.6	1.3	1.0	2.8	-0.9	-0.7	0.3	0.2	-0.3

Source: State Statistical Office and NBRM calculations.

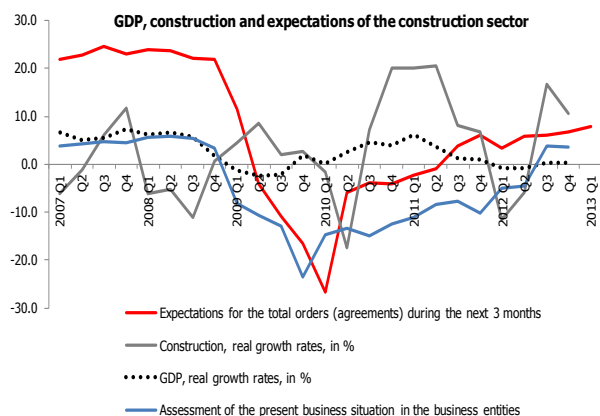


In the last quarter of the year, construction activity increased on a quarterly¹⁰ and annual basis. Despite the slowdown in the quarterly growth due to extremely high construction activity in the third quarter, on annual basis the activity in this sector has exceeded the performances registered in the same period last year. Such achievements in construction (particularly favorable in the second half of the year) resulted in historically high value added of construction for the entire year. Regarding the Surveys, the slowing construction activity in the last quarter was confirmed through the slightly lower assessment of the economic activity in the Business Tendency Survey in construction¹¹. However, the positive assessment of current economic activity for the second consecutive quarter¹², points to the optimism that prevails among construction companies. Positive perceptions of companies, according to the Survey are a result of the reduced impact of certain limiting factors for improvement of the construction activity. The negative

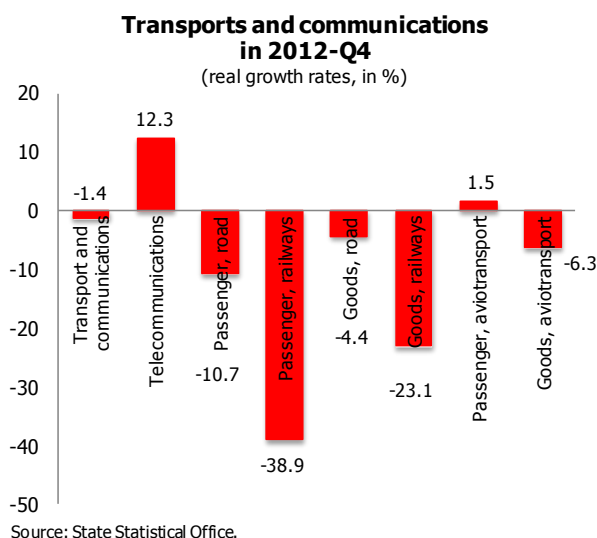
¹⁰ Analyzed on a seasonally adjusted basis.

¹¹ Refers to the fourth quarter of 2012.

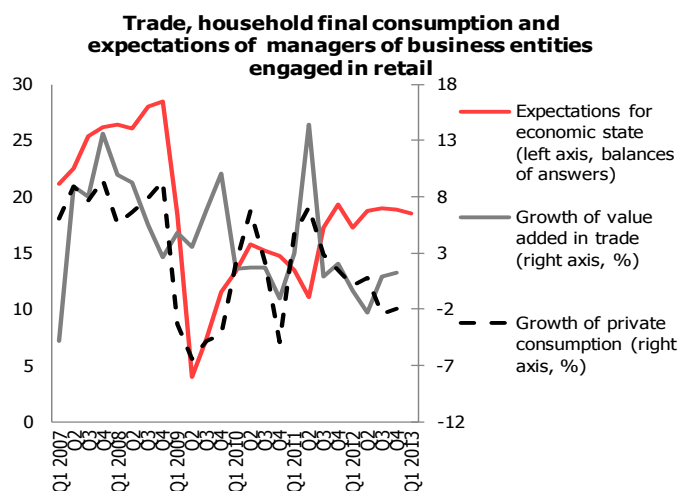
¹² From the first quarter of 2009 to the second quarter of 2012, negative assessments of the current economic situation of the enterprises in construction prevailed.



Source: State Statistical Office.



Source: State Statistical Office.



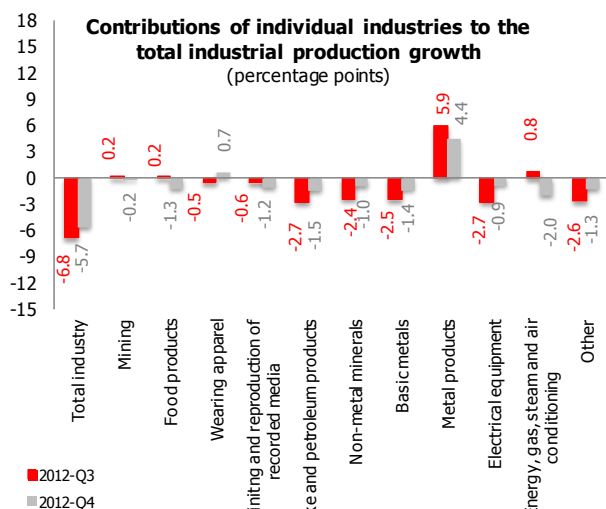
Source: State Statistical Office.

impact of the costs for materials and labor, the obtaining of bank loans, competition, lack of trained staff and lack of demand is assessed to be lower. Also, for the fourth consecutive quarter positive perceptions regarding the financial situation of enterprises outnumber the negative ones. In terms of expectations of the managers¹³ of construction companies for the next three months, there is an increased optimism relative to the previous quarter regarding the expectations for signing new contracts and the possible period for providing work, while the expectations for growth in selling prices are lower.

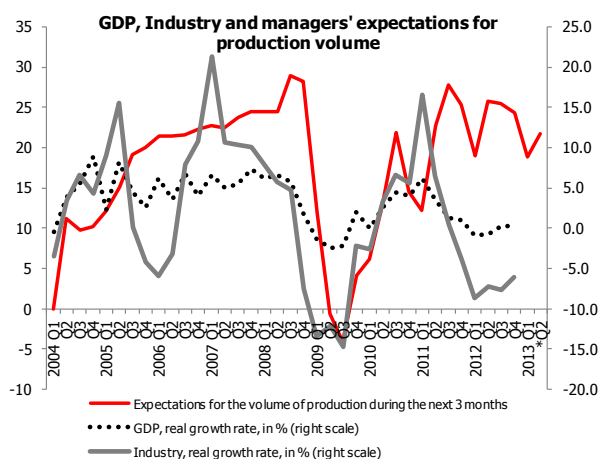
The value added of trade in the fourth quarter of 2012 registered a small quarterly and annual growth. The quarterly recovery of trade has led to further recovery of the activity in this area on an annual basis, after the decline registered in the first half of the year. In conditions of reduced private consumption on annual basis, reduced retail trade and trade in motor vehicles, the increase in the value added of trade in the third quarter, was again driven by the high annual growth in wholesale trade, which in February 2011 showed double-digit growth rates. The weaker performance in retailing is perceived through the Survey of the managers in **retail trade**¹⁴, whose assessments indicate a slight worsening of the current business and financial condition of these companies compared with the assessments in the previous quarter. According to their observations, there is an increased impact of competition in the market, which limits the improvement of their economic condition. The expectations of the

¹³ From the Business Tendency Survey in construction, of the SSO, for the fourth quarter of 2012.

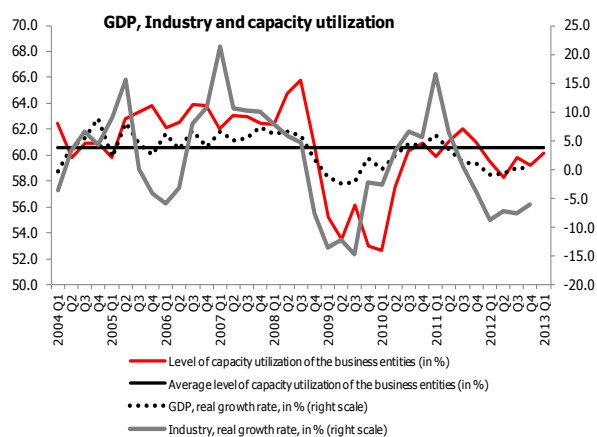
¹⁴ From the Business Tendency Survey in retail, of the SSO, for the fourth quarter of 2012.



Source: State Statistical Office and NBRM.



Source: State Statistical Office.



Source: State Statistical Office.

managers of commercial enterprises regarding the orders for the next three months are lower, and accompanied with decreased optimism regarding the number of employees, selling prices and business condition in the next six-month period.

The decline of industrial activity in the fourth quarter of 2012 slowed both on a quarterly and on an annual basis.

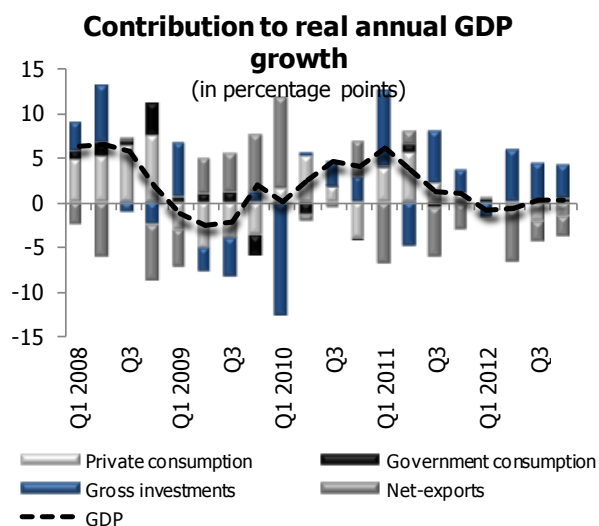
Amid worsening global macroeconomic outlook and reduced foreign effective demand, industrial activity has registered a steady decline on an annual basis since September 2011. The largest contribution to the annual decline in the fourth quarter was that of the manufacturing industry, where the lower production of tobacco products and of petroleum derivatives offset the positive effect of the annual growth of some of the export-oriented facilities. At the same time, electricity, gas, steam and air conditioning supply had a significant negative contribution to the decline of industrial activity. The weaker performance in the industry was confirmed by the Business Tendency Survey in the **manufacturing industry**. The average capacity utilization in the fourth quarter, declined on a quarterly and annual basis. Thus, the average utilization over entire 2012 remained below the historical average of the past eight years. Although the assessments of the current economic situation were worse, enterprises, however, positively evaluated the current production volume. Regarding the factors that limit the increase in production, the Survey indicates the increasing importance of the lack of skilled labor, competitive imports and insufficient foreign demand. The assessments in the Surveys regarding the first two months of the first quarter of 2013, indicate increased optimism concerning the assessment of current economic conditions and production volume, amid lower constraining impact of



both the financial problems and competitive imports, and the lack of raw materials, equipment and energy. Such estimates resulted in positive expectations regarding the volume of production and number of employees in the next three months.

1.3. Aggregate demand

The moderate annual economic growth recorded in the last quarter of 2012, was again a result of domestic demand factors. The domestic demand has had a positive contribution to the GDP growth for three quarters in a row. Such a positive dynamics is due mainly to gross investment, whose pace of growth in the last quarter was slower, in line with the slower construction activity. As in the previous quarter, public consumption grew, at even faster pace, while private consumption decreased, but moderately. The disposable income continued to decrease, with part of household consumption being satisfied by increased lending. On the other hand, in conditions of slower decline in external demand, exports registered a small increase, despite the decline in the previous quarter, which together with the growth in domestic demand resulted in a rapid growth of imports. Hence, net exports had a negative contribution to growth also in this quarter.



In the fourth quarter of 2012, economic activity increased on a quarterly basis (by 0.7%¹⁵), thus continuing the trend of slow strengthening of the economic growth, which started at the beginning of the year. On annual basis, a small and positive economic growth was registered again, which equaled 0.2%. However, given the sharper decline in the first half of the year compared with the growth in the second, the whole economy in 2012 recorded a small annual decline of 0.3%, as opposed to the growth in the previous two years. Annual GDP growth in the last quarter of 2012, as well as in the previous quarter, was entirely due to the positive contribution of domestic demand, while net exports had a negative contribution. In terms of individual components of consumption, investments

¹⁵ Seasonally adjusted.



have had the greatest positive contribution to the change in GDP for three quarters in a row. Public consumption again acted positively in the overall economic growth, while exports of goods and services returned to the zone of positive growth rates after the decline registered in the previous quarter. Conversely, private consumption again had a negative contribution to growth, but it is still lower than in the previous quarter. Imports which have registered fast growth, also had negative contribution.

Real annual growth rates (%)

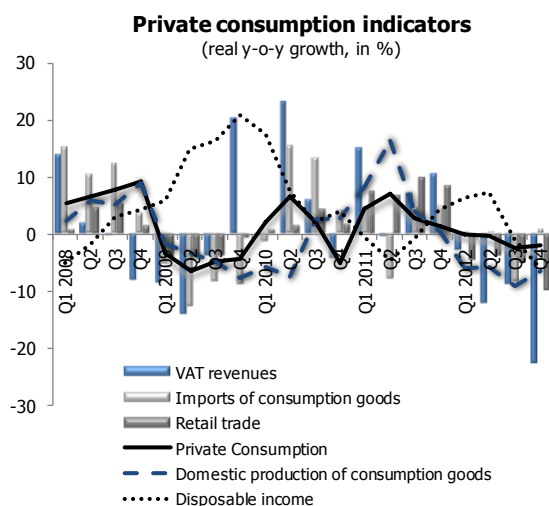
	2010-Q1	2010-Q2	2010-Q3	2010-Q4	2010	2011-Q1	2011-Q2	2011-Q3	2011-Q4	2011	2012-Q1	2012-Q2	2012-Q3	2012-Q4	2012
Private consumption	2.0	6.7	2.1	-4.9	1.3	4.6	7.0	2.8	1.5	3.9	0.1	-0.3	-2.4	-2.0	-1.2
Government consumption	-0.6	-7.1	0.7	-0.8	-2.0	0.6	5.1	-2.8	-0.1	0.7	1.7	-2.3	2.1	3.5	1.2
Gross investment	-44.0	1.7	14.9	10.0	-4.3	54.4	-19.1	28.8	8.6	12.3	-6.8	29.6	15.5	10.8	12.1
Exports of goods and services	10.0	17.7	24.8	40.0	23.6	37.2	12.7	3.0	0.2	11.2	0.0	0.7	-2.9	0.6	-0.4
Imports of goods and services	-10.2	12.8	18.8	16.0	9.5	36.6	6.1	11.3	4.7	13.2	-0.3	9.6	1.4	3.8	3.6
Domestic demand	-8.3	3.5	4.0	-0.8	-0.4	10.5	1.3	6.7	3.1	5.2	-0.9	4.4	2.0	2.3	2.0
Net exports*	-35.1	3.6	2.9	-16.3	-13.8	35.4	-7.6	38.0	14.7	17.9	-1.0	32.3	11.7	10.2	12.6
GDP	0.0	2.5	4.5	4.0	2.9	6.1	3.6	1.3	1.0	2.8	-0.9	-0.7	0.3	0.2	-0.3

*decrease represents lower deficit

Source: SSO and NBRM calculations.

1.3.1. Private consumption

In the last quarter of 2012, household consumption decreased on both quarterly and annual basis, but with less intensity. Compared to the previous quarter, consumption fell by 1.1% (seasonally adjusted), while the annual decline was 2% (2.4% in the third quarter). Thus, private consumption recorded an annual decline of three consecutive quarters. The annual decline in private consumption in the last quarter of 2012 can be explained by the faster decline in disposable income. The paid wage bill decreased, but at a slower pace, in circumstances of faster annual growth in the number of employees, while the decline in real wages moderately increased, in circumstances of higher inflation. Pensions had an additional negative effect on disposable income. They



decreased in real terms, compared to the growth they registered in the previous five quarters. However, the decline in disposable income was partially complemented by retail lending, which grew at a faster pace. Reduced households consumption is reflected also through the real decline in retail trade, common for the whole 2012, while the largest decline was recorded in the last quarter. Decline, however at a slower pace, was recorded also in domestic production of consumer goods, while imports of such goods grew, despite the sharp decline in the previous quarter.

The latest available data¹⁶ for the first quarter of 2013 point to favorable shifts in private consumption. Retail trade has registered real growth for the first time after falling in the previous four quarters, although the expectations of managers for the first quarter are unfavorable compared to the previous quarter¹⁷. Growth in trade caused upward adjustments in domestic production of consumer goods, which in the first quarter of 2013 registered real growth, as opposed to the decline in the imports of consumer goods. Assessments for positive shifts in private consumption are supported by the enhanced credit activity of banks with the households, which is consistent with the banks' expectations¹⁸ for increased demand for consumer loans and partial easing of credit conditions. At the same time, pensions registered real growth, while the decline in real net wages has slowed down, amid moderate reduction in

¹⁶ Data on domestic production of consumer goods, pensions, VAT, import of consumer goods and household credits are as of February, while the data on wages and retail trade are as of January.

¹⁷ From the Business Tendency Survey in retail trade, of the SSO, conducted in the fourth quarter of 2012.

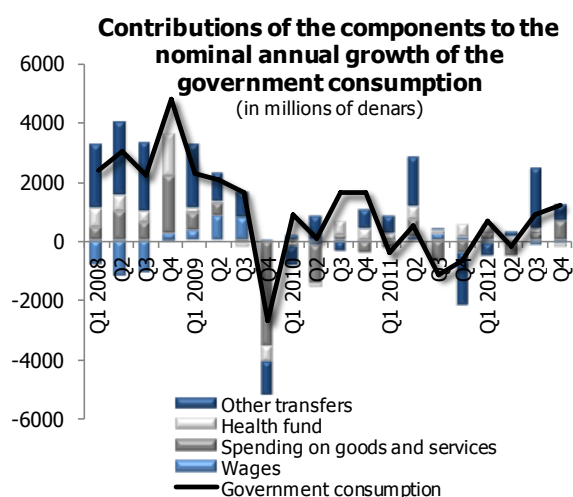
¹⁸ From the Bank Lending Survey, conducted by the NBRM in January, 2013.



inflationary pressures. Against the background of generally more favorable expectations about the number of employees in the economy¹⁹ compared to the previous quarter, it is expected the number of employees in the first quarter to register an annual growth. Hence, the wage bill would decline, however at a moderately slower pace. On the other hand, private transfers registered adverse changes, i.e. acceleration of the annual real decline, which largely stems from the high base effect.

1.3.2. Public consumption

In the fourth quarter of 2012, public consumption recorded quarterly growth of 2.2% seasonally adjusted, leading to an acceleration in the annual growth of 3.5% (growth of 2.1% in the third quarter). Data on the budget for the first two months indicate continuity of such movements in the first quarter of 2013. Thus, the repayment of government arrears by the end of February caused a significant annual growth in the costs of goods and services in the first two months of the year. Hence, **for the first quarter of 2013, real annual growth of public consumption is expected again.**



Source: State Statistical Office and Ministry of Finance.

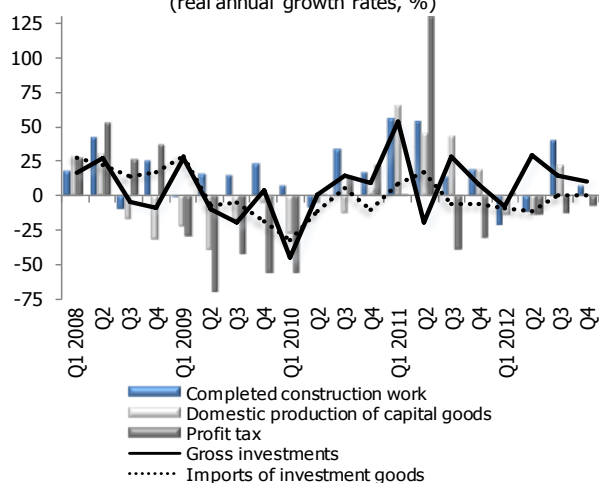
1.3.3. Investment consumption

In conditions of a quarterly decline (of 10.8%, seasonally adjusted), gross investment registered an annual growth of 10.8%, which is a moderate slowdown of the growth. However, also in the last quarter of 2012, investment activity was an essential

¹⁹ From the Business Tendency Surveys in manufacturing industry, retail trade and construction, of the SSO, conducted in February 2013, i.e. in the fourth quarter of 2012.



Gross investment and indicative series
(real annual growth rates, %)



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

factor in the annual growth of the overall economy. With the growth achieved in the last three quarters, gross investments reached their historically highest quarterly level.

The slowdown in investment growth mainly stems from the slower construction activity. Slower investment growth affected also the domestic production of capital goods, the growth of which slowed down significantly, while imports of investment products were almost unchanged compared to the same quarter last year. On the other hand, the Government stimulated the investment activity, after the real decline in government capital expenditures in the previous two quarters, while the decline in foreign direct investments slowed down. Slower real decline was registered also in the long-term lending to the corporate sector, amid largely unchanged demand for long-term loans²⁰. **For the first quarter of 2013, indicative available data send different signals²¹.** Thus, the value of completed construction works registered fast growth, partly due to the low comparison base in the first quarter of the last year, when due to the extremely low temperatures the construction work was kept to a minimum. In line with these movements are the expectations of the managers in construction²², who have more favorable expectations for the orders in the first quarter, compared to the previous quarter, so the assessment of the possible period of engagement in construction work has increased. Imports of investment goods have also registered faster annual real growth at the expense of domestic production which decreased slightly on an

²⁰ From the Bank Lending Survey, conducted by the NBRM in January, 2013.

²¹ Data on completed construction works and foreign direct investments are given as of January, while the remaining data are given as of February.

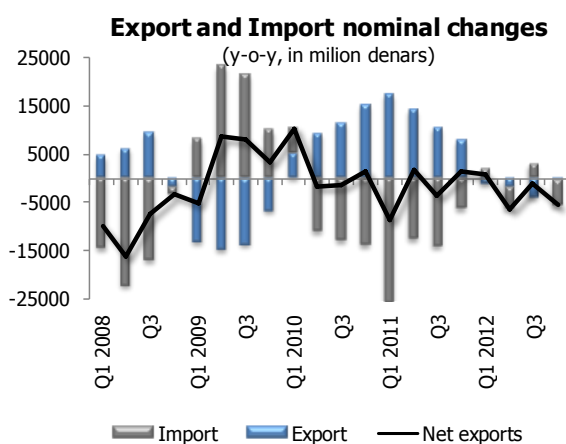
²² From the Business Tendency Survey in construction, of the SSO, conducted in the fourth quarter of 2012.



annual basis. Government investments, which registered sharp decline, point to downward movements, which would decelerate the growth of investments. Foreign direct investments also registered further decline. At the same time, long-term lending to businesses has registered faster real decline, which is consistent with the expectations of banks²³ for moderate reduction in demand.

1.3.4. Net export demand

In the last quarter of 2012, the adverse impact of the global environment on the Macedonian economy shrunk, so the export sector experienced modest growth. Growth of exports and enhanced growth of domestic demand, caused rapid growth of imports of goods and services. Consequently, net exports had a negative contribution to the annual change in GDP also in the last quarter of 2012.



Source: State Statistical Office.

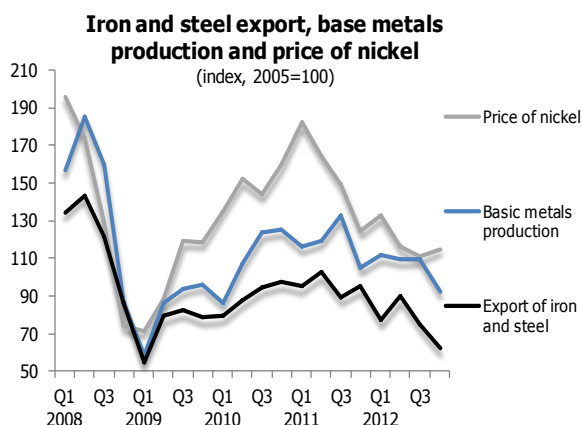
In the last quarter of 2012, exports registered quarterly growth (of 5.8%, seasonally adjusted), which resulted in a return in the zone of positive annual growth (small annual growth of 0.6%). The moderate slowdown in the decline of foreign effective demand, amid slower decline also in export prices, contributed to favorable developments also in the domestic export manufacturing sector. These positive trends in the exports, given the growth in domestic demand, led to a rapid annual growth in imports, which made imports grow for three consecutive quarters. The annual growth was 3.8% (1.4% in the previous quarter), while on a

²³ From the Bank Lending Survey, conducted by the NBRM in January, 2013.



quarterly basis they registered a decline (1.8%, seasonally adjusted).

In the first quarter of 2013, a certain revival in the domestic economy began, including in the export sector, which in the first two months registered a nominal growth of 2.6%. The further slowing of the decline in foreign demand had a positive effect on exports and domestic production. Thus, amid larger utilization of the industrial capacities in the first two months of the year, industrial output recorded an annual growth for the first time after the continual decline throughout 2012. Moreover, the expectations of managers in the manufacturing industry for the first two months of 2013 were more favorable compared to the previous quarter²⁴. Hence, the expected real growth in exports and domestic demand, would lead to expected real growth also in imports. These assessments are in line with the data on foreign trade, which in the first two months of the quarter showed a nominal growth of imports. Moreover, in terms of higher growth in exports compared with imports, in the first quarter of 2013, a slight narrowing of the balance of foreign trade is expected.



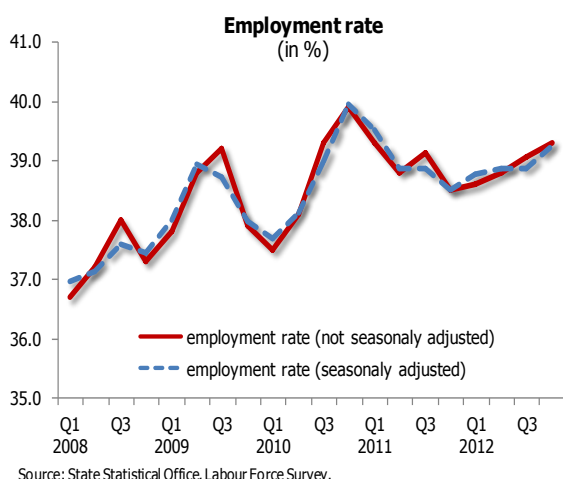
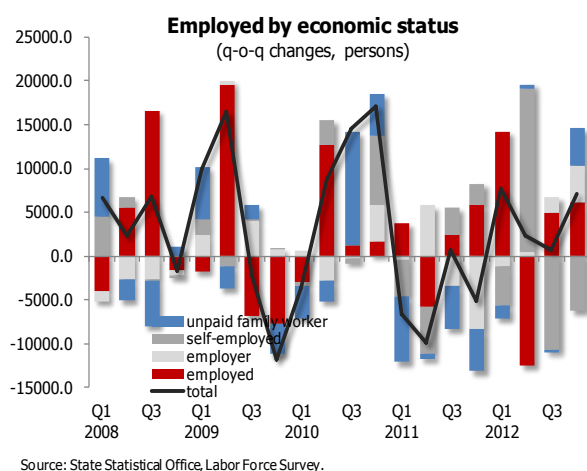
Source: State Statistical Office, IMF monthly database and NBRM calculations.

1.4. Employment and wages

The favorable developments in the labor market, observed by the number of employed persons, continued in the last quarter of the year. The number of employed persons grew further on a quarterly basis, at a significantly faster pace. These trends indicate positive second-round effects of the moderate economic recovery, present in the second half of the year. However, amid faster increment of the supply relative to the demand for labor, unemployment recorded minimum quarterly rise, while the unemployment rate remained at the level of the previous quarter. Faster increase in the number of employees was reported also on an annual

²⁴ From the Business Tendency Survey in manufacturing industry, of the SSO, conducted in February 2013.

basis, caused by the increased number of employees in trade and construction. Such developments in these sectors reflected on the activities associated with construction and transportation. New investments in construction and new manufacturing facilities opened with foreign direct investments also influenced the annual growth in the number of employees. As for labor cost, nominal wages continued to grow slowly, while their real decline accelerated in the last quarter. Labor productivity has reduced on annual and quarterly basis, while annual and quarterly deterioration was also registered in the competitiveness in terms of labor, due to the increase in the unit labor costs.



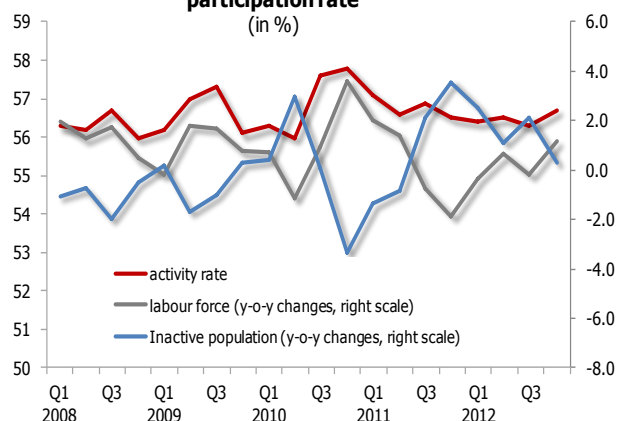
The increase in the number of employees continued in the last quarter of 2012, registering a quarterly²⁵ growth of 1.1%²⁶, which denotes faster positive quarterly dynamics. These changes correspond with the continued quarterly growth of the economic activity in the last three quarters. The employment rate also increased by 0.2 percentage points, which contributed to the continuation of the positive quarterly dynamics registered since the beginning of the year. In terms of the economic status, quarterly employment growth stems from the growing number of employees, unpaid family workers and employers. Analyzed by activities, quarterly employment growth was mostly due to the activity "transport, storage and communications", hotels and restaurants and agriculture. **On annual basis, the number of employees increased by 2.9%, which is a significant acceleration of the positive dynamics.** At the same time, the employment rate increased compared with the same period last year and reached the level of 39.3%. Analyzed by activities, annual employment growth mostly stems from trade and construction. The increase

²⁵ The analysis of the quarterly dynamics of employment, unemployment and total active population is made with seasonally adjusted data.

²⁶ Starting from January 2011, the State Statistical Office has been applying the new National Classification of Economic Activities (NACE rev. 2) for compilation of data on the labor market (wages and employment).



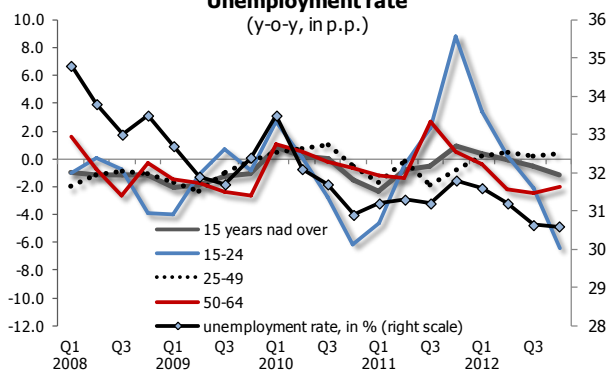
Labour force, inactive population and participation rate
(in %)



Source: State Statistical Office, Labor Force Survey.

in the number of employed persons in these activities, on an annual basis, corresponds with the growth of their value added. In addition, positive movements in trade and construction are confirmed by the results of the Survey on Job Vacancies²⁷, according to which in the fourth quarter, about 18% of the newly opened or vacant jobs were in trade and construction activity. Transportation and "administrative and auxiliary services"²⁸, which are partly related to positive developments in trade and construction activity, had an additional impact on the annual employment growth. According to the aggregate signals from Business Tendency Surveys²⁹ relating to expectations regarding the movements in the labor market, some improvement in the demand for labor is expected for the next three-month period. These expectations correspond with recent favorable trends in the domestic economy and the gradual recovery of the global economy.

Unemployment rate
(y-o-y, in p.p.)



Source: State Statistical Office, Labor Force Survey.

The growth in demand caused a quarterly increase also in the supply of labor. After the decline in the previous quarter, active population increased quarterly by 0.8% in the last quarter of

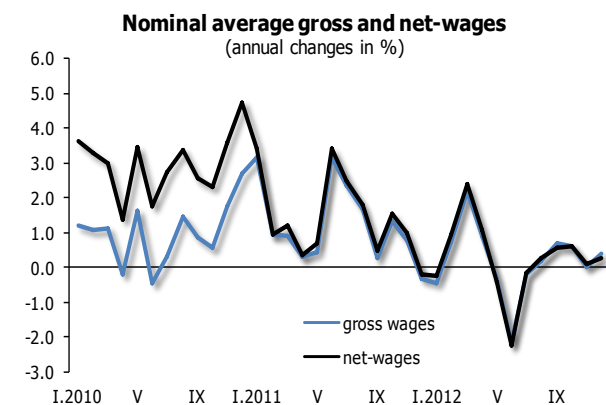
²⁷ In 2012, the State Statistical Office for the first time began to conduct a Survey on Job Vacancies as part of the labor market research. The purpose of the Survey is obtaining quarterly information on job vacancies in the enterprises in the Republic of Macedonia as an important indicator of the macroeconomic trends and labor market policies.

²⁸ The working engagement that municipalities offered to 4,000 people to perform public works for a period of six months, has a positive influence on employment in this sector. These are people who are unemployed, with low qualifications or elderly people. This Government measure aims to improve the financial condition of the employed persons, and to enable them acquire new skills necessary for establishing a permanent employment.

²⁹ Source: State Statistical Office, Business Tendency Surveys in manufacturing industry (February 2013), construction (fourth quarter of 2012) and in trade (fourth quarter of 2012).



2012. In conditions of quarterly growth in the labor force and reduction of the inactive population, the activity rate increased to the level of 56.7% (56.3% in the previous quarter). **Total active population grew also on an annual basis (1.2%)**, and in conditions of much slower growth of the inactive population, the activity rate registered an annual increase for the first time after five consecutive quarters of negative annual growth.



Source: State Statistical Office.

Against the background of faster growth in the supply than in the demand for labor, unemployment recorded minimum quarterly increment. Thus, the number of unemployed persons registered a slight growth of 0.2% in the last quarter of the year, after three quarters of continuous decline. On the other hand, amid faster growth of the demand relative to that of the supply of labor, the number of unemployed persons decreased by 2.6% on an annual basis. Simultaneously, an annual decline of 1.2 percentage points was registered also in the unemployment rate, which remained at the level of the previous quarter of 30.6%.

Annual changes in average paid net wage by sectors in Q4.2012
(in %)

	nominal changes	real changes
Agriculture, forestry and fishing	3.8	-1.0
Mining and quarrying	0.6	-4.0
Manufacturing	1.2	-3.5
Electricity supply	0.2	-4.4
Water supply	-0.3	-5.0
Construction	2.3	-2.4
Trade	2.1	-2.6
Transportation and storage	-1.2	-5.8
Accommodation and food service activities	-0.6	-5.2
Information and communication	3.7	-1.1
Financial and insurance activities	-2.8	-7.3
Real estate activities	-1.5	-6.1
Scientific activities	5.1	0.2
Administrative activities	-6.1	-10.5
Public administration and defence	-0.1	-4.7
Education	-0.1	-4.7
Health and social work	2.3	-2.4
Arts, entertainment and recreation	-8.7	-12.9
Other service activities	1.2	-3.5

Source: State Statistical Office.

Similarly to the previous quarter, the average wages paid in the last quarter of 2012, registered a minimal nominal annual growth. Thus, nominal net and gross wages registered an annual growth of 0.3% and 0.4%, respectively, which represents a minimum acceleration of the growth rate. This movement fully reflected the wage growth registered in the agricultural and industrial sectors, with almost stagnant movement of wages in the services sector. On a quarterly basis, nominal net and gross wages rose by 1.3% and 1.2%, respectively. The growth of nominal wages on a quarterly basis was offset with the quarterly inflation of 1.6%. Thus, a decrease in the real purchasing power was registered, amid a quarterly



decline in real net wages (of 0.3% compared to 0.4% in the previous quarter). The quarterly decline was solely associated with the real reduction of net wages in agriculture and industry, while in the services sector a real growth was recorded. **The deepening of the real annual wage decline continued in the last quarter of the year, due to the acceleration of the inflation.** Thus, the average real net wage was lower by 4.3% on an annual basis. With this, real net wages have registered a continuous decline on an annual basis over eight consecutive quarters. The slow movement of nominal wages growth in conditions of an increased number of employees, suggests that employers deal with the insufficient foreign and domestic demand, rising costs for materials and uncertain economic environment through the wage channel, rather than through the mechanism of reducing the number of employees.



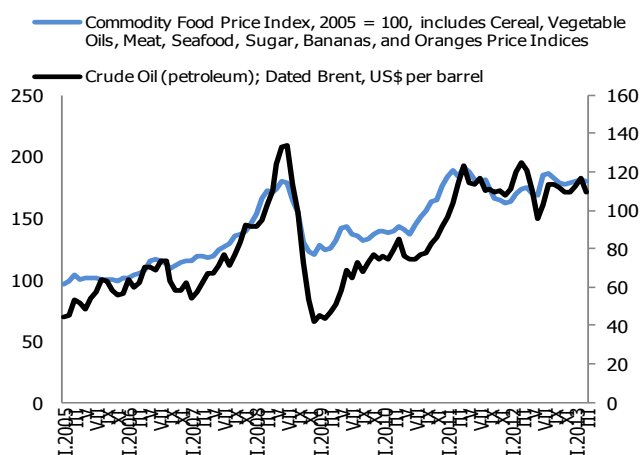
Labor productivity still decreases on an annual basis, with the decline being faster compared to the previous quarter. The decline in productivity of 2.6% reflects the more intensive employment growth compared to the growth of the economic activity. After the quarterly growth in the previous quarter, productivity decreased also on a quarterly basis, amid more dynamic growth in the number of employees than of the production growth. **The annual decline in productivity coupled with rising gross wages led to intensification of the annual growth of unit labor costs (3.0%).** Deterioration of competitiveness in terms of labor costs has been reported also on a quarterly basis, with an increase in unit labor costs by 1.6%.



1.5. Inflation

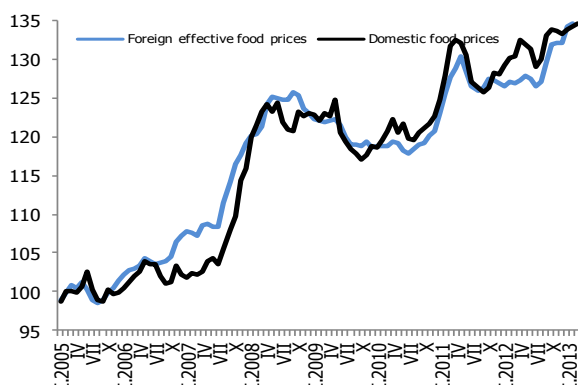
In the first quarter of 2013, inflation registered a quarterly decline, for the first time in five quarters. The quarterly downward movement of consumer prices of 0.3% on a seasonally adjusted basis is solely due to the food and energy components. The annual inflation rate registered slowdown in growth from 4.9% in the previous to 3.4% in the current quarter. In conditions of a quarterly decline, the annual growth in inflation reflects the effect of the growth of regulated prices (electricity and central heating) and food prices in the second half of the last year. Therefore, the data on the first quarter indicate probable strengthening of the second-round effect of the growth of these prices on other prices. Namely, the core inflation intensified its quarterly and annual dynamics of growth (0.8% and 3.3%, respectively). Along with the rising prices of food and energy in the past, the faster growth of long-term inflation component could be in part explained by the influence of one-off factors which are likely to be exhausted in the next period, given the still weak demand.

Crude oil and food prices



Source: IMF Primary Commodity Prices.

Foreign effective food prices* and domestic food prices

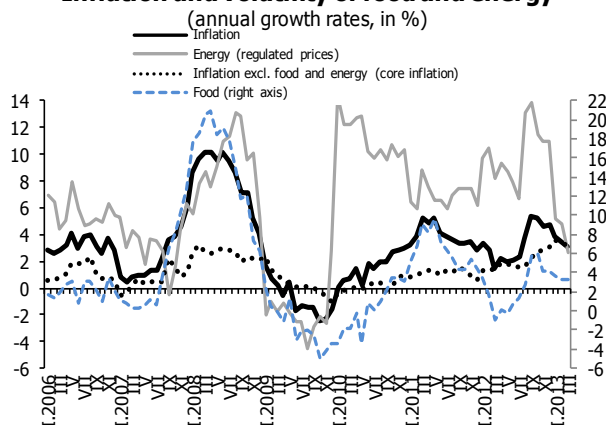


* Foreign effective food prices are calculated as weighted sum of food prices in countries that are major trade partners with Macedonia.
Source: State statistical office, Eurostat and NBRM calculations.

In the first quarter of 2013, for the first time in five quarters, there was a reduction in inflationary pressures. The quarterly downward movement of consumer prices of 0.3% on a seasonally adjusted basis is a result of the food³⁰ and energy components³¹, which are lower by 0.9% and 2.1%, respectively. In terms of global trends, the prices of internationally traded primary food products show a downward correction in relation to the record high level registered in August 2012. However, the prices of these products in March were only 3.5% lower than the recent maximum. The decline in these prices is associated with decreased global demand as well as the favorable weather conditions in the European Union, the Black Sea region, China and India. However, prices of primary food products are still vulnerable to the global decline in the inventories of cereals, especially wheat, the continuous dry weather in the USA, Argentina, South Africa and Australia, as well as the

³⁰ Mostly due to lower prices of fresh food, but primarily of fresh vegetables.

³¹ By a decision of the ERC the cost of central heating for households was reduced by 13.8%. The new price effectively applies from 1 March 2013.

**Inflation and volatility of food and energy**

Source: State statistical office and NBRM calculations.

weakening of the dollar as a limiting factor for their greater reduction. On the other hand, effective food inflation with our most important trading partners in the first³² quarter registered an accelerated pace. Namely, given the usual time lag, the rise in the prices of the food component is explained mainly by the higher prices of inputs as a second-round effect of the fluctuations in the world prices of food and energy in the previous period, and in some countries also by the limited domestic supply of agricultural products due to the unfavorable weather conditions. Additionally, the acceleration of the effective food inflation is due also to the rising VAT rates³³ in some countries with which we have more intensive trade.

Individual price categories

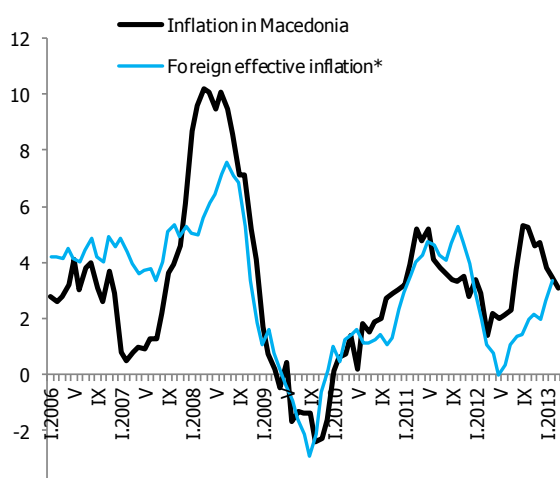
(annual rates, %)

	(annual growth rates, in %)											(contributions to annual growth rates, in p.p.)										
	2011				2012				2013			2011				2012				2013		
	Q1	Q2	Q3	Q4	2011	Q1	Q2	Q3	Q4	2012	2013	Q1	Q2	Q3	Q4	2011	Q1	Q2	Q3	Q4	2012	2013
Consumer price index - all items	4.1	4.7	3.6	3.2	3.9	2.5	2.1	3.8	4.9	3.3	3.5	4.1	4.7	3.6	3.2	3.9	2.5	2.1	3.8	4.9	3.3	3.5
Food	7.1	8.4	5.4	4.7	6.4	1.4	0.2	3.4	4.7	2.4	3.3	2.7	3.2	2.0	1.8	2.4	0.6	0.1	1.3	1.9	1.0	1.3
Fresh food	4.6	6.7	1.7	2.9	4.0	0.7	-0.4	6.2	7.4	3.5	4.8	0.8	1.2	0.3	0.5	0.7	0.1	-0.1	1.1	1.3	0.6	0.9
Processed food	8.5	9.9	8.4	6.2	8.3	2.0	0.6	1.1	2.6	1.6	2.1	1.7	2.0	1.8	1.3	1.7	0.4	0.1	0.2	0.6	0.3	0.4
Energy	7.1	6.9	7.0	7.2	7.1	9.4	8.7	11.2	11.1	10.1	4.2	0.9	0.9	0.9	1.0	0.9	1.4	1.2	1.6	1.6	1.5	0.6
Fuels and lubricants	18.4	10.9	12.2	12.4	13.5	7.9	10.5	8.0	5.1	7.9	0.2	0.6	0.4	0.4	0.5	0.5	0.4	0.5	0.4	0.2	0.4	0.0
Electrical power	1.8	5.4	5.4	5.4	4.5	11.5	7.7	14.9	18.4	13.1	9.9	0.1	0.4	0.4	0.4	0.3	0.8	0.5	1.0	1.3	0.9	0.7
Heating power	6.3	5.7	4.2	4.9	5.3	7.6	7.7	7.7	4.0	6.7	-2.8	0.2	0.2	0.1	0.2	0.2	0.2	0.2	0.2	0.1	0.2	-0.1
Food and energy (volatile prices)	7.1	8.0	5.8	5.4	6.6	3.5	2.4	5.5	6.5	4.5	3.6	3.6	4.1	3.0	2.7	3.4	1.9	1.3	3.0	3.5	2.4	2.0
Core inflation (inflation excl. food and energy)	1.0	1.2	1.1	0.7	1.0	1.4	1.8	1.8	2.9	2.0	3.3	0.5	0.6	0.6	0.5	0.5	0.6	0.8	0.8	1.3	0.9	1.5

Source: State Statistical Office and NBRM calculations.

Domestic inflation and foreign effective inflation

(annual growth rates, in %)



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

Seasonally unadjusted data indicate quarterly growth in consumer prices of 0.5%. The quarterly upward movement slowed down and is completely a result of the long-term and the food component.

³² Based on the performances in the first two months of the quarter.

³³ Croatia increased the general VAT rate from 23% to 25% from 1 March 2012. Also, from 1 January 2013, pursuant to the amendments to the VAT Act, and in order to achieve compliance with EU directives, Croatia phased out the zero VAT rate. Thus, Croatia has a general rate of 25%, and two rates of 10% and 5%. According to these changes, the tax rate of 5% is, among others, applied also to bread, milk and medicines. In Serbia, the increase in the VAT rate came into effect on 1 October 2012, with the overall tax rate being increased from 18% to 20%.

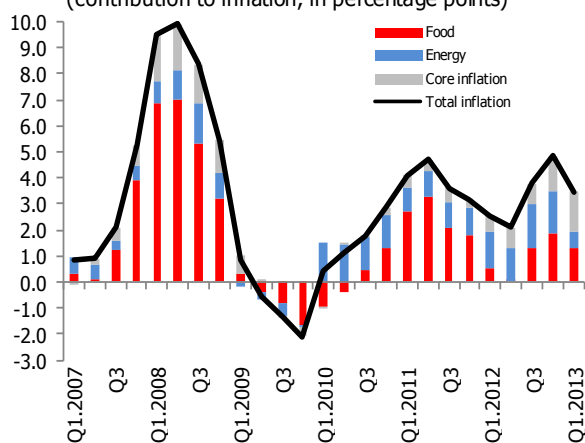


The annual inflation rate of 4.9% in the previous quarter slowed down to 3.4% in the current quarter.

In circumstances of quarterly slowdown, the annual inflation reflects the effect of the growth of regulated prices (electricity and central heating) and food prices in the second half of the last year. However, in the first quarter, the inflationary pressure generated by the second-round effect of the rise in these prices, further strengthened. Thus, the contribution of the long-term component to the annual inflation has continued to rise. Food and energy components remain to have positive, albeit reduced contribution to overall inflation. Intensification of the annual dynamics was registered also with foreign effective inflation³⁴ (3.1% versus 2% in the previous quarter), in circumstances of quarterly upward movement (0.8%), however at a slower pace.

Volatile (food and energy) and long-term component of inflation

(contribution to inflation, in percentage points)



Source: State statistical office and NBRM calculations.

The long-term component of inflation has continuously intensified its annual dynamics for five consecutive quarters.

The annual rate of core inflation (price component excluding food and energy) reached 3.3% in the first quarter, which is an acceleration of 0.4 percentage points. In the absence of pressure from domestic demand³⁵, intensification of this component is mostly

³⁴ The calculation of foreign effective inflation is derived from the weighted sum of the indices of consumer prices in countries that are major exporters of consumer goods in the Republic of Macedonia. Weight structure is based on normalized shares of nominal imports from each country in the total nominal imports in the period 2005-2010. The calculation of this indicator includes Bulgaria, Germany, Greece, France, Italy, Austria, Slovenia, Croatia, USA and Serbia.

³⁵ Estimates of the NBRM show that domestic production is still below the potential level (negative output gap).

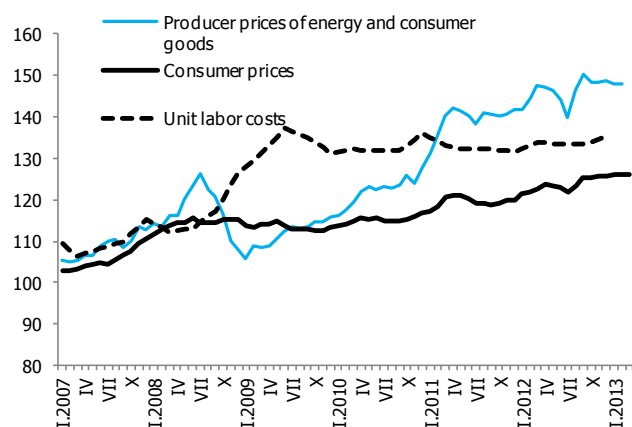


explained as a second-round effect of the increase in the prices of energy and food in the previous period. The largest individual contribution to the annual rate of core inflation is that of the prices of clothing and footwear, the hygiene and health items, as well as the prices of food and beverages in catering facilities. However, the effect of these factors is expected to be temporary, whereas the greatest likelihood of downward adjustment is associated with the prices of clothing and footwear.

In the first quarter³⁶, the prices of the producers of industrial products registered a downward movement.

The quarterly decline in these prices was 0.3% (1% on a seasonally adjusted basis). The largest individual contribution to the decline was that of the production cost of food products. On an annual basis, the prices of the producers of industrial products increased by 3.1%, which denotes deceleration of the positive dynamics registered in the previous period. The largest contribution to the annual growth was that of the prices of the producers of energy (petroleum products and electricity), but also the prices of metals and food products. **The movement of production prices affecting the domestic component of inflation (durable and non-durable consumption products and energy) points to reduction of the inflationary pressures in the forthcoming period.** Namely, amid quarterly decline of 1.6% on a seasonally adjusted basis, the annual dynamics of these prices slowed down from 5.4% in the previous to 2.4% in the current quarter.

Factors affecting consumer prices
(indices, 2005=100)



Source: State statistical office and NBRM calculations.

In the fourth quarter, **unit labor costs** registered an annual growth of 3%, which denotes further intensification of the growth from the previous period. At the

³⁶ The data refer to the first two months of the quarter analyzed.



same time, also the quarterly comparison indicates their intensification. However, the quarterly growth comes after the downward movements in labor costs over the past two consecutive quarters. Given the further maintenance of the negative output gap, we do not expect inflationary pressures through the channel of labor costs.



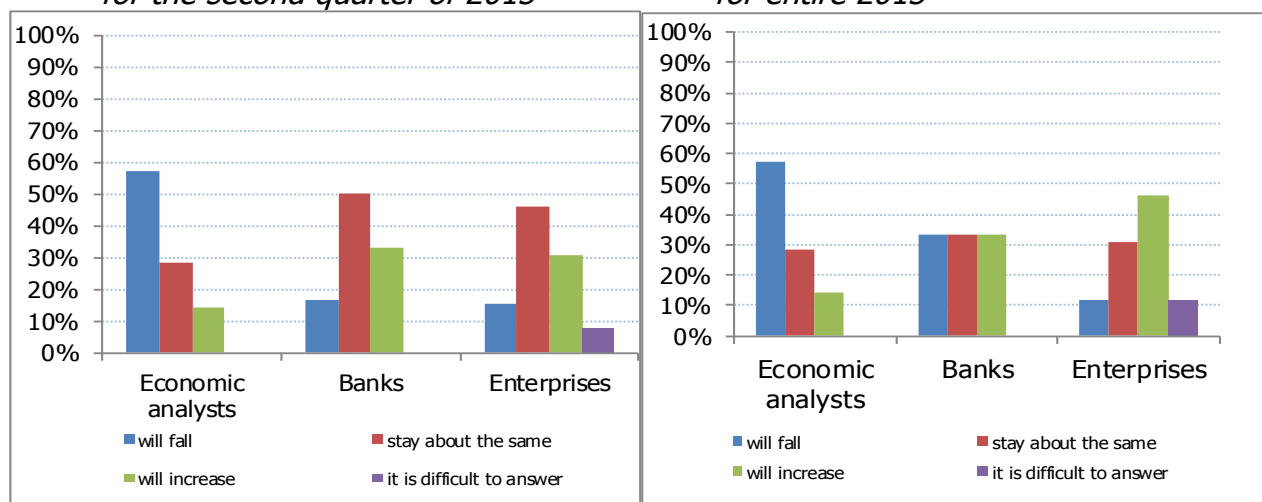
Appendix 1: Inflation expectations of economic agents in the Republic of Macedonia

In the Inflation Expectations Survey conducted in April 2013³⁷, for the end of the second quarter of 2013, the expectations for unchanged inflation are predominant (43.6% of respondents). The percentage of respondents who expect higher inflation was 28.2%, while the percentage of those who expect its decline is slightly smaller and equals 23.1%³⁸. In terms of individual groups of respondents, 57.1% of the surveyed **economic analysts** expect lower inflation, 28.6% had stable inflation expectations, while the remaining 14.3% believe that inflation will be higher. Unlike economic analysts, the majority of surveyed **banks** have stable inflation expectations (50%), the remaining respondents expect higher inflation 33.3%, while a smaller proportion (16.7%) expected lower inflation. Similar expectations prevail with the **companies**, with the majority expecting stable inflation (46.2%), 30.8% of the surveyed enterprises expect lower inflation, while 15.4% believe that inflation will be higher.

Distribution of answers regarding the expectations of inflation by groups of respondents

for the second quarter of 2013

for entire 2013



Source: NBRM, Inflation Expectations Survey.

In comparison with 2013, the responses of respondents are relatively evenly distributed, on average. In fact, 38.5% of the respondents expect higher inflation than the average achieved in the first quarter of 2013, 30.8% expect retention of the inflation rate by the end of the year, while 23.1% expect lower inflation. Among the surveyed **economic analysts** expectations for lower inflation rate prevail (57.1%),

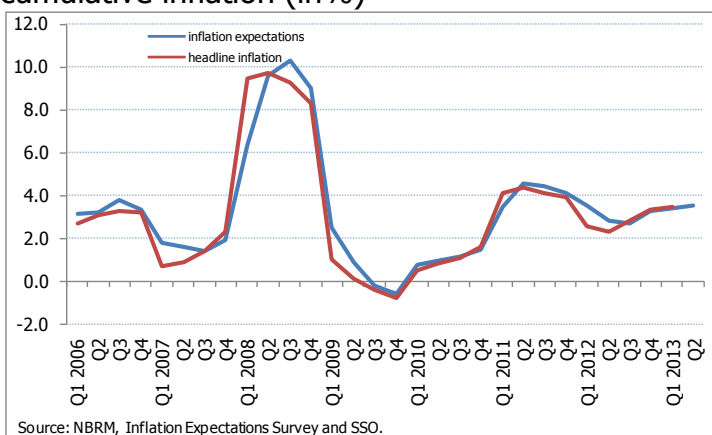
³⁷ The responsiveness was 53.4%, i.e. 39 of 73 respondents responded to the survey. Analyzed by groups of respondents, 85.7% were banks, followed by 53.8% of economic analysts and 49.1% of enterprises.

³⁸ The remaining percentage to 100% throughout the text, refers to respondents who chose the option "it is difficult to determine."



28.6% have stable inflation expectations, while a smaller proportion (14.3%) expect it to accelerate. The responses of the **surveyed companies** are with opposite distribution relative to that of analysts, with 46.2% of them expecting higher inflation rate relative to the first quarter, 30.8% have stable inflation expectations, while a small proportion (11.5%) expect it to decline. Among the surveyed **banks**, expectations are equally divided (33.3%) for lower, stable or higher inflation. The average expected rate of inflation in 2013, based on the responses of economic agents, is about 3.5%.

Expectations for the average inflation rate for the year and the registered average cumulative inflation (in%)



Source: NBRM, Inflation Expectations Survey and SSO.

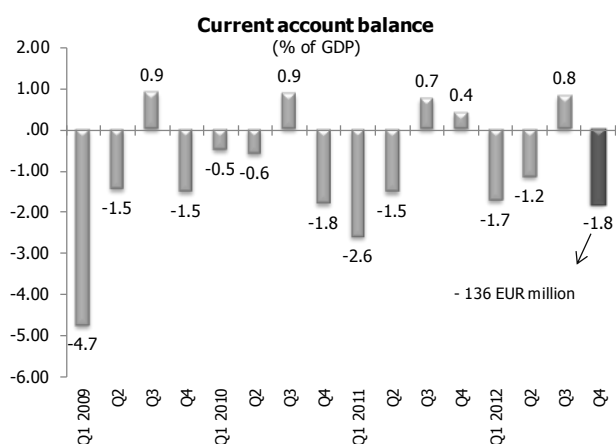
The second-round effect of the lower projected world prices of energy and food on domestic prices, amid reduced foreign demand from European countries, is considered to be the main factor that contributed to the formation of the economic agents' inflation expectations. On the other hand, respondents pointed to upward risks to domestic consumer prices arising from the flooded plantations on agricultural land in the first quarter and the fiscal policy relaxation.



1.6. Balance of payments

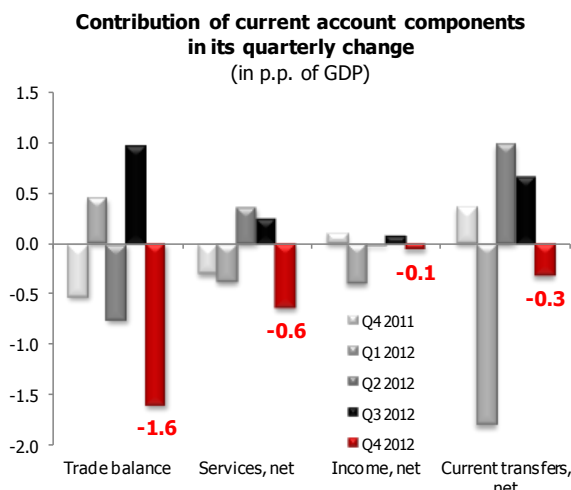
Movements in the balance of payments current account during the last quarter of 2012 followed the usual seasonal dynamics, but a significant expansion in the deficit was noted, as a result of the negative quarterly changes in all individual components. The trade deficit was again the most important driver of quarterly change. The increase in the import component, driven by seasonal factors in energy imports, imports for personal consumption and imports of raw materials, was more emphasized than the slight quarterly increase in the exports. Changes in the trade balance were the most significant driver also of the annual expansion of the current account deficit, coupled with deteriorating trade in services, higher outflows in income and lower current transfers, whereby the quarterly and annual changes in the balance of payments current account were caused by simultaneous adverse movements in all components. Despite the deterioration in the current account, during the fourth quarter high net inflows were registered in the capital and financial account. Credit growth based on trading transactions with non-residents and external lending to the private sector were compounded by increased net inflows of foreign direct investment. At the same time, banks created additional inflows in the item "currency and deposits", withdrawing part of their deposits in foreign banks. Net outflows were recorded only in currency and deposits of households, whereby the downward trend in this category continued, but at a significantly slower pace. Capital flows significantly exceeded outflows in the current account, creating further accumulation of foreign reserves and ensuring their future maintenance around the adequate level. Total net inflows in the capital and financial account are higher on both quarterly and annual basis.

1.6.1. Current account

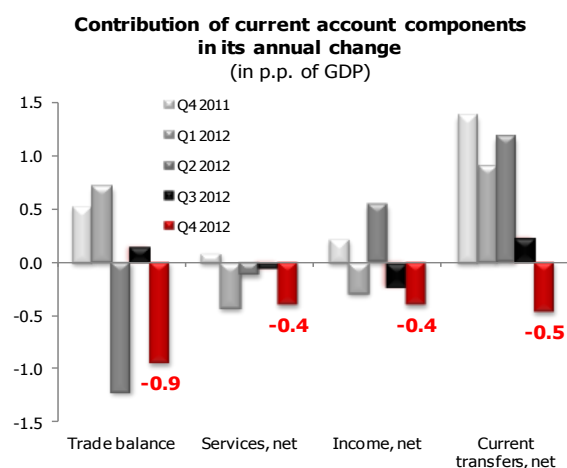


Source: NBRM.

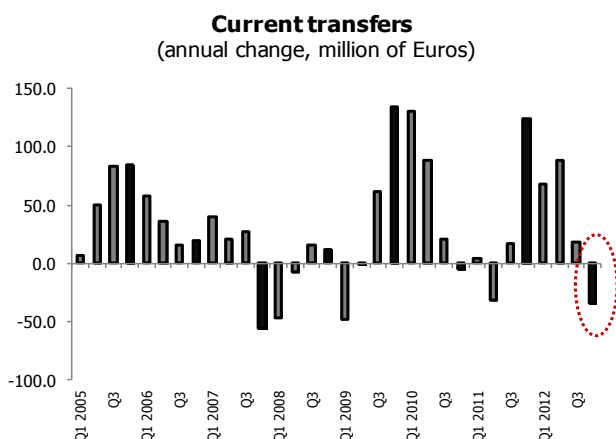
In the last quarter of 2012, the balance of payments current account recorded a deficit of Euro 136 million or 1.8% of GDP, which represents a change of 2.6 percentage points of GDP compared to the previous quarter when a surplus in the current account was registered. The quarterly change is due to the adverse movements in all components of the current account. Quarterly changes in the trade balance and current transfers, are largely caused by specific seasonal factors that significantly influence the movement of the two categories. The most significant contribution to the expansion of the current



Source: NBRM.



Source: NBRM.



Source: NBRM.

account deficit is that of the trade balance (by 1.6 pp of GDP), driven by the growth in imports of raw materials for industry and the characteristic seasonal imports of energy and personal consumption products. The remarkable growth in imports, amid simultaneously more moderate growth in exports, resulted in a significant quarterly expansion of the trade deficit. Trade in services recorded negative quarterly change due to the deteriorating balance in construction services by non-residents in the country³⁹ and the seasonal decrease in the net inflows from tourist services.

The annual analysis of the movements in the current account for the fourth quarter of 2012, indicates widening of the deficit by 2.2 percentage points of GDP. Trade balance, especially the balance of trade in industrial products, significantly redounded to the increase in the current account deficit. Increased imports of raw materials and simultaneous reduction in the exports of industrial products⁴⁰ caused divergent movements in both components of foreign trade, annual growth in the imports and fall in the exports. The comparison base had a significant effect on the change in current transfers, which in the fourth quarter of last year were extremely high, driven in part by the instability in the euro area and the negative expectations for the future of the

³⁹ During December there was an outflow of funds based on completed construction services in the country, for construction of Corridor X. They were provided by the IPA component III during the same month and contributed to the increase in the official transfers in the fourth quarter.

⁴⁰ The decline was mostly due to the lower annual exports of iron and steel, which in part is a result of the high base. Namely, during the fourth quarter of 2011, atypically high export of this product group was generated, which does not correspond to the usual export dynamics.

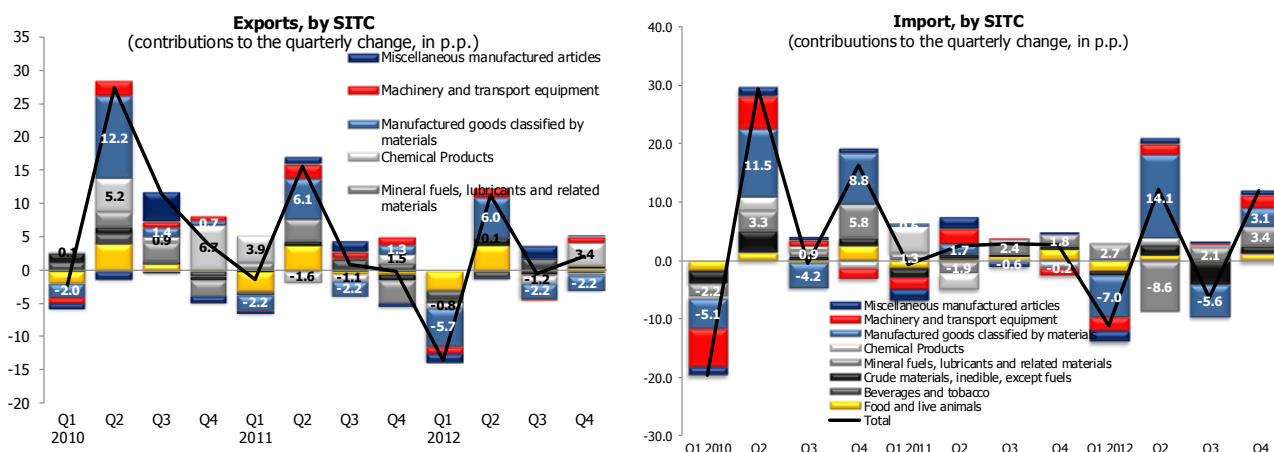


common currency⁴¹. The annual decline is entirely a result of the lower private transfers in cash, evident from the lower net purchase on the currency exchange market. Against the background of a slightly lower demand for foreign cash, the change is a result of the fall in demand, which is expected amid stabilization of the expectations about the future of the euro and decreased conversion of Euros into Denars. The negative change in services is due to the increased deficit in the balance of other services due to higher outflows on the basis of construction and various business services, while the annual expansion of the income deficit in the quarter was caused by the higher outflows on the basis of income from investments. Other components of "income" did not register significant changes compared to the same period last year. **According to the latest data on the balance of payments, current account deficit was registered also in January,** but the deficit was lower compared to January last year. The improvement on an annual basis was due to the improved performances in the trade of goods and services. In contrast, current transfers, influenced by lower private transfers in cash and income, acted towards expanding the current account deficit.

⁴¹ Net foreign assets purchased at the currency exchange market that flows into the banking sector is used to estimate the private transfers in cash. In December 2011, the supply of foreign exchange on the currency exchange market registered high growth, which in large part stems from the uncertainty about the future of the euro. During the entire fourth quarter, Euros were converted into Denars, but it was most pronounced in the last month, which caused an atypically high net purchase of cash on the currency exchange market. With the stabilization of the situation in the euro area and restoring the confidence in the euro as a common currency, the process of conversion slowed down.

Appendix 2. Foreign trade of goods and movement of the nominal and real effective exchange rate (NEER and REER)

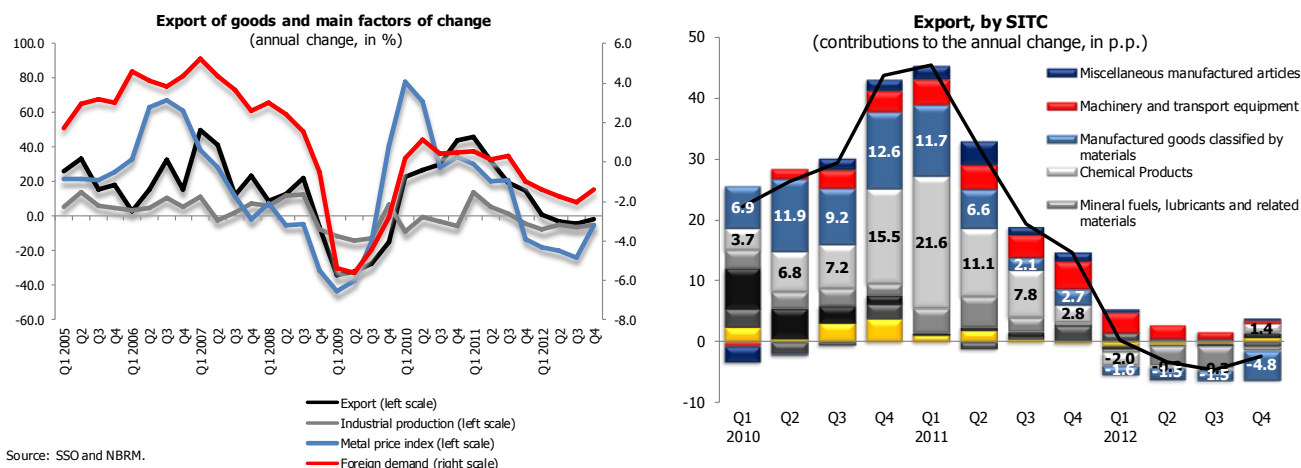
In the last quarter of 2012, **foreign trade of the Republic of Macedonia registered quarterly growth, which is consistent with the common seasonal dynamics. Increased foreign trade was due to the increase in nominal exports and imports which grew by 2.1% and 11.9%, respectively.** The higher growth of imports compared to the exports of goods resulted in a **widening of the trade deficit by 30%.** In terms of individual balances, the increased deficit is largely explained by the worsening of the non-energy balance (contribution of 65%) and to a lesser extent by the negative energy balance. The weaker export performances (reduced surplus) in iron and steel, seasonally increased imports of raw materials for the textile industry, as well as higher imports of machinery and equipment are the main drivers for the expansion of the non-energy balance, while in the energy balance, the increased deficit is a result of oil and oil derivatives and electricity, due to the higher import prices.



Source: SSO and NBRM.

Total trade increased also on an annual basis, fully reflecting the growth in imports. In the fourth quarter of 2012, **the exports again registered an annual decline (2.4%).** Negative annual growth rates of exports are common from the second quarter of 2012. The absence of meaningful stimulus through foreign effective demand and consequently, the lower production volume in the domestic economy, amid unfavorable conjuncture in metal prices on world markets in the last quarter of the year were the main factors that adversely affected the performance of export-oriented metal processing facilities (annual decline in the exports of iron and steel of 25.4%). Thus, these exports had the highest contribution to the decline in the export activity and the export realized in this quarter is the lowest, compared with the amounts realized in the same period from 2010 onwards. The annual decline in exports was caused by the decline in other traditional export products, tobacco, oil and oil products and clothing and footwear (36.3%, 14.3% and 2.8%, respectively). The decline in these export categories was partly offset by the annual increase in the exports of machinery and equipment, ores, chemicals, food and beverages. These trends point to further favorable developments in the export structure considering that much of them are products of the new industrial facilities (FDI) that not

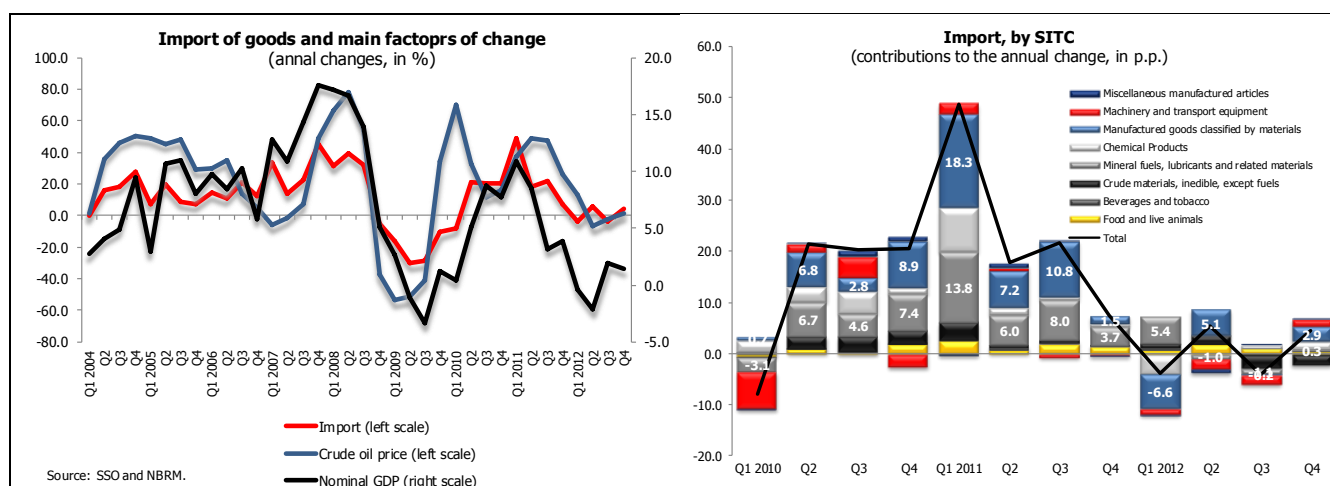
only diversify exports, but also are products with higher value added.



The import of goods in the analyzed period grew by 4.4% on an annual basis. The increase largely reflected the high import and energy dependence of the Macedonian export, as well as the intensified investment activity in the economy. Observed by product, most of the growth in imports is explained by the high import of raw materials for a larger plant in the free economic zone (increased imports of non-ferrous metals and imports of inorganic chemical products, by 28.2% and 2.9 times, on an annual basis, respectively). Increased gross investments in the domestic economy caused growth in the imports of machinery and transport equipment of 8.9%⁴². Increased import was registered also in oil and oil products (by 4.9%), due to the changed import structure in the energy category (higher quantity of imported oil products, as opposed to the imports of crude oil and accordingly, higher price of oil derivatives). On the other hand, the decline in metal production in the domestic economy led to a decline in the raw materials for this industry, i.e. imports of metal ores and metal scrap⁴³ decreased by 48.5% on an annual basis. Such movements in the components of the trade of goods with foreign countries caused **further widening of the trade deficit in the fourth quarter by 16%, on an annual basis.** In terms of the balances, the deterioration of the trade deficit is primarily due to the expansion of the negative gap in the non-energy balance (with a contribution of about 88% in the annual change) and to a lesser extent to the increase in the energy deficit. Moreover, in the non-energy balance, a significant reduction in the surplus of iron and steel is the dominant factor for the negative change, while in the energy balance, it is the growing deficit in oil and oil derivatives.

⁴² Higher imports of vehicles is due to the increased imports of the government in the last quarter.

⁴³ Slowed activity of a larger metal processing plant, which has a high import component.



The latest available data on foreign trade, **for the first two months of 2013**, indicate unchanged trade deficit compared with the same period last year, amid almost equal growth in exports and imports of goods. The annual growth (of 2.6%) in the export of goods is mainly due to the ores, chemical products, food and clothing and textiles, while the annual growth (of 1.6%) in the import of goods mainly comes from the imports of raw materials for a larger plant in the free economic zone and for the metal industry (iron and steel).

The analysis of the foreign trade by countries in the fourth quarter of 2012, shows that still, most of the trade in goods is carried out with the European Union (EU), then with the countries in the region and the emerging markets (Russia, China and Turkey). In terms of dynamics, the annual increase in the deficit was almost entirely due to the deepening deficit in the trade with the EU and the reduced surplus with the countries of the region. Moreover, within the EU, the deficit is mainly due to the increased imports from Greece, Great Britain, Romania and Italy⁴⁴, despite the increased surplus to our largest trading partner, Germany. Within the trade of goods with the countries in the region, the reduction in the positive balance results from the lower surplus in the trade with Kosovo (reduced exports of oil products). As for the emerging economies, the trade with Turkey and China registered an increase in the negative trade balances, while positive change, i.e. reduction of the annual deficit was recorded in the trade with Russia⁴⁵.

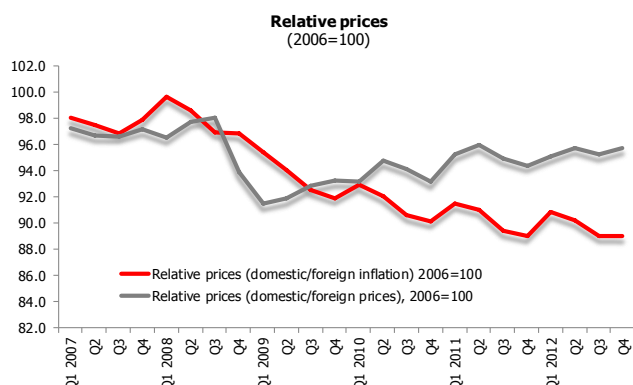
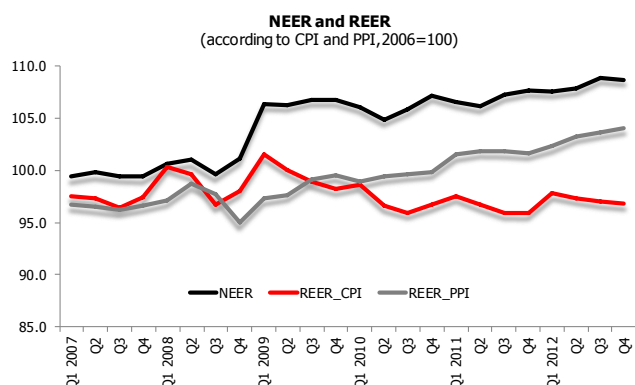
Also in the last quarter of 2012, the price competitiveness indicators give different indications of the changes in the competitiveness of the domestic economy. The REER index rate of the Denar, calculated according to the consumer prices, has depreciated for the third quarter in a row (by 0.2% on a quarterly basis), indicating

⁴⁴ Increased imports from Greece, are mainly due to higher imports of petroleum products, while higher imports from the UK come from the imports of non-ferrous metals (raw material for the production plant in the free economic zone). The growth of imports from Romania and Italy, is largely a result of the higher imports of iron and steel, i.e. machinery and equipment, respectively.

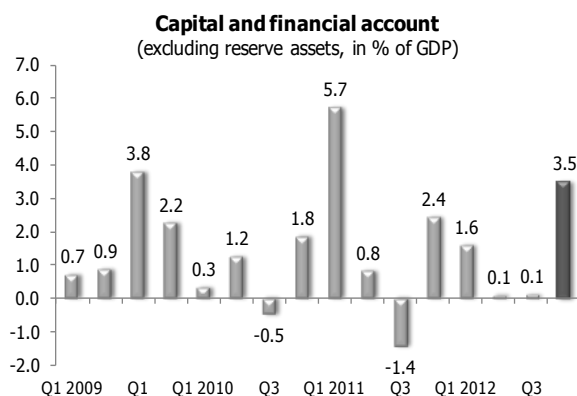
⁴⁵ In the trade with Russia there is a noticeable reduction in the imports of crude oil.



improved price competitiveness. Given the almost unchanged ratio of relative prices (equal increase in domestic and foreign inflation), the improvement results from the depreciation of the NEER (lower value of the Denar against the Serbian Dinar). On the other hand, the REER index rate of the Denar deflated by the prices of the producers of industrial products again shows quarterly appreciation, a trend which is common for the whole of 2012. Appreciation of the REER in the fourth quarter was 0.4% and it was entirely due to the more intensive growth of domestic compared to foreign prices of the producers of industrial products (by 0.5%), completely offsetting the depreciation of the NEER rate of the Denar (of 0,2%).

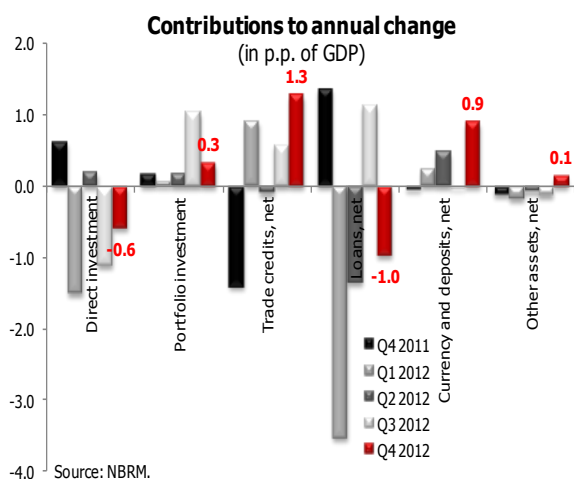
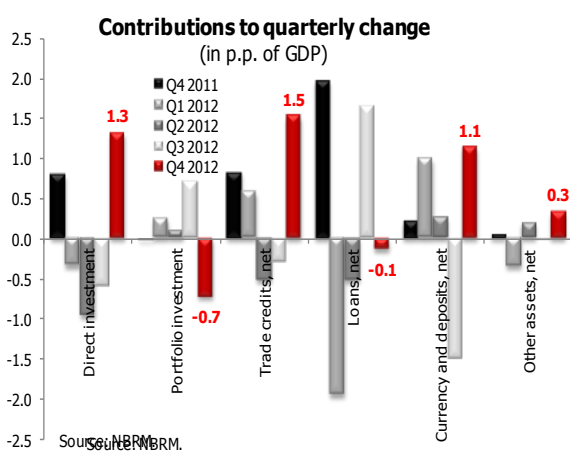
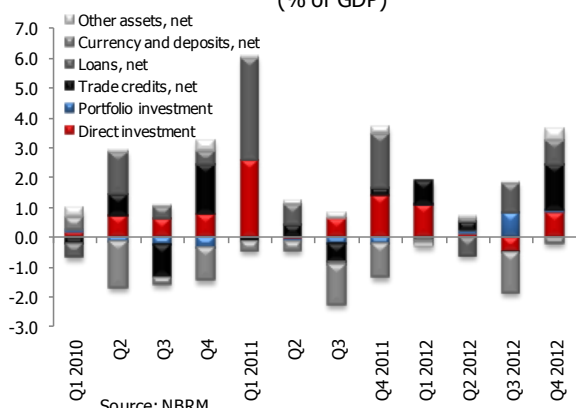


1.6.2. Capital and financial account



Source: NBRM.

In the fourth quarter, significant inflows were generated in the capital and financial account, in the amount of Euro 261.2 million or 3.5% of GDP. The inflows were sufficient to cover the current account deficit and provided additional accumulation of official foreign reserves. Net inflows were registered in all components of the capital and financial account, excluding currency and deposits, which again registered outflows, but with significantly lower intensity. The analysis of capital flows by sector suggests that inflows are fully generated by the private sector, amid negative foreign net-borrowing of the government. Trade credits totaling Euro 112.7 million or 1.5% of GDP have the highest contribution to the growth of capital flows. Accumulation of liabilities based on foreign trade corresponds with the more significant widening of the trade deficit in the fourth quarter. Additional financial inflows were generated from the intensified external borrowing of the private corporate

**Financial account, by components**
(% of GDP)

sector and from foreign direct investment. After the poor performance in the second and third quarters of the year, FDI inflows intensified in the last quarter, driven by reinvested earnings and equity, without a significant contribution of intercompany borrowing, i.e. without additional accumulation of external liabilities to parent companies. Outflow was observed only on the basis of currency and deposits. Households continued with the withdrawal of currency and deposits in this quarter, but at a significantly slower pace. Banks acted in the opposite direction by withdrawing their deposits with foreign banks in the domestic economy⁴⁶, which contributed to mitigating the still high outflows of currency and deposits of households.

In the fourth quarter of the year, capital and financial accounts showed improvement on both quarterly and annual basis. The quarterly change indicates improvement of 3.4 p.p. of GDP due to the capital flows of trade credits and foreign direct investment, as opposed to outflows in these categories in the third quarter, and to the more moderate negative flows in currency and deposits. Compared to the previous quarter, portfolio investments and loans recorded lower net inflows⁴⁷. The analysis of the quarterly movements on annual

⁴⁶ The withdrawal of bank deposits in foreign banks was fully realized during December, while in the previous two months of the quarter, banks moderately increased the deposits on accounts in foreign banks.

⁴⁷ In the third quarter, high inflows in the portfolio investment were generated, as a result of the disinvestment of the domestic pension funds in the Macedonian Eurobond. The change in the investment policy of pension funds was due to the changes in legislation (amendments to the Law on Mandatory Fully Funded Pension Insurance, "Official Gazette of RM" no.98 from 01.08.2012) which limits the investment of pension funds in the government securities issued solely on the domestic market. Inflows registered in the loans in the same period were the result of government external borrowing.

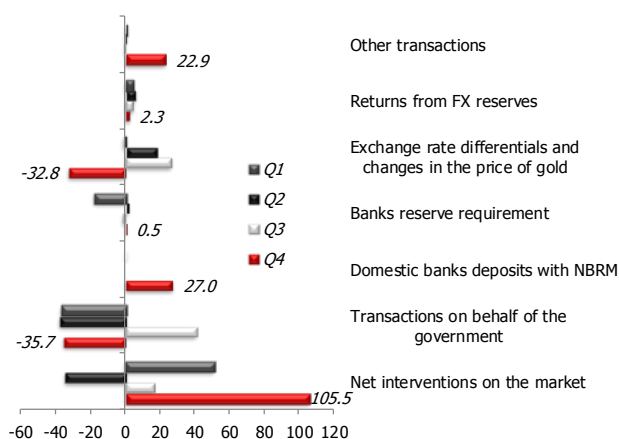


basis indicates milder positive movements in capital flows. In fact, compared with the fourth quarter of 2011, annual growth is evident in trade loans and realized inflows of currency and deposits of banks amid milder net outflows of currency and deposits in the household sector. Direct investments and net borrowing from abroad acted in the opposite direction. The change in loans is exclusively due to the higher external government borrowing in the fourth quarter of the previous year⁴⁸, while quarterly net borrowing of the private sector realized an annual growth.

Recent data for January indicate high net inflows in the capital and financial account of Euro 139.2 million. The most significant flows are generated on the basis of government external borrowing, which withdrew nearly Euro 150 million on the net basis⁴⁹. The withdrawal of funds is in the form of trade credits, while external liabilities were reduced by the payment of the matured Eurobond and reduction of the liabilities in the "portfolio investments" category.

*At the end of 2012, **gross foreign reserves** amounted to Euro 2,193.3 million.* Growth in reserves, compared to the end of the previous quarter, was Euro 89.7 million, and it was mainly due to the high realized net purchase by the NBRM on the foreign exchange market, and the growth of foreign currency deposits of banks with the NBRM. On the other hand, transactions on behalf of the government,

Factors of influence on the change of the level of gross reserves in 2012, by quarters
(in EUR million)



Source: NBRM.

⁴⁸ In December 2011, the government borrowed from a foreign commercial bank, using a guarantee from the World Bank.

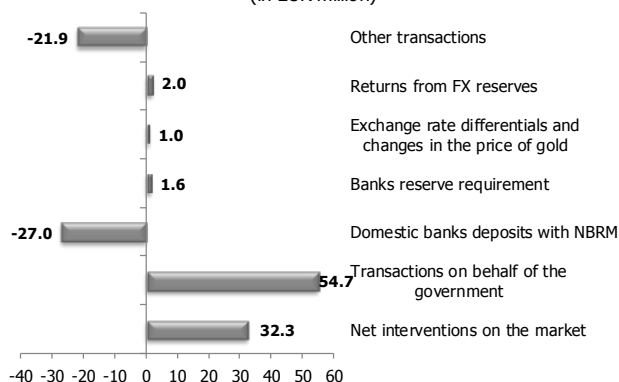
⁴⁹ In January, the government borrowed from the World Bank a loan intended for improvement of competitiveness and additionally from the Deutsche Bank by using a guarantee from the World Bank. At the same time, during the same month the government Eurobond was paid off, originally issued in 2009, a transaction which was reflected as an outflow in the portfolio investments.



and the currency and price changes acted toward depletion of the foreign reserves. Compared with the end of 2011, an annual growth of foreign reserves of Euro 124.4 million was registered. The annual accumulation of foreign reserves was due to the net purchase by the NBRM on the foreign exchange market, and to the growth of banks' deposits with the central bank, higher income from the investment of foreign reserves and the net effect of other transactions.

At the end of the first quarter of 2013, foreign reserves amounted to Euro 2,236 million, which is an increase of Euro 42.7 million. The increase in foreign reserves was due to the transactions executed on behalf of the government and net purchase realized through the NBRM interventions on the foreign exchange market.

Factors of influence on the change of the level of gross reserves in Q1 2013
(in EUR million)

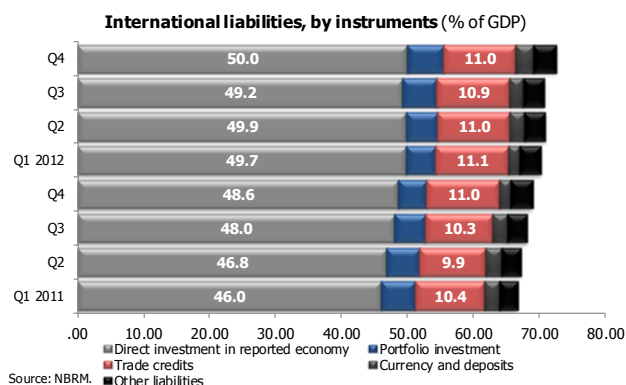
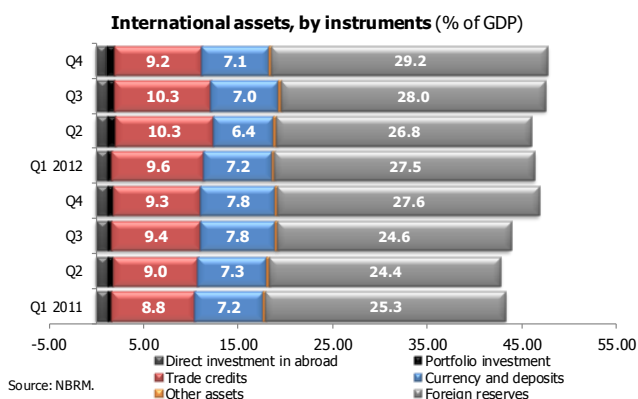
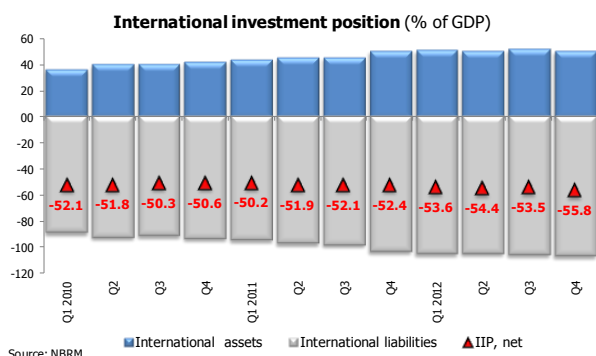


Source: NBRM.



1.6.3. International investment position⁵⁰ and gross external debt

In the last quarter of the year, **the negative investment position of the Republic of Macedonia against the rest of the world widened⁵¹** again on a quarterly basis. **Net liabilities increased by Euro 169.8 million or 2.3 percentage points of GDP and as of 31.12.2012 they amounted to Euro 4,196.4 million or 55.8% of GDP⁵².**



Deepening of the net debt position of the country against the rest of the world on a quarterly basis, is mainly due to the **decline of international assets** (claims on non-residents) of 2.7%, and to a lesser extent to the growth of **international liabilities** (liabilities to non-residents) which increased by 0.8% on a quarterly basis. **The quarterly decline in assets is a result of the lower claims of the monetary**

⁵⁰ In September 2012, the NBRM started disclosing data on the international investment position (IIP) of the Republic of Macedonia, by quarter. IIP data are available at the NBRM website:

(www.nbrm.mk/statistika/eksterni_statistiki).

⁵¹ The trend of steady quarterly growth of the negative IIP lasted seven quarters (starting from the fourth quarter of 2010) and was interrupted in the third quarter of 2012.

⁵² In the second quarter of 2011, the NBRM started concluding repo and reverse repo transactions. The conclusion of repo transactions produces liabilities (classified under the category of loans) that contribute to the increase of the gross debt. The conclusion of reverse repo transactions creates claims that contribute to the increase of gross claims. The NBRM simultaneously conducts matched conclusion of repo and reverse repo agreements, in almost identical amount. Overall, since they are concluded concurrently, on net basis these transactions have neutral net-effect, i.e. they appear in almost identical amount on the side of both liabilities and claims, thus having no effect on the total net IIP and the total net external debt. *Therefore, data presented further in the text are presented without repo transactions, unless otherwise indicated.*



authority based on loans (reverse repo transactions) and of the reduced claims based on commercial loans in the other sectors of the economy. **On the liabilities side, the quarterly increase** was due to higher liabilities for all instruments (excluding loans) mostly on the basis of direct investment in the country, currency and deposits (foreign exchange liabilities of banks) and other liabilities.

The analysis of the international investment position by sector, shows that the quarterly deterioration of the negative net IIP results from the increase in the net liabilities of the nonbank private sector, for the most part, and of the banks. This change is partly offset by the monetary authority and the government, whose net positions (increase in net assets and decrease in net liabilities, respectively) led to improvement of the investment position of the country.

	Q4 2011	Q3 2012	Q4 2012	quarterly change			annual change		
	in EUR million			difference	contribution	in %	difference	contribution	in %
IIP, net	-3,931.0	-4,026.6	-4,196.4	-169.8	4.2	4.2	-265.4	6.8	6.8
Government, net	-1,417.4	-1,553.5	-1,543.9	9.6	-0.2	-0.6	-126.4	3.2	8.9
Monetary authorities, net	1,991.8	2,027.3	2,095.8	68.5	-1.7	3.4	104.0	-2.6	5.2
Banks, net	-456.9	-520.9	-562.7	-41.8	1.0	8.0	-105.8	2.7	23.2
Other sectors, net	-4,048.5	-3,979.5	-4,185.7	-206.1	5.1	5.2	-137.2	3.5	3.4

On an annual basis, the trend of further deepening of the net debt position of the country, which started in the first quarter of 2011, continued. **In the last quarter of 2012, the negative net IIP registered an annual growth of Euro 265.4 million, or 3.4 percentage points of GDP.** *Given the almost unchanged international assets, this change is solely due to the increase of international liabilities (by Euro 266.6 million or 3.3 percentage points of GDP).*

Regarding international assets, the small annual change (growth of Euro 1.2 million) was primarily due to the increased gross international reserves of the monetary authorities, in conditions of significantly lower claims based on loans

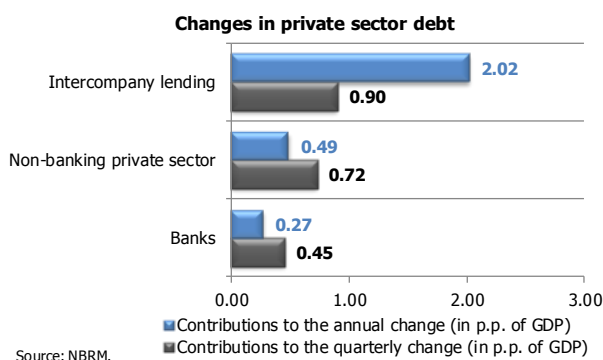
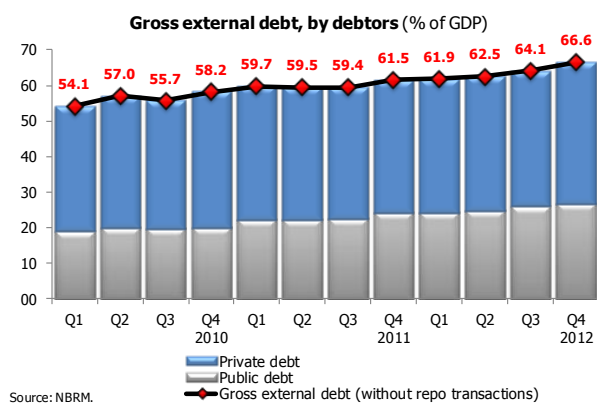


(repo transactions) and reduced currency and deposits of banks (withdrawal of foreign assets from banks' accounts abroad, for the third quarter in a row). **Increased international liabilities on an annual basis** generally result from higher liabilities to direct investors, growth in the liabilities for portfolio investment (mainly due to the sale of government Eurobonds owned by residents, to non-residents) and increased liabilities of banks based on deposits of non-residents.

The analysis according to individual institutional sectors shows that the annual expansion of the negative gap in the international investment position of the country is due to the higher net liabilities in all sectors, with the exception of the monetary authority.

At the end of 2012, gross external debt of the country reached the level of Euro 5,163.2 million, or 68.6% of GDP. If repo transactions of the monetary authority are excluded, gross external debt amounted to Euro 5,005.6 million or 66.6% of GDP⁵³.

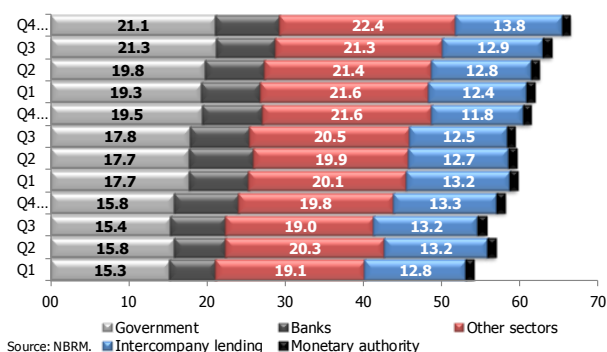
On a quarterly basis, the gross debt of the country increased by Euro 186.1 million, which is 2.5 percentage points of GDP. The largest contribution (about 84%) to the increase in the gross debt in the last quarter of the year was that of the increased **private debt**, reflecting the higher inter-company borrowing (mostly short-term liabilities to direct investors), increased liabilities of the non-bank private sector in the form of loans, and the increased debt of the banking sector (mainly an increase in short-term liabilities on the basis of deposits of non-residents). In the public sector, the higher



⁵³ Overall further analysis refers to the gross external debt without liabilities of the monetary authority based on repo transactions.



Gross external debt, by institutional sectors (% of GDP)



level of debt on a quarterly basis was due to the increased long-term liabilities of public companies and MBDP, as opposed to the small decline in the debt of the central government.

The annual analysis indicates a steady growth of external debt, since 2007 onwards. The annual growth of Euro 391.5 million, or 5.1 percentage points of GDP, is a result of the growth of both the private and the public debt (contribution of 55% and 45%, respectively). Higher liabilities to direct investors largely (71.4% contribution) explain the growth of the private debt. The higher level of public external debt reflects the increased debt of the central government due to the long-term borrowing and the sale of the government Eurobonds by residents to non-residents, but also the increased borrowing of public enterprises and the MBDP.

The analysis of the dynamics of the external indebtedness of the country registered an annual improvement in almost all **solvency indicators**, with the exception of the gross external debt to GDP ratio, which deteriorated. Significant improvements were seen in the gross debt to exports of goods and services ratio and the indicator for debt servicing covered with export of goods and services, where the three-year growth trend was interrupted, while a small positive change (decline) was registered also with the indicator for servicing of interest covered with export of goods and services. According to the methodology of the World Bank, according to the level of external debt, the Republic of Macedonia is in the group of low indebted countries, with the exception of the external debt to GDP ratio, which is the only indicator that categorizes it in the group of highly indebted countries. **Liquidity indicators** for the external debt of the country, generally indicate a



relatively favorable position, or nearly complete coverage of liabilities on the basis of the short-term debt (residual maturity) with foreign reserves, although this indicator registered a slight worsening at the end of 2012.

<i>Indicators for external indebtedness</i>	<i>Solvency</i>				<i>Liquidity</i>		
	Interest payments/ Export of goods and services and other inflows	Gross debt/ Export of goods and services and other inflows	Gross debt/ GDP	Debt servicing/ Export of goods and services and other inflows	Foreign reserves/ Short-term debt	Foreign reserves/ Short-term debt, with residual maturity	Short-term debt/ Overall debt
	in %				ratio	ratio	in %
31.12.2004	2.24	120.1	49.3	11.5	1.14	0.89	30.3
31.12.2005	2.33	128.5	56.3	9.7	1.67	1.04	26.7
31.12.2006	2.88	109.8	51.8	18.2	1.95	1.34	29.0
31.12.2007	2.38	102.3	53.2	16.6	1.35	1.08	39.8
31.12.2008	2.30	101.1	55.3	8.8	1.29	0.95	35.2
31.12.2009	2.10	113.3	58.5	10.2	1.29	0.94	32.9
31.12.2010	2.78	121.1	60.1	11.9	1.31	0.90	32.0
31.03.2011	2.70	124.9	63.2	14.5	1.46	1.05	29.1
30.06.2011	2.70	124.4	63.0	14.5	1.40	1.00	29.3
30.09.2011	2.70	124.2	62.9	14.5	1.42	0.99	29.1
31.12.2011	2.70	128.5	65.1	14.5	1.53	1.06	29.4
31.03.2012	2.46	114.5	63.2	11.3	1.48	0.93	30.0
30.06.2012	2.46	115.8	63.9	11.3	1.40	0.91	30.7
30.09.2012	2.46	118.6	65.5	11.3	1.48	0.96	29.5
31.12.2012	2.46	123.2	68.0	11.3	1.40	0.93	31.3
<i>Moderate indebtedness criterion</i>	<i>12 - 20%</i>	<i>165 - 275%</i>	<i>30 - 50%</i>	<i>18 - 30%</i>	<i>1.00</i>		

*The moderate indebtedness criterion is according to the World bank's methodology of calculationg indebtedness indicators, which implies 3-year moving averages of GDP and exports of goods and services in the calculation of the indicators. Data for 2012 are according to BoP projection October 2012. In compliance with "External debt statistics: Guide for compilers and users," published by the IMF.

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

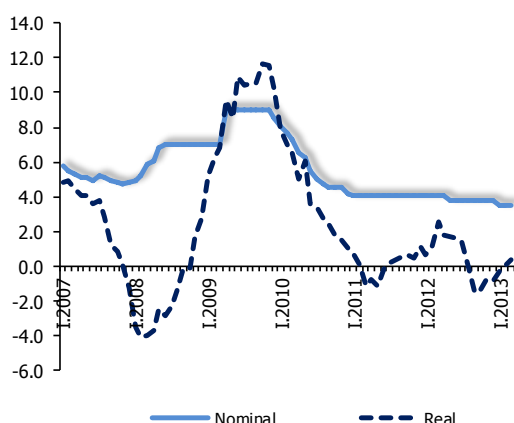
Source: NBRM.



II. Monetary policy

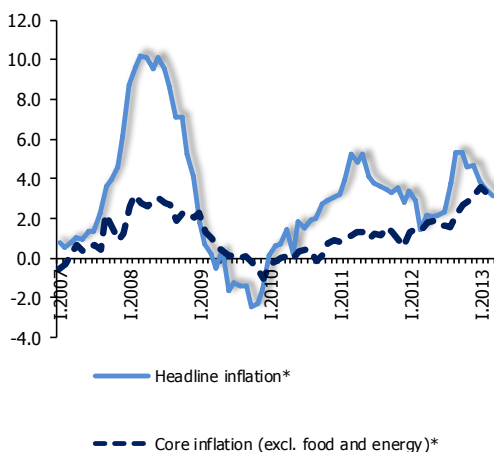
At the beginning of the first quarter of 2013, NBRM reduced the interest rate on CB bills from 3.75% to 3.5%, against the background of assessments for relatively favorable conditions, observed from a monetary point of view. At the end of the last year, the amount of foreign reserves exceeded the expectations, while at the same time inflation stabilized at somewhat faster pace than expected, indicating a reduction in inflationary pressures caused by the growth of import and regulated prices. Indicators of economic activity pointed to further anemic state of the economy, and similar signals came from the credit market. By the end of the quarter, monetary policy remained unchanged, amid already made monetary easing through the interest rate and the reserve requirement, the continuity of the movement of main macroeconomic indicators, but also the present risks manifested by relatively high core inflation and narrowing of the margin between Denar and foreign exchange savings. Also in the next period, NBRM will continue to closely monitor the situation in order to make timely and adequate adjustment of the monetary policy.

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



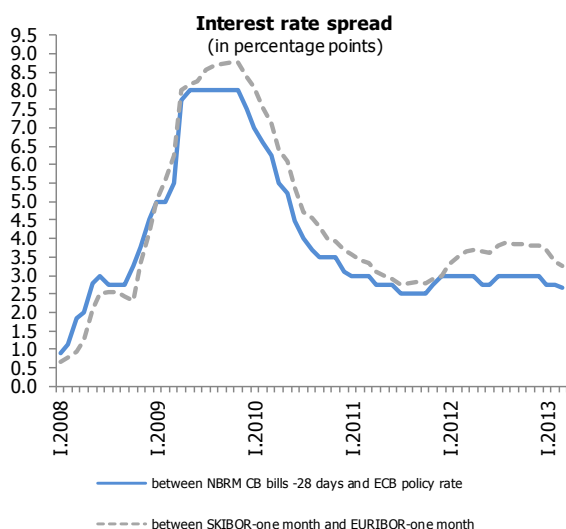
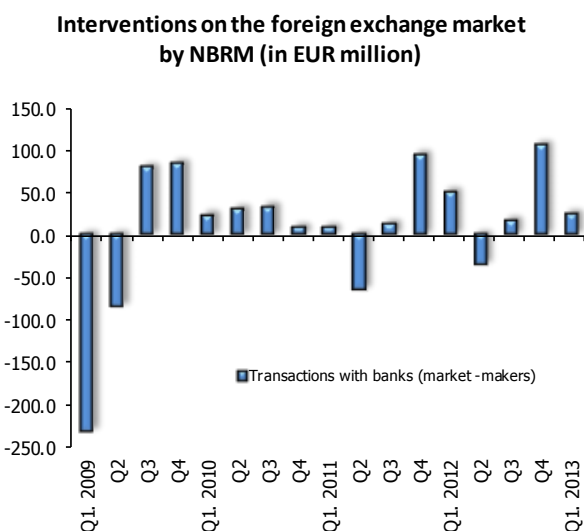
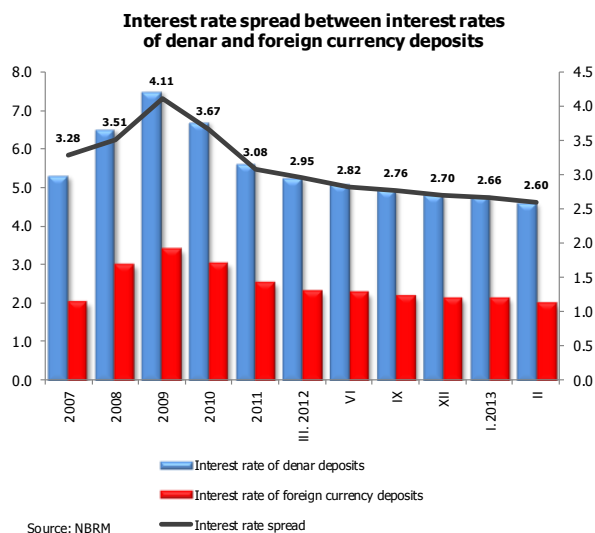
Source: NBRM.

Inflation (in %)



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

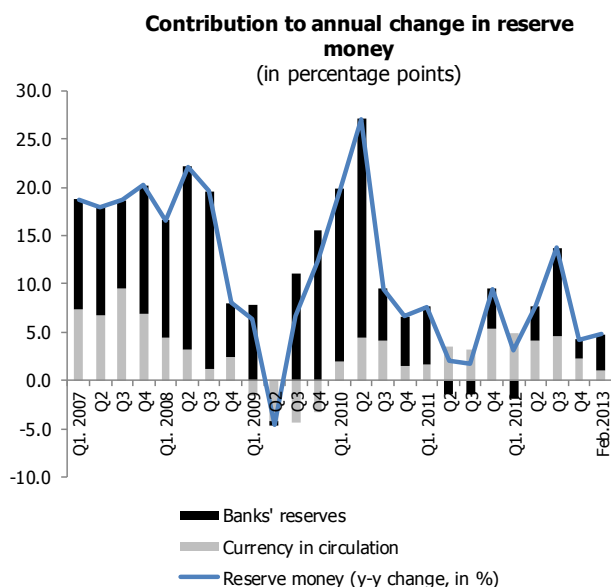
At the beginning of the first quarter of 2013, NBRM reduced the key interest rate to 3.5%, amid assessments for favorable movements from a monetary point of view. Namely, at the end of the last year, the amount of foreign reserves was well above the expectations and the downward adjustment of inflation was faster than projected. At the same time, weak economic activity and slowing credit growth indicated lack of inflationary pressures through demand which created room for monetary easing in early January. For the quarter, from the interventions in the foreign exchange market the NBRM realized net purchase in the amount of Euro 24.3 million, which was solely due to the high net purchase in January. In February and March, NBRM interventions were aimed at net sales, where reserves were still maintained at an adequate level, without major deviations from the projections. The dynamics of the inflation rate during the quarter was below the expectations, where the inflation in March was 3.1% and credit flows continued to grow at a slower pace. The latest data on the real sector showed a decline in the economic activity in 2012, amid a simultaneous decline in the



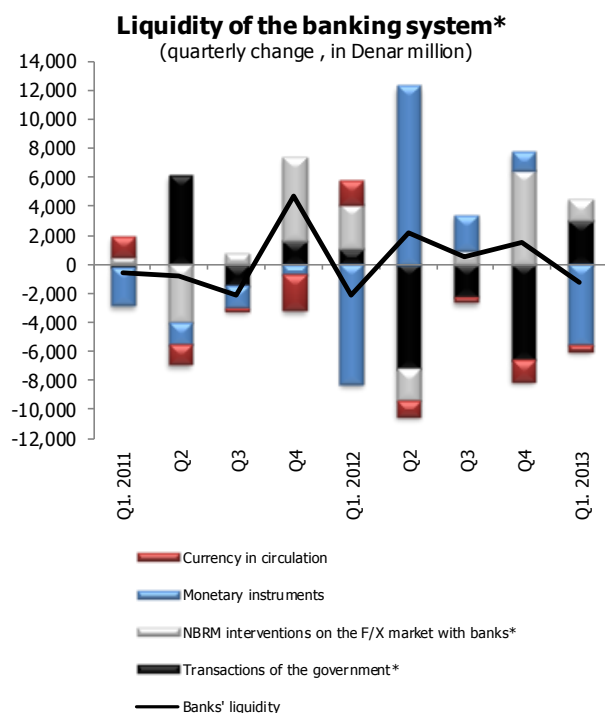
European economy and poor prospects for recovery in 2013. Given the current stage of the business cycle in the country and the world, credit flows in the domestic market were also weak, reflecting the findings of increased credit risk of banks, and partly the effect of the policies of some parent banks. Despite the absence of inflationary pressures from the demand under such conditions, the growth of core inflation above expectations pointed to possible upward inflationary pressures and imposed a need for caution in conducting the monetary policy. The interest rate spread between foreign exchange and Denar interest rate continued to narrow gradually, which was also a sign of greater caution. In such conditions, and amid expectations for materialization of the effects of the monetary easing already performed, NBRM kept the key interest rate unchanged until the end of the quarter.

Interest rate spread between the key interest rate of the NBRM and the key interest rate of ECB was reduced and equaled 2.67 percentage points at the end of the first quarter. The narrowing of the interest rate margin is a result of reducing the interest rate on CB bills, given the unchanged interest rate policy of the ECB. The decision of the ECB to keep the same interest rate also in the first quarter of 2013 was passed amid declining inflation, weak economic activity and negative credit growth, but also amid balanced risks to inflation in the forthcoming period. However, the ECB continued to conduct accommodative monetary policy also in the first quarter, where on a net basis, despite the repayments of last-year LTRO by banks, there is still sufficient excess liquidity in the system⁵⁴. In conditions of unchanged key interest rate of the ECB, also the one-

⁵⁴ Mario Draghi, President of the ECB, press conferences of the ECB, 07.02. and 07.03.2013.



Source: NBRM.



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

month EURIBOR was stable and amounted to 0.1%. On the domestic financial market, SKIBOR⁵⁵ followed the direction of the key interest rate and went down to 3.38% at the end of the quarter. Under these conditions, the interest rate spread between the one-month SKIBOR and the one-month EURIBOR narrowed and in March it was 3.3 percentage points (3.8 percentage points in December).

2.1 Bank liquidity and developments on the interbank money market

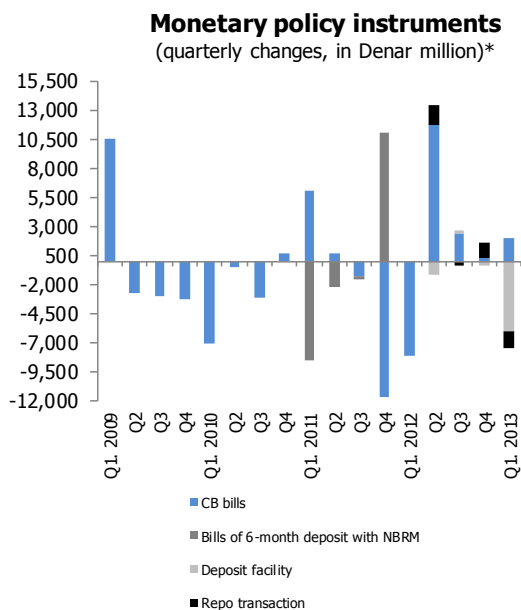
At the end of March 2013, the liquidity of banks decreased by Denar 1,266 million compared to the end of the last year. Thus the balance on the accounts of banks with the NBRM⁵⁶ stood at Denar 17,326 million, at the end of March. In February, the annual growth rate of reserve money⁵⁷ equaled 4.8%, versus 4.3% at the end of the last year.

In the first three months of 2013, the autonomous factors, net, acted towards creating liquidity in total amount of Denar 4,241 million. Within these frameworks, government transactions contributed towards creating liquidity (totaling Denar 3,036 million) by spending deposits from the government Denar account with the NBRM. In the same vein were the foreign exchange transactions of the NBRM with the market-makers, in line with the realized net purchase of foreign currency on the foreign exchange market (of Denar 1,489 million). Currency in circulation had moderate contribution towards withdrawing liquidity (in the amount of Denar 455 million).

⁵⁵ Interbank interest rate on Denar deposits, calculated using the quotations of referent banks.

⁵⁶ Refers to Denar accounts of banks, obliged to allocate reserve requirement.

⁵⁷ Includes the foreign currency reserve requirement.



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

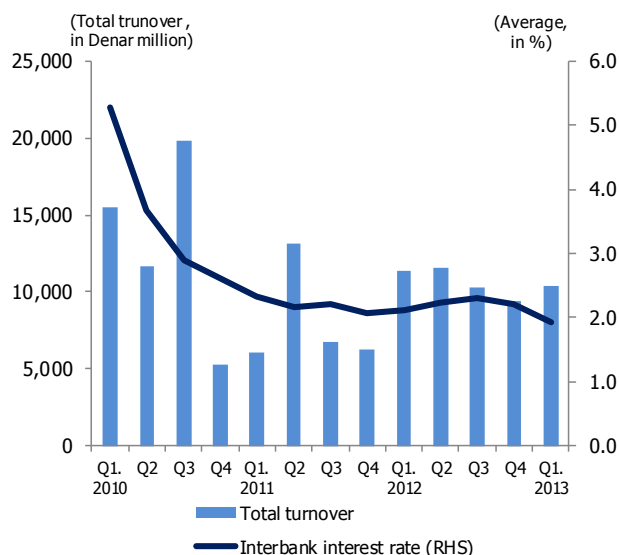
In the first quarter, the monetary instruments of the NBRM, acted towards withdrawing liquid assets in the total amount of Denar 5,507 million. Of that, liquid assets totaling EUR 1,980 million were created through CB bills. In this period, three auctions of CB bills were held. At the auctions, NBRM determined the size of the supply of CB bills within the due amount, with the demand by banks being slightly higher than the amount offered, on average. The interest rate realized at all three auctions, moved close to the maximum interest rate set by the NBRM and averaged 3.46%. **Repo transactions during the third quarter provided less liquidity in the system compared to the previous quarter, while banks were increasingly interested in investing in the standing deposits with the NBRM (banks invested Denar 6,087 million).** During the first quarter, released liquidity in accordance with the changes in the **reserve requirement** had some effect on the liquidity of banks⁵⁸. In the first quarter, banks continued to maintain a relatively lower level of excess liquidity over the reserve requirement, a trend common for the period after the introduction of the monetary changes from April 2012. Compared with the previous three quarters, the average excess liquid assets allocated over the reserve requirement in the first quarter of 2013

⁵⁸ The amendments, among other things, allow a decline in the basis for the reserve requirements of banks for the amount of newly granted loans to net exporters and companies for financing projects for domestic production of electricity for own and/or commercial use, as well as for investments in debt securities denominated in national currency issued by the above-mentioned non-financial companies. The decision provides for full exemption from mandatory allocation of reserve requirement for banks' liabilities on the basis of issued debt securities in local currency and original maturity of at least two years. Find more details on these changes in the Quarterly Report, January 2013.



were slightly higher and averaged 0.9% (0.5% on average in the fourth quarter and 1.6% on average in the first quarter of 2012).

Interbank deposit market



Source: NBRM.

In the first quarter of 2013, a turnover of Denar 10,386 million was realized on the interbank market, which compared to the previous quarter, was an increase of 10.2%. Compared with the same period last year, the activity on the interbank market in the first quarter shows a decrease of 8.5%. The comparison of the interbank activity by maturity still points to higher interest in trading with longer maturities (seven days and a month) compared to last year, with the share of this type of transactions in the total executed transactions being 28.6%. The interbank interest rate (MBKS)⁵⁹ in the first quarter of 2013 averaged 1.94% (2.21% on average in the fourth quarter). In the last quarter, the interbank interest rate for overnight transactions (MKDONIA) averaged 1.85%, versus 2.10%, as it averaged in the fourth quarter. On the **secondary money market**, a high turnover of approximately Denar 1,071.4 million was realized in the last quarter, which is a turnover about seven times higher than the one realized in the preceding quarter.

2.2. Monetary and credit aggregates

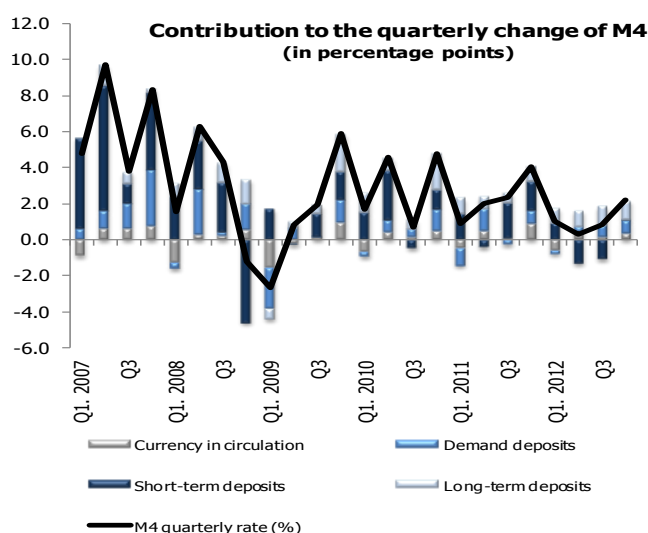
Money supply continued to grow in the fourth quarter of 2012, at a faster pace than the average quarterly growth in the previous three quarters. Such dynamics of monetary growth is the effect of seasonal factors, but also reflects the changes in the real and financial flows in the economy. Indicators of economic activity point to quarterly growth in three consecutive quarters, while the positive position of the balance of payments in the last quarter contributed to additional monetization. Speaking of

⁵⁹ Average interest rate on the interbank money market.



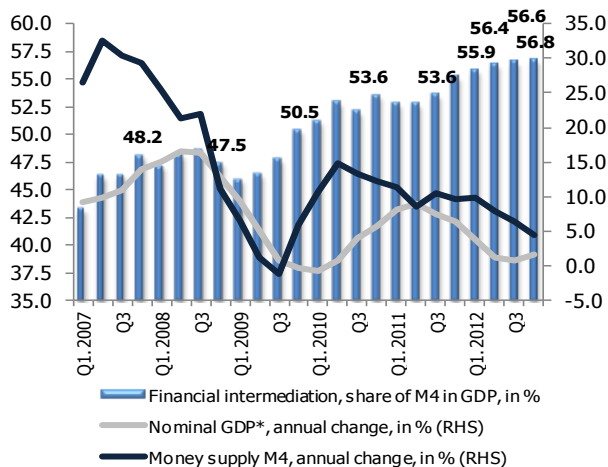
structure, the quarterly growth in the money supply reflects the higher demand for most liquid assets with banks, the growth of long-term households' savings and for the first time after two quarters, the increased funds on the accounts of the corporate sector. The activity on the credit market slowed significantly in the last quarter, and the growth rate of loans in the domestic economy was less than one-third of the average amount of loans placed in the first three quarters of the year. The utilization of the deposit potential of banks for lending to the private sector continued to decline, showing the reticence of banks to take greater risks. The banks remain oriented towards conducting cautious credit policy amid still present risks and vulnerability of the real sector. By sectors, there is a minimal increase in corporate loans, amid slower quarterly growth of loans to households. The slower credit growth continued during the January-February period, and in this period an increase in non-performing claims on enterprises was registered.

2.2.1. Monetary aggregates



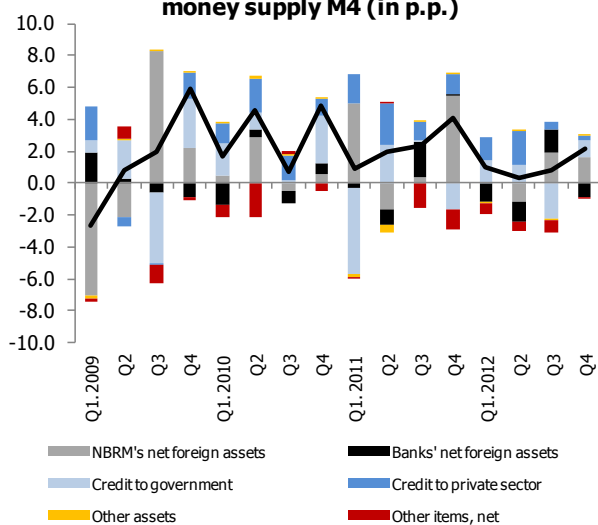
Source: NBRM

In the last quarter of 2012, monetary growth accelerated from 0.8% to 2.2% on a quarterly basis. This dynamics of money supply is an effect of seasonal, but also of fundamental factors, i.e. moderate economic recovery and foreign exchange inflows through the balance of payments. As a result of the faster growth in the money supply relative to the nominal GDP, the monetization rate registered a moderate growth of 56.6% to 56.8% on a quarterly basis. Regarding the structure, the growth of the broadest money supply is a result of the intensification of the growth of the banks' deposit potential, but also of the further growth of most liquid assets (currency in circulation and demand deposits). Total savings have a positive contribution to monetary growth for the first time after two quarters. Namely, in the second and third quarters of the year, despite the continued growth of households' savings, the outflows from the corporate sector accounts for the payment of dividends and lending to parent companies abroad resulted in a negative effect on the monetary growth dynamics. **On annual basis, the growth of the broadest money supply M4 continued**

**Money supply M4 and nominal GDP**

* Annualized nominal GDP calculated as moving sum of 4 consequent quarters.

Source: NBRM and SSO

Contribution in quarterly changes of money supply M4 (in p.p.)

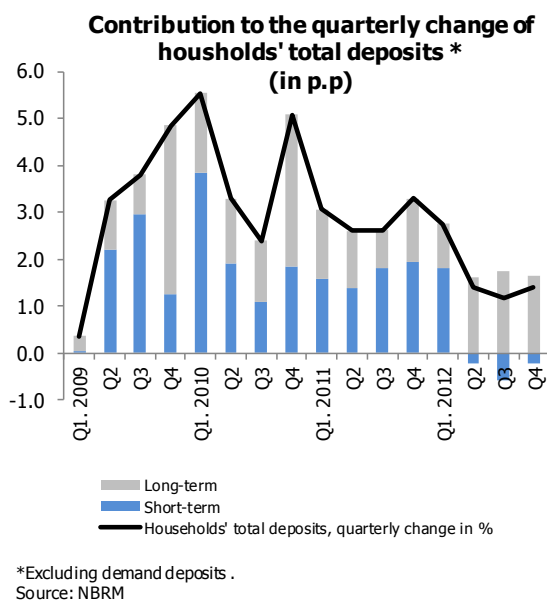
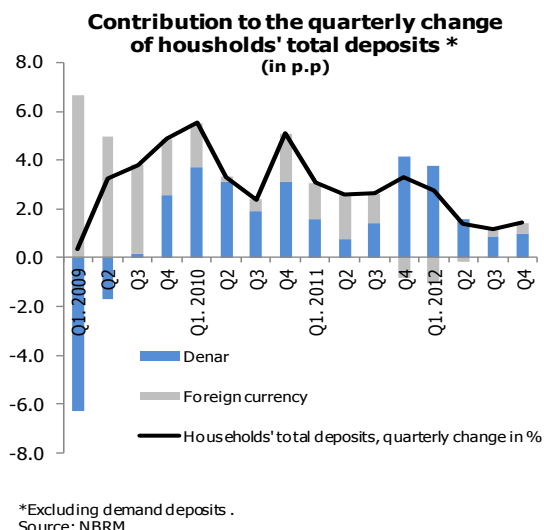
Source: NBRM.

to decelerate, and in December it reduced to 4.4% (versus 6.3% in September). Denar deposits still have the largest contribution to the growth of the broadest money supply M4, although with reduced participation in the growth of 80% versus 97% in September, followed by the participation of the most liquid monetary aggregate M1 (41%), while the negative contribution of the foreign currency deposits declined.

In the fourth quarter of the year, a quarterly growth in total deposits of 1.5% was registered, versus the stagnation in the previous period. In this period, certain changes in the structure of total deposits compared to previous periods were registered. So, after two quarters, short-term deposits for the first time had a positive contribution to the growth of total deposits. Long-term deposits remain the dominant category contributing to the increase in the deposit potential of banks, but with less intensity. On the other hand, after a year, for the first time a positive contribution of foreign currency deposits was registered. These developments contributed to the decelerated slowdown of the rate of Euroization⁶⁰, a trend that was present throughout the whole 2012.

Regarding the highly liquid component of the broadest money supply in the fourth quarter, acceleration of the quarterly growth of the narrowest monetary aggregate M1 was registered, from 3.3% to 4.4%. Namely, in this period, seasonal effects of New Year and Christmas holidays contributed to the intense growth of the components of this most liquid monetary aggregate.

⁶⁰ Expressed through participation of foreign currency deposits in broad money M4.

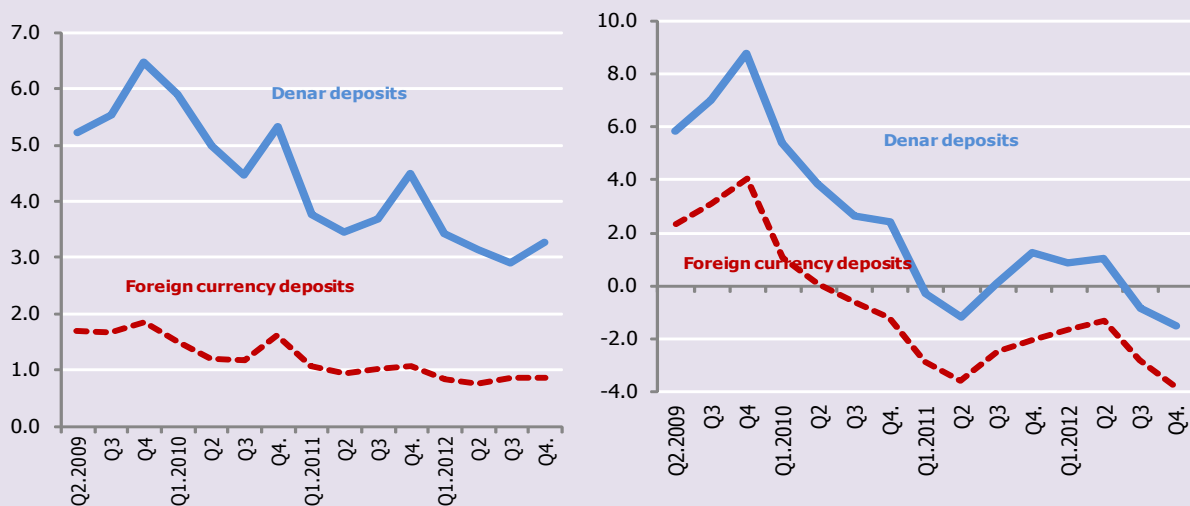


In terms of sectors, the total household deposits (excluding demand deposits) had a quarterly growth of 1.4% versus 1.2% in the previous quarter. This represents a break in the trend of slowing quarterly growth of total deposits of this sector common for early 2012. In terms of currency, the trend of quarterly growth in foreign exchange savings, which started in the previous quarter, continued in the last quarter, indicating a gradual stabilization of the process of intensive Denarization of this part of households' financial assets. Thus, the contribution of foreign currency deposits in total deposits growth increased on a quarterly basis from 24% to 32%. In terms of maturity structure, the quarterly growth of household deposits is entirely the result of long-term deposits, while short-term deposits declined for the third consecutive quarter. Amid higher yields from long-term savings and high confidence in the stability of the banking sector, long-term deposits have been the main drivers of total household deposits for a longer period of time. In terms of interest rates on new Denar and foreign currency deposits, adverse movements compared with the previous quarter were registered. The yields on new Denar deposits increase on average, while the yield on foreign currency deposits declined slightly. The real yield on Denar and foreign currency deposits remains negative, in conditions of higher average inflation rate relative to the previous quarter.

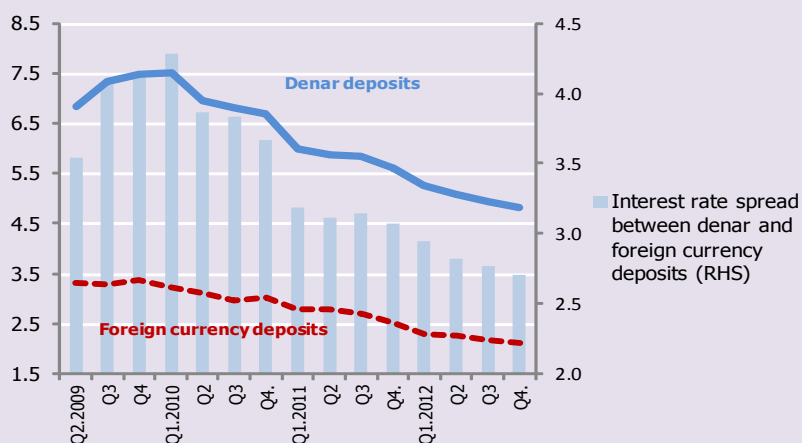


Banking conditions - Households deposit market

Interest rates on newly received deposits of households, in %, on annual level



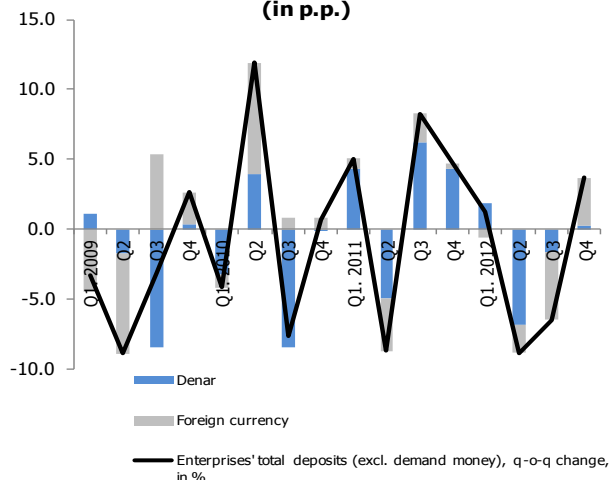
Interest rates on outstanding amount of total deposits, in %, on annual level



Source: NBRM.

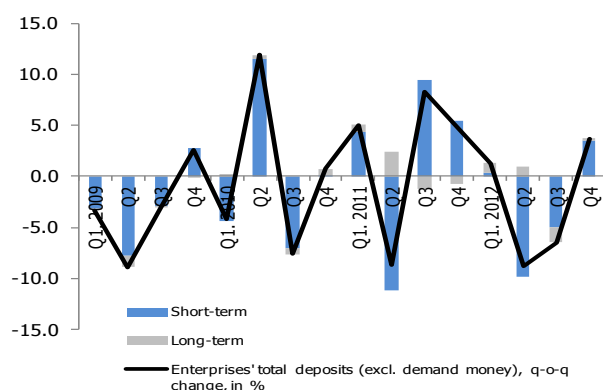


Contribution to the quarterly change of enterprises' total deposits* (in p.p.)



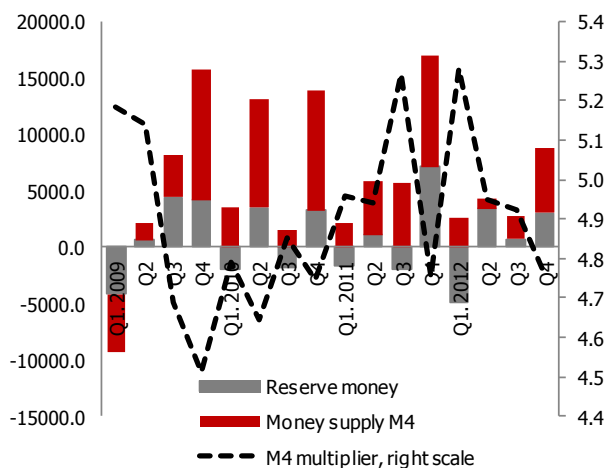
*Total deposits and denar deposits don't include demand money.
Source: NBRM.

Contribution to the quarterly change of enterprises' total deposits* (in p.p.)



*Total deposits and short-term deposits don't include demand money.
Source: NBRM.

Components of monetary multiplier M4
(q-o-q changes, in Denar million)



Source: NBRM.

In the fourth quarter, corporate deposits registered quarterly growth of 3.7%, as opposed to the decline in the previous two quarters (8.9% and 6.5% in the second and third quarter, respectively). The absence of major outflows of funds for payment of dividends, common for the previous period, was one of the reasons that contributed to the increase in companies' savings potential. Furthermore, the growth of economic activity in the country and the moderate improvement in the credit support of banks further acted in this direction. The payment of government arrears also had an effect on the growth of funds on the accounts of enterprises. Regarding the structure, all maturity and currency components of the deposits of the corporate sector registered quarterly growth, as opposed to their decline in the third quarter. Foreign currency and long-term deposits had the largest contribution to the growth of corporate deposits.

The trend of slowing the process of monetary multiplication common for the two previous quarters continued in the fourth quarter. Thus, the monetary multiplier of the M4 money supply was 4.76 versus 4.92 in the previous quarter. The slower process of multiplication occurred amid slower average monthly growth of money supply relative to the average growth of reserve money. Namely, in this period, the reserve money experienced faster growth relative to the previous period, on average, as a result of the increase in liquid assets of banks and the present seasonal effect in the currency in circulation.

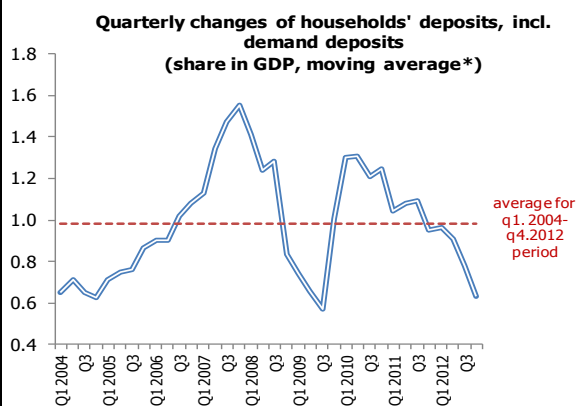
The latest monetary data for the January-February period indicate acceleration in the annual growth of the banks' deposit potential and of the M4 money supply, and in February they amounted to 4.2% and 4.9%, respectively.



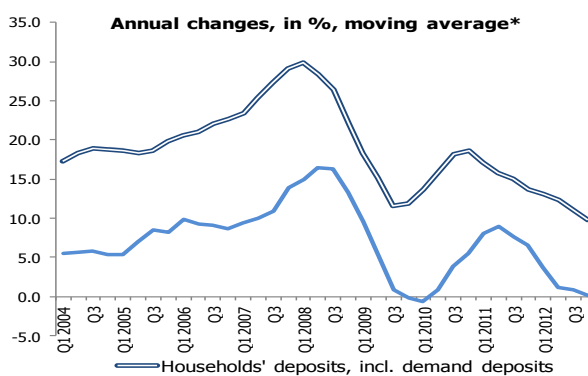
This represents a break in the trend of slowing their annual growth rates, which started in September 2012.

Appendix 3: Analysis of the factors of change of household deposits in the Republic of Macedonia in 2012

Households' propensity to save, i.e. decisions about how much of the currently available income or additional increment of income they will put into savings and how much into consumption, has been subject of continuous interest among macroeconomic policy-makers. Maintaining a solid savings rate of households is significant from both the microeconomic and macroeconomic aspects. **Economic theory suggests several motives for households saving,** which could be systematized in four broad categories: 1) redistribution of the disposable financial resources over time in order to allow maintenance of a relatively stable profile of consumption over the life time, 2) financial provisioning for post-retirement and leaving inheritance, 3) financing certain high costs expected at some point in life (such as investments in real estate and education) and 4) protection against the risk of unexpected reduction in the disposable income (i.e. precautionary saving). Also, household savings are very important for the economic development as they are an important source of funding the economy, contributing to the increase in its productivity. High rates of savings provide significant domestic support of the activity, reducing the need for debt financing from abroad. **Regardless of personal preferences and motives, the key element that determines the rate of household saving is the extent of disposable assets, which suggests a close connection between household savings and the phase of the business cycle.**

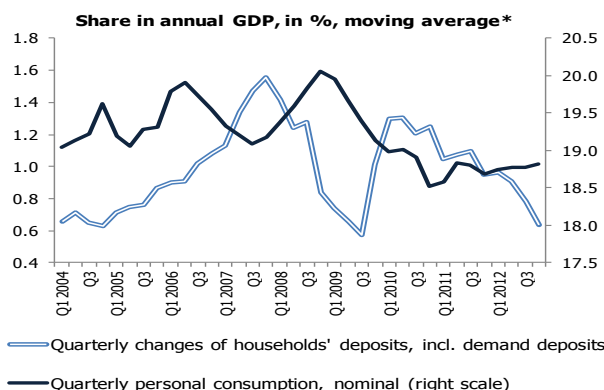


Source: NBRM's calculations based on data from the NBRM and SSO.



Source: NBRM and SSO.

* Moving average corresponding current and previous quarters.



Source: NBRM and SSO.

of the value of the indicator in the previous three



The analysis of historical trends in the Republic of Macedonia indicates connection of household savings, analyzed in the narrow sense through the changes in household deposits in the banking sector, with the pace of economic activity. Thus, during the economic expansion from 2006 until the first half of 2008, the savings growth rate significantly accelerated. The emergence of the global crisis in late 2008 led to a slowdown in the deposit growth. In the third quarter of 2009, the households saving rate⁶¹ hit its minimum, descending to the level of 2004, followed by a period of recovery. Namely, after three consecutive quarters of annual decline in GDP, growth was detected in the last quarter of 2009, which was followed by a recovery in household savings. During the 2010-2011 period, the positive economic trends remained. The recovery of the economic activity was accompanied by acceleration of the growth rate of household savings in 2010. However, starting from 2011, the rate of growth of household deposits slowed down again, which was especially evident in 2012, against the background of adverse economic developments. Such movements indicate general compliance of household savings with the phase of the business cycle. However, it is characteristic that the intensity of adjustment is different. That is, in times of economic expansion, household savings accelerate with significantly higher intensity compared to the intensity of the acceleration in the GDP rate, while in times of economic contraction, the downward adjustment of savings is at a slower pace. Namely, since the emergence of the global crisis household savings have continually increased, achieving solid growth rates even during periods of recession trends in the domestic economy, which by definition generate limiting effects on disposable income. **Such developments suggest that in addition to the domestic economic performance, households saving capacity is determined by the influence of additional factors, among which more significant are the inflows of income from abroad on different bases.**

This appendix focuses on the household deposits during 2012, as the year in which the Macedonian economy experienced a slight decline in the real economic activity on annual basis. However, despite these achievements, household savings continued to realize solid growth rates. Thus, at the end of 2012, the annual growth rate of household deposits (including deposit money) amounted to 7.2%, compared to 12% in the previous year. Observed as a share in GDP, total growth of household savings in 2012 amounted to 2.5%, which is a moderate decrease compared to 2011, when deposits of households changed by 3.8% of GDP⁶². **Considering such developments, this appendix aims at drawing some conclusions about the factors of growth of household savings in the Republic of Macedonia in 2012, through the implementation of a simple descriptive analysis. In this context, we analyze the dynamics of the key indicators, i.e. the disposable income of households and the private consumption, whose dynamics greatly influences the dynamics of household savings.** In the absence of a series of

⁶¹ Measured by the share of the quarterly growth of household deposits in the nominal annual GDP.

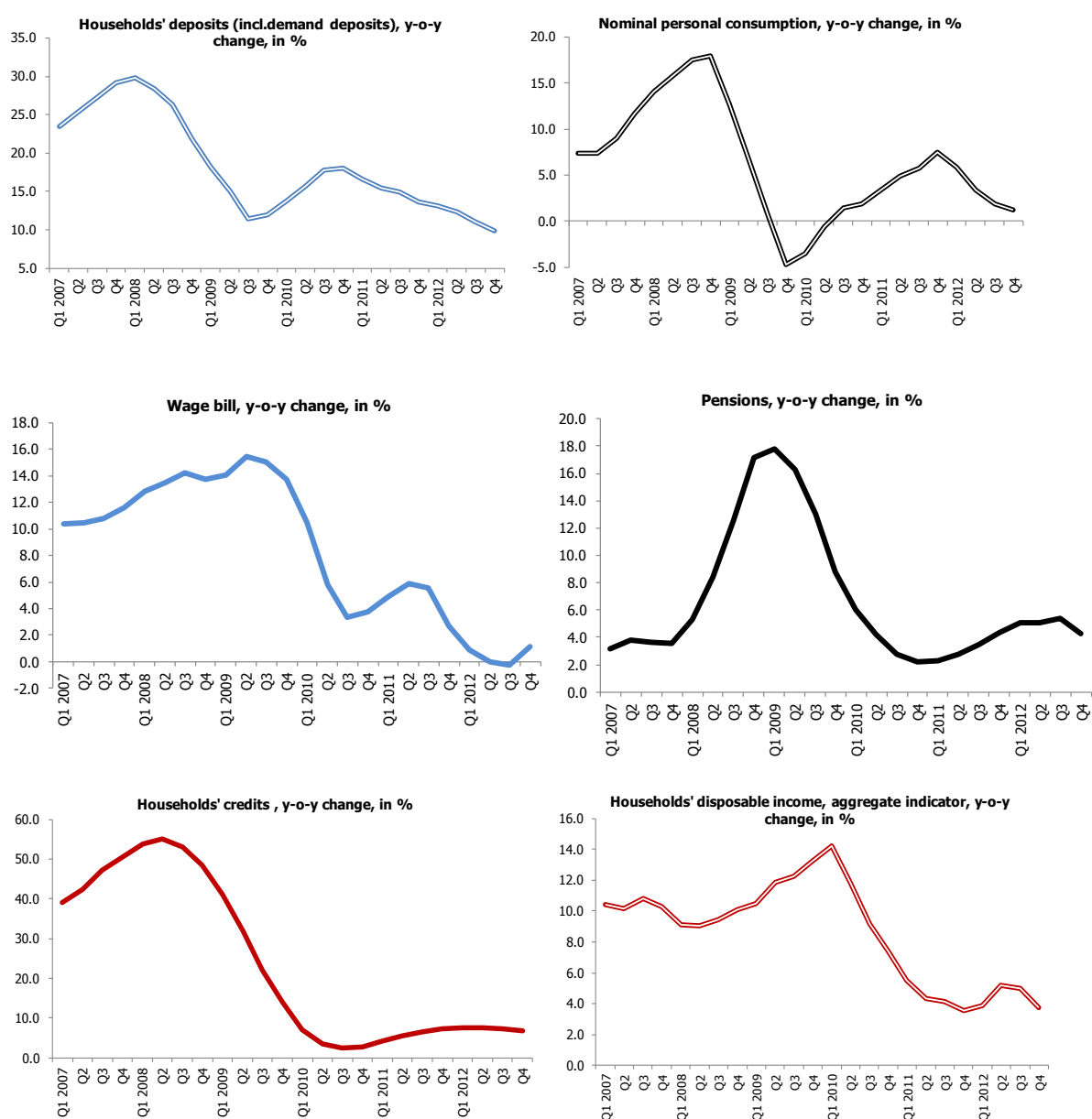
⁶² In 2011, the nominal GDP grew by 6.4% annually, while in 2012, it registered a small increase of 0.2% on an annual basis.

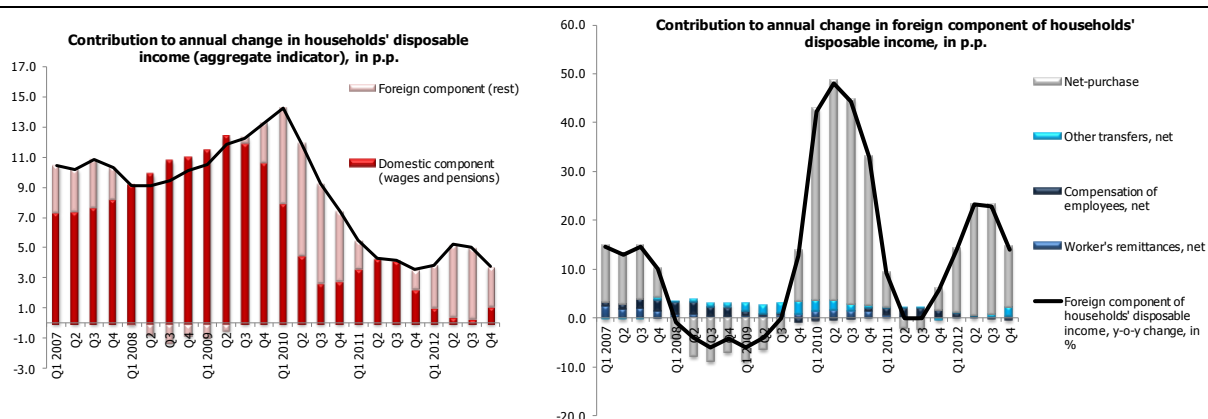


official data on households' disposable income, we derive our own indicator of households' disposable income, which includes the basic flows of income which, in our opinion, affect the formation of the households' disposable income, and the data on which are available from the official statistics on a monthly or quarterly basis. Since the objective is to draw some conclusions about the connection between foreign and domestic flows of income with the growth of household savings, separately, we analyze the indicator of the households' disposable income dissected into two components - domestic and foreign. The domestic component of disposable income is composed of the wage bill and pensions paid. This means that the indicator for the domestic component of disposable income includes only the basic sources of financial income of households, which they generate on the basis of employment or retirement. On the other hand, households may earn income from other sources, such as income from investments in the capital market in the form of dividends and capital gains, rents and other income from property and property rights, copyrights, interest income, social transfers etc. Although, as dominant factors that form the disposable income, proceeds on the basis of salaries and pensions are supposed to quite solidly approximate the dynamics of total disposable income over time, these additional flows of income, which we do not include in our analysis, could affect the total disposable income of domestic origin to a lesser or greater extent. It means that this indicator of the domestic disposable income underestimates the value of the total disposable income of domestic origin, which of course, to some extent may affect the final conclusions of the analysis. The foreign component of disposable income includes a number of variables of the balance of payments, as follows: net remittances from workers abroad, net compensations based on salary from abroad, other private transfers, net (rents, pensions and disability compensations) and net cash from currency exchange operations. Currency exchange operations are included to cover the effect of "unofficial" remittances that enter the domestic economy as cash rather than through the banking sector and the effect of "under the mattress" saving. However, it should be noted that inflows on the basis of currency exchange operations are a broad and heterogeneous category, which besides by the unofficial cash remittances from abroad is determined by the influence of many other factors, whose relative importance is difficult to assess. Thus, part of the proceeds on the basis of currency exchange operations is probably related to the gray economy, part reflects the psychological reactions of households to various shocks that affect the domestic economy, which influences their propensity to dispose of domestic or foreign currency and withdrawal of foreign exchange savings "from under the mattress", and the like. Year 2012 could be pinpointed as a representative example of the conditionality of net inflows based on currency exchange upon psychologically motivated reactions of households. Namely, at the end of 2011, speculations on the escalating European debt crisis culminated resulting in distrust in the euro as a reliable reserve currency, were reflected through increased propensity of households to dispose of Denar assets and convert part of the foreign currency savings "from under the mattress" into domestic currency. Consequently, in late 2011 and in the first half of 2012 above average high inflows from currency exchange operations were registered. Starting from the second half of 2012, when tensions on the European level calmed down, expectations of domestic actors stabilized, which resulted in the stabilization of the inflows from currency exchange operations. Since the indicator of the foreign part in the disposable income includes the net inflows



from currency exchange operations as a whole, there is a risk that we overestimate the foreign component of disposable income for the part of the currency exchange operations, which is determined by other factors other than the unofficial cash remittances from abroad. However, despite these shortcomings, we believe that this constructed, domestic and foreign components of disposable income can provide useful clues as to what are the factors that explain household savings in the banking sector. In the analysis, we use the dynamics of domestic and foreign components of disposable income as an indicator of households' saving capacity, while the pace of private consumption gives indications of possible changes in the propensity to consume versus the propensity to save, as an additional factor affecting the changes in household deposits in the banking sector. Below we give a graphical representation of the dynamics of the basic indicators we use in our analysis.





Note: Annual growth rates are presented as moving averages of the annual rate of change in the current and previous three quarters.

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

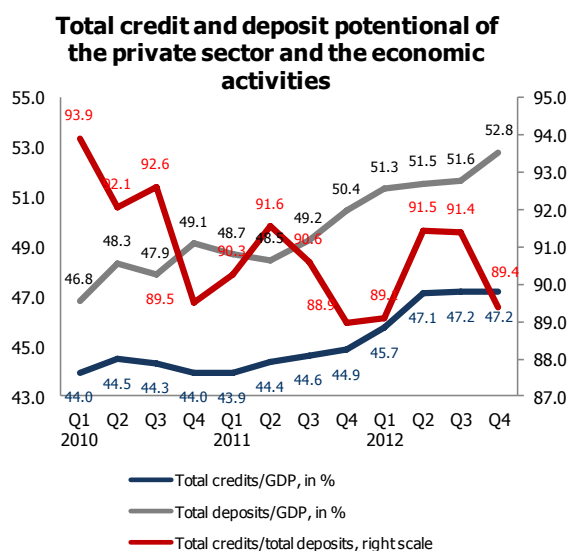
As can be seen from the figures, household disposable income, measured by the derived indicator, remains in the zone of growth also in the course of 2012. After the significant slowdown in the growth rate of disposable income in 2010 and its stabilization in 2011, starting from the beginning of 2012, the growth rate of disposable income registered acceleration, which was retained until the third quarter. The acceleration in the growth rate of household disposable income since 2012 was entirely driven by the accelerated growth of its foreign component, at a time when the growth of the domestic component slowed down at the beginning of the year. These developments reflect the slower growth of the wage bill since the beginning of the year, followed by their stagnation on an annual basis during the second and third quarters. The end of the year was marked by positive tendencies in this main source of funds for households, manifested by re-growth of the wage bill on an annual basis. The positive change in the wage bill entails accelerated growth of the total domestic component of disposable income in the last quarter. Since the beginning of 2012, pensions registered steady growth close to the level of 2011, while at the end of the year the growth rate of this source of income slowed down. Although the growth of the wage bill entails accelerated growth of the domestic component of disposable income in the last quarter, the growth of the foreign component in this period slowed down, resulting in slower growth of the total disposable income of households in the last quarter of 2012.

The analysis of the foreign component of disposable income by individual components shows that the net inflows from currency exchange operations have the dominant influence on the changes in this component. Such is the case also in 2012, when the growth rate of net inflows from currency exchange operations accelerates in the beginning of the year and enters into the zone of slower growth in the last quarter, determining almost identical dynamics also in the total disposable income of foreign origin. Apart from the currency exchange operations, positive contribution to the growth of the foreign component of disposable income comes also from other transfers, whose growth particularly accelerates towards the end of the year. Based on the analysis of the foreign flows of income for the households, one may conclude that foreign remittances are relatively resilient to the crisis. Namely, although they are significantly smaller in size compared to the inflows from currency exchange operations, since the beginning of the crisis,

inflows from remittances from abroad are almost continuously held in the positive zone. Such movements are typical also for 2012, meaning that remittances from abroad continue to provide support to household income.

In summary, our descriptive analysis suggests that the growth of household savings in 2012 largely corresponds with the further increase in disposable household income, which is primarily driven by the growth of its foreign component. The dynamics of the foreign component of the disposable income is predominantly determined by the net inflows from currency exchange operations. These findings suggest that inflows from currency exchange operations provide some support to the disposable income of households in the Republic of Macedonia, contributing to the growth of savings in the banking sector. However, one should bear in mind the impact of certain specific factors on the currency exchange operations, explained earlier in the text, due to which this conclusion should be interpreted with some reserve. The growth of household savings corresponds also with the slower growth of private consumption since the beginning of the year, suggesting a potentially higher propensity to save at the expense of consumption. Maintenance of positive growth rates of banks' lending to households during 2012, in part contributed to the growth of the deposit base of households, and it was approximately at the level registered in 2011. **Based on this analysis we may conclude that in 2012, the deposits of households, in addition to domestic, were probably under the influence also of other factors, different from the phase of the domestic business cycle. That is, the analysis shows that beside domestic income, inflows from abroad also give certain support for the household savings in the banking sector.**

2.2.2. Lending activity

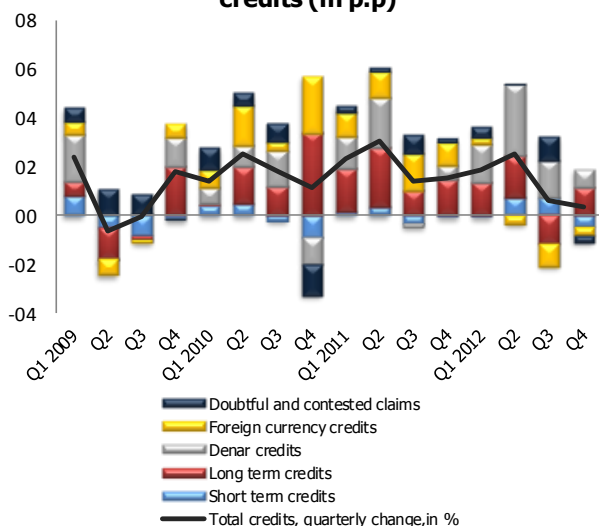


In the fourth quarter of 2012, credit growth of banks in the domestic economy continued to decelerate, from 0.6% to 0.4% on a quarterly basis, reaching the lowest quarterly growth in the last three years. Despite the growth of activity in the domestic economy in the second half of the year, the recovery is slow, which is transferred also to the banking system by increasing the credit risk. Non-performing claims decreased in the fourth quarter, but already in the first two months of 2013 they registered a significant increase, pointing to the still-present vulnerability of the domestic economy. Due to these developments banks continue to conduct a precautionary lending policy favoring the preservation of solvency and reliability vis-a-vis profitability. Regarding the main

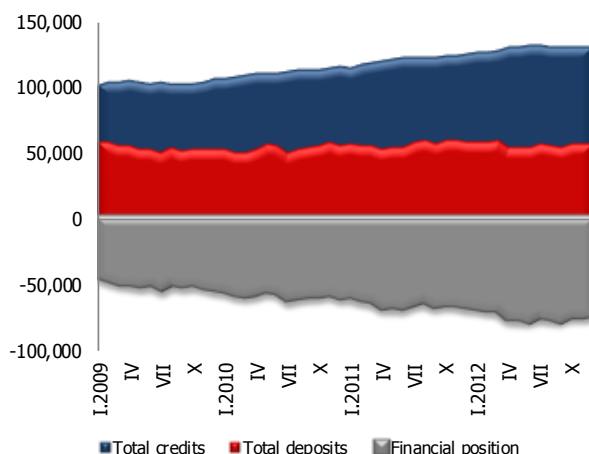


2012	Q1	Q2	Q3	Q4
Total credits (in million denars)	210,912	216,246	217,537	218,368
quarterly change, in %	1.8	2.5	0.6	0.4
Doubtful and contested claims (in million denars)	20,967	21,040	23,178	22,551
quarterly change, in %	4.5	0.3	10.2	-2.7
Short term credits (in million denars)	52,668	54,240	55,791	54,787
quarterly change, in %	0.0	3.0	2.9	-1.8
Long term credits (in million denars)	134,941	138,513	136,068	138,614
quarterly change, in %	2.1	2.6	-1.8	1.9
Denar credits (in million denars)	153,024	159,123	162,423	164,001
quarterly change, in %	2.2	4.0	2.1	1.0
Foreign currency credits (in million denars)	57,888	57,123	55,114	54,367
quarterly change, in %	1.0	-1.3	-3.5	-1.4
Households credits (in million denars)	82,288	84,544	86,172	86,916
quarterly change, in %	0.8	2.7	1.9	0.9
Enterprises credits (in million denars)	128,127	131,069	130,634	130,697
quarterly change, in %	2.5	2.3	-0.3	0.0

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



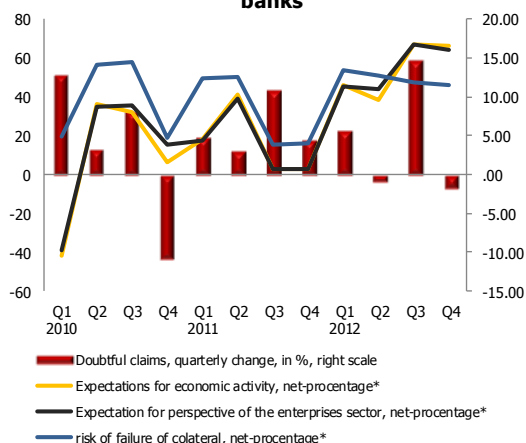
Financial position of enterprises (in million denars)



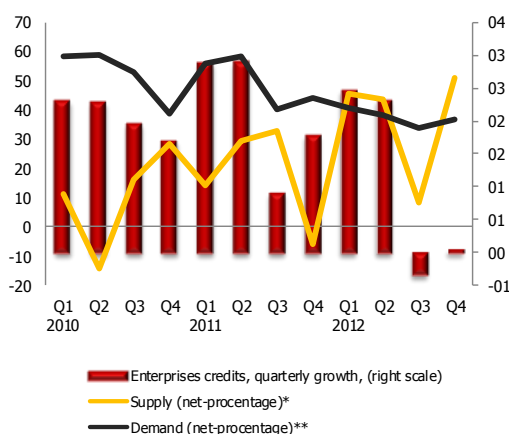
source of funding for banks, there was a significant expansion of the deposit base in the last quarter of 2012. Yet, this potential was not sufficiently used for new lending, as reflected by the movement of the indicator of the share of total loans in total deposits, which on a quarterly basis decreased from 91.4% to 89.4%. From the viewpoint of market movements, as regards the supply, according to the Lending Survey, tightening of lending conditions for corporate loans was noted, while lending conditions for household loans eased. Regarding the demand, the responses of banks are almost balanced in terms of their assessment of unchanged/increased demand for corporate loans, while regarding the household loans, most of the banks indicated that the demand is largely unchanged. Regarding the cost of total loans (in Denars and in foreign currency), there is a minimal reduction in the total interest rate from 8% to 7.9% on a quarterly basis.

Regarding the structure of total loans, in the fourth quarter of 2012, there were opposite trends compared to the previous period. Thus, the increase in total loans was entirely due to the rise in long-term loans, unlike the previous quarter when it was due to the increase in short-term loans. As for the currency structure, there was a smaller contribution of Denar loans in the growth of total loans compared to the previous quarter, and a reduced negative contribution of foreign currency loans.

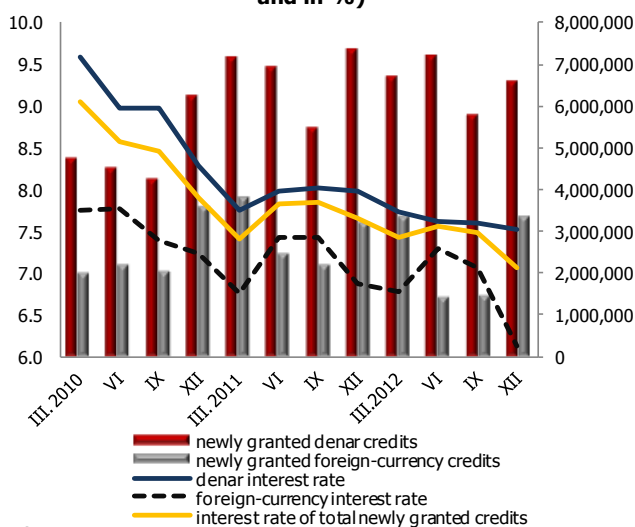
In the fourth quarter, corporate loans registered a minimal growth of 0.1%, or 62 million Denars, after the quarterly decline of 0.3%, registered in the previous period. In conditions of more favorable economic developments in this period, a decrease in the negative

**Doubtful claims and risk perceptions of banks**

*Negative net-procentage, factors which contribute to relaxing of credit conditions, positive net-procentage, factors which contribute to tightening of credit conditions
Source: NBRM

Supply and demand of enterprises credits

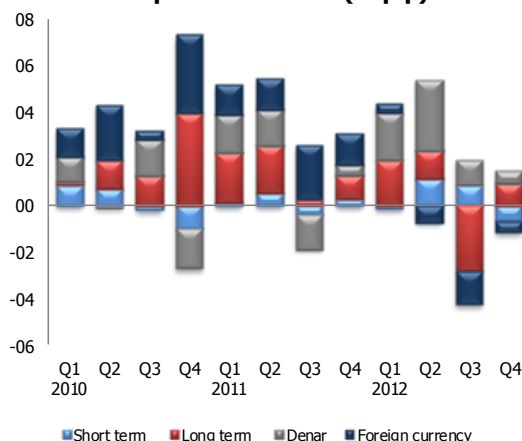
*positive net-procentage-tightening of credit conditions, negative net-procentage, easing of credit conditions
**positive net-procentage-increase of credit demand, negative net-procentage-decrease of credit demand
Source: Bank credit survey, NBRM

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

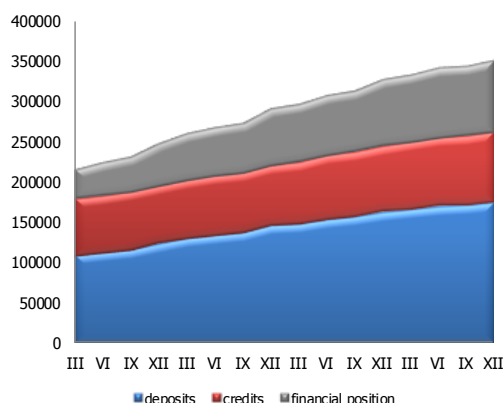
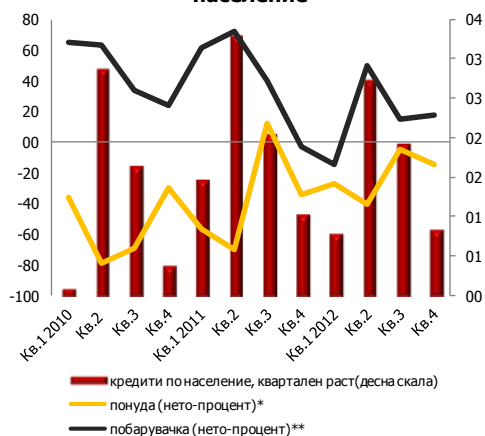
Source: NBRM.

financial position⁶³ of the corporate sector was registered, as a result of the increase in their deposits, amid minimal new debt. However, the corporate sector is still on a higher debt position compared with the period before the crisis. In terms of the supply, according to the Lending Survey, in the fourth quarter lending conditions were tightened, with the banks' risk perceptions still being the major factor for their behavior. Thus, more than half of the banks still emphasize that the risks of the future movements in the overall economic activity and prospects of the branch the enterprise belongs to, as well as the possibility not to be able to foreclose the collateral, are the factors that affect the tightening of the credit conditions. Regarding the specific credit conditions, tightening is observed only in the obligation for collateral, while the other conditions are largely unchanged. As for the credit demand, banks are divided in their assessments of the trends in the demand for corporate loans between unchanged and partly increased. Banks still emphasize the need of the enterprises to invest in inventory and working capital as factors that affect the increase in credit demand. Also, the need for debt restructuring and investment in fixed assets further contributed to the enterprises' growing interest for loans. Since the beginning of the year there has been a decrease in the number of banks which indicates that the need for financing the investments in fixed assets affects the increase in demand, with some of the banks having indicated this factor as a factor that acts toward demand reduction. As for the cost of newly

⁶³ It is defined only in terms of deposit and credit position of companies, and does not take into account the other components of their portfolios. Financial position is the difference between the total corporate deposits and loans. If the difference is negative, the corporate sector is debtor to the system, if it is positive, the corporate sector is creditor in the system.

**Contribution in quarterly change of corporate credits (in p.p)**

Source: NBRM

Financial position of the households (in million denars)**Понуда и побарувачка на кредити на население**

*позитивен нето-процент-заострување на кредитните услови, негативен нето-процент-релаксирање на кредитните услови

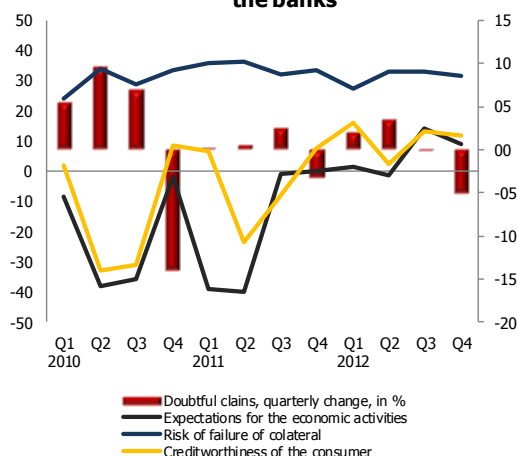
**позитивен нето-процент-зголемување на побарувачката, негативен нето-процент-намалување на побарувачката
Извор: Анкета за кредитна активност, НБРМ

extended loans to enterprises, in the last three months of 2012, there was a quarterly decline in their interest rate by 0.4 percentage points, which was reduced to 7.1% at the end of the year.

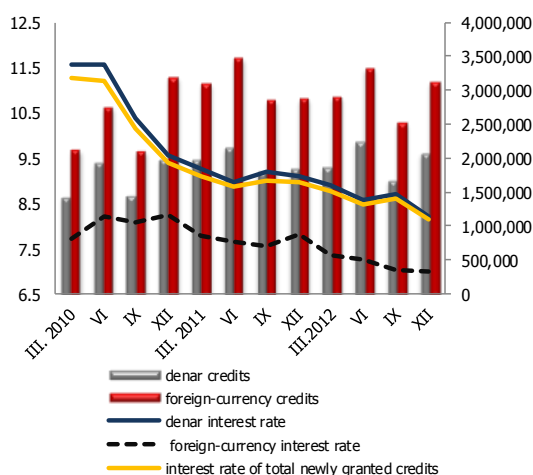
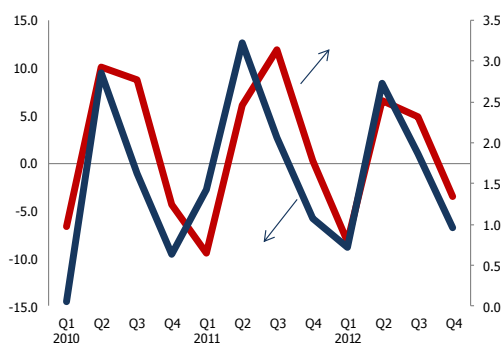
Regarding the maturity structure of corporate loans, the increase in the total corporate loans in the fourth quarter is entirely due to the rising long-term loans, unlike the previous quarter when they determined the decline of total loans. Short-term loans dropped on a quarterly basis, compared to the registered growth in the previous period. The analysis in terms of the currency structure shows that Denar lending fully contributes to the quarterly increase in the loans to enterprises, in conditions of continuing decline in foreign currency loans, but at a slower pace.

The slowdown in lending to the households continued also in the last three months of 2012, with the lending to this sector registering quarterly growth of 0.9% (1.9% in the previous quarter). However, in circumstances of more favorable trends in the labor market, an improvement in the financial position of the households⁶⁴ was registered, due to the more intensive growth of household deposits, amid moderate new borrowing. In terms of the supply, according to the Lending Survey, in the fourth quarter, the conditions for approval of residential and consumer loans were mostly unchanged. However, compared with the previous period, there was an increased number of banks indicating partial relaxation of lending conditions. Regarding the factors that influence lending conditions, the banks' perception of risk is still present, but with

⁶⁴ Difference between total household deposits and loans. If the difference is negative, the households are debtor to the system, if it is positive, the households are creditor in the system.

**Doubtful claims and risk perceptions of the banks**

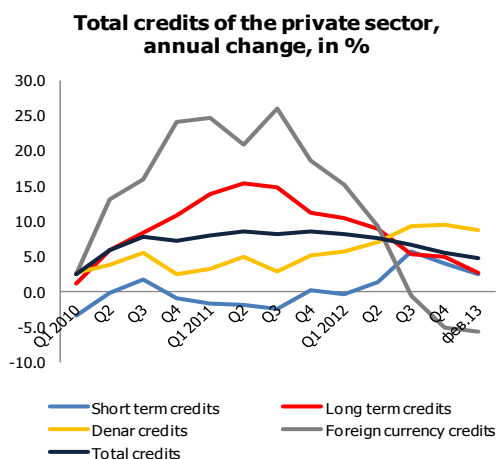
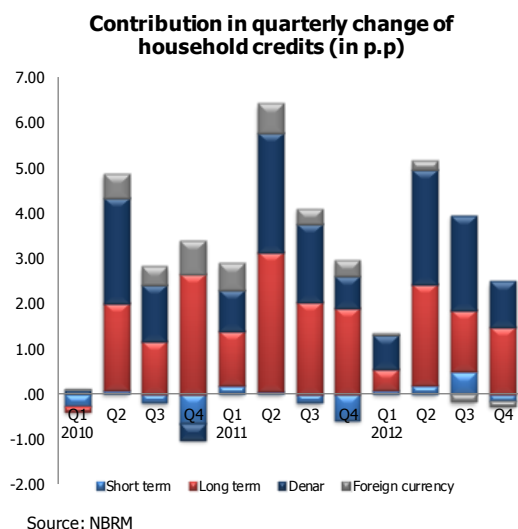
*Negative net-percentage-the influence of the factors is in direction of realizing the credit conditions, positive net-percentage-the influence of the factors is in direction of tightening of the credit conditions
Source: NBRM

**Newly granted household credits and their interest rate
(in thousand of denars and in %)****Household credits and disposable income, quarterly change, in %**

less intensity than before. This perception of banks is supported by the movement of non-performing claims and overdrafts on current accounts, where a quarterly decline was registered in the fourth quarter, with no significant change being registered even at the beginning of 2013. In terms of the specific lending conditions, in this period they were mostly unchanged, except for housing loans where part of the banks indicated that the fees have been partly relaxed. In terms of demand, most banks indicate unchanged demand for housing and consumer loans. However, some of the banks pointed to partial increase in the demand for housing loans, and reduction in the demand for consumer loans. These developments partly contributed to the deceleration in the quarterly growth of consumer loans, with faster growth being registered in housing loans. Banks emphasized consumer confidence as a factor that acts toward increasing the demand, while loans from other banks and the use of alternative financing act toward reducing the demand. Regarding the total cost of newly approved loans to households, it declined by 0.4 percentage points on a quarterly basis, and reduced to 8.2% at the end of the year.

Regarding the maturity, the slowdown in the household credit growth is entirely due to the decline in short-term loans, amid moderate acceleration of the growth of long-term loans on a quarterly basis. Thus the share of long-term loans also increased from 70.8% to 71.7% on a quarterly basis. Currency structure analysis shows that the growth of household loans is entirely due to the Denar loans, though their growth slowed down on a quarterly basis. On the other hand, foreign currency loans still register a negative quarterly growth rate.

**Analyzed on an annual basis,
credit growth in the domestic**



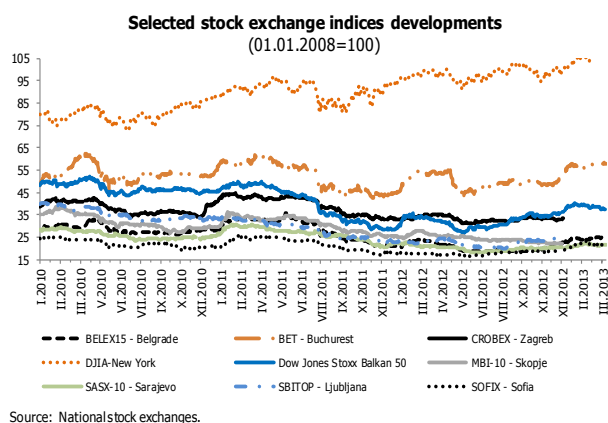
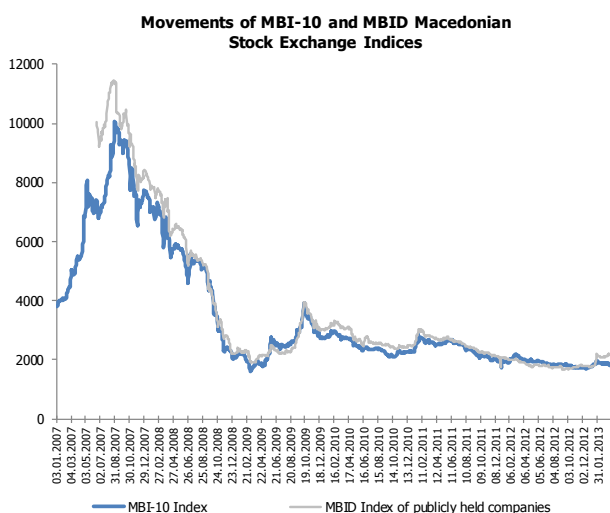
economy continued to slow down and in December 2012 it reached the lowest rate in the past two years of **5.4% (6.7% in September)**. The total loans to GDP⁶⁵ ratio remained at the same level of 47.2%, as in the previous quarter. **Annual credit growth continued to decelerate in the first two months of 2013, and in February it was 4.8%.** Loans-deposits coverage ratio continued to decline to 88.1% in February (versus 89.4% in December) further reflecting lower use of the deposit potential for lending. Further slowdown of growth was registered in corporate loans, while loans to households registered moderate acceleration in the annual growth.

⁶⁵ Annualized nominal GDP, calculated as a moving sum of the respective four quarters.



III. Stock exchange indices and real estate prices

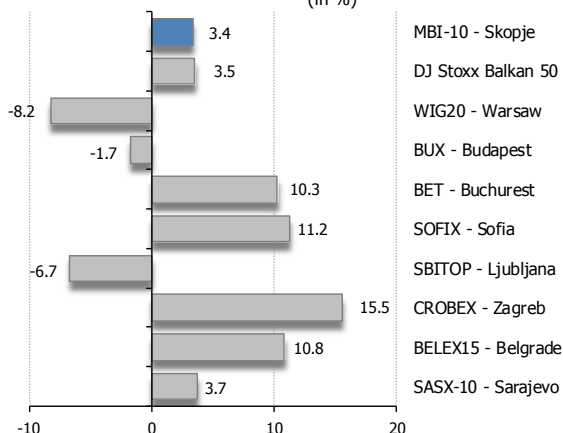
The decline in the Macedonian stock exchange index MBI - 10 present in the previous three quarters, was terminated in the first quarter of 2013, by a moderate quarterly increase. The MBID index continued to increase, while the OMB index, after a brief stagnation and minimal decline, began to rise moderately. However, given the fact that the Macedonian economy is highly connected with the European, where due to the debt crisis there is great uncertainty about the recovery, it is too early to assess the sustainability of the positive developments in the Macedonian capital market. In the same period regional stock exchange indices, similar to the domestic capital market, were volatile and generally moved upward, with the exception of some indices which decreased in their value. Such events are generally associated with the developments in the euro area and the strengthening of the debt crisis. Real estate prices in the domestic market retained the negative trend. These movements on the real estate market are mainly influenced by factors from the supply side, but also by the demand.



During the first quarter of 2013, the trend of continuous decline in the value of the Macedonian stock exchange index MBI - 10, which started in the first half of the last year, was interrupted. In late March 2013, the MBI - 10 index positioned at a level higher by 2.5% compared to the level registered at the end of the previous quarter. Typical for MBI - 10 is that in a period of three quarters the index consistently declined, while in the first month of 2013, it registered a growing dynamics and on January 21st it reached the highest value of 1955.9 index points. In the second month of the quarter, the index registered stagnation with short periods of growth and decline, while at the end of the quarter it began to decline in value. However, despite the reduction in value, on average, the index maintained the upward trend and the value of the index at the end of the quarter was at a higher level compared with the beginning of the quarter, which is typical for the last three years. The index of publicly owned companies (MBID) continued to grow. At the end of March, this index increased by 23.9% relative to the end of December



Quarterly changes of the regional stock exchange indices
(in %)



Source: national stock exchanges.



Source: calculations by the employees of the NBRM based on the data from the daily newspapers.

2012. Growth was registered also in the bonds index (OMB) whose value increased by 1.1 % compared with the level of 28.12.2012.

The value of regional stock indices during the first quarter of 2013, generally moved upwards, with the exception of some indices which decreased in value. In the first month of the quarter, the value of the indices of regional stock exchanges generally increased. It was due to the solid data on retail sales and the labor market in Germany, and the positive signals from the economies of the USA and China, where a decline in unemployment and an increase in industrial activity was registered. The growth slowed in the last month of the quarter as the reticence of investors increased, primarily due to the rising uncertainty about the debt crisis in the euro area. In such conditions, indices on the stock exchanges of Budapest, Warsaw and Ljubljana noted a downward trend, where most pronounced was the fall of the Budapest stock exchange index. On average, the indices on the other markets registered a positive trend, with the most dynamic growth being registered in the Zagreb stock exchange index.

The decrease in real estate prices that began in the second quarter of the last year, continued at a faster pace in the first quarter of 2013. The index of apartment prices⁶⁶ registered an accelerated decline of 2.1% on a quarterly basis, which is the fourth consecutive decline contributing to the further deepening of the decline on an annual basis (from 3.5% in the fourth

⁶⁶ Hedonic index of the apartment prices, prepared by NBRM on the basis of the advertisements for sale in the capital city, published by the real estate agencies. The apartment price is a function comprised of the size, the settlement it is located in, the floor, whether the flat has central heating and whether the flat is new.



quarter of 2012 to 5.5% in the first quarter of 2013). The continuation of the downward trend in the price of apartments can be explained by the tendency of growth of the completed construction works, i.e. the residential buildings constructed in the past few years, in part stimulated by foreign investment in the construction of real estate. In terms of the indicators of demand, the growth of housing loans is relatively stable, although in the first two months of 2013 the growth slowed down moderately.



IV. Macroeconomic projections and risks

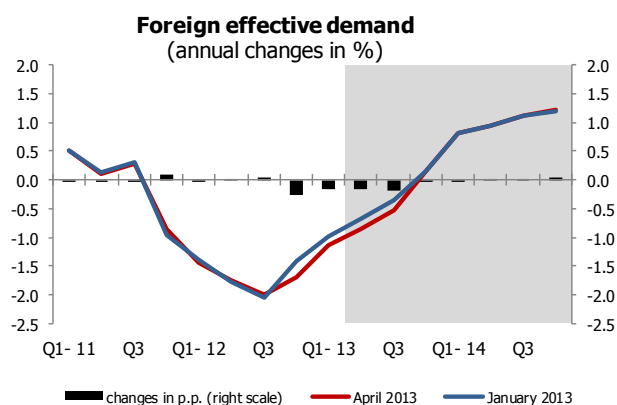
In 2012, economic activity fell by 0.3%, which is close to the January projection whereby stagnation of economic growth in 2012 was expected. Available high frequency indicators for the first quarter of 2013 do not indicate significant differences in terms of the expectations in the January projection. Also, recent assessments of future trends of the major internal and external factors of growth in the domestic economy are in line with the January expectations. **Under these conditions, the estimates for economic growth in 2013 and 2014 have not changed compared to the previous projection, i.e. in 2013, GDP growth of 2.2% is expected, while in 2014 the growth will accelerate to 3%.** The latest macroeconomic scenario envisages growth structure similar to the January projection. The increase in 2013 is mainly explained by exports and investment, while in 2014 beside these two sources of growth, an additional effect is expected from the acceleration of private consumption. In the external sector no major changes in the projected movements were registered either. **In 2013 the current account deficit is projected at around 4% of GDP, while in 2014, it is expected to widen to 6% of GDP, due to higher imports associated with new investment flows and the revival of private consumption.** However, the expected capital inflows, mainly based on foreign direct investment and government borrowing, will be sufficient for financing the higher deficit and for additional accumulation of foreign reserves. In such conditions it is estimated that foreign reserves in the entire projection period will remain at an adequate level. **Data on the movement of domestic prices in the first three months of the year indicate faster slowdown in the rate of inflation compared with the expectations in the January projection.** Lower initial conditions, supplemented with downward revision of import prices caused expectations of lower inflation rate in 2013 of 2.8% (versus 3.2% in the January projection). For 2014, inflation rate is expected to equal 2.3%.

4.1. Assumptions in the external environment projection

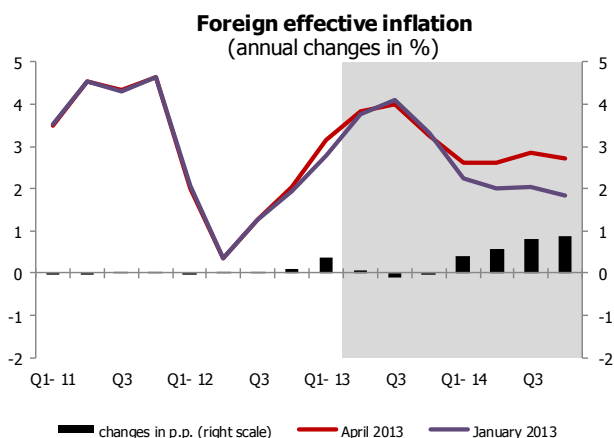
In early 2013, the prospects for the global economy improved, but the global recovery remained unbalanced and conditioned by the implementation of appropriate economic measures by the policy makers in key world economies. Assumptions about the external economic environment are similar to the previous projection, and take into account the effects of the recession in the euro area and its gradual overcoming and the favorable economic developments in the



USA, despite the possible negative effects of the commenced fiscal adjustment⁶⁷.



Regarding the foreign effective demand for Macedonian products, in 2013 it was slightly changed compared to the previous projection, i.e. now the fall is projected to reach 0.6% instead of 0.5%. The minimum downward correction is mainly a result of the currently higher expected negative contribution of the Italian economy, the lower positive contribution from the economic growth of Bulgaria and the expected negative rather than positive contribution of Croatia. On the other hand, the latest projections assume no changes in the movement of foreign effective demand in 2014, i.e. as in the January projection, it is expected to grow by 1%, largely as a result of the expected solid demand for Macedonian products from Germany and Serbia.



In the first quarter, the estimated foreign effective inflation of 3.2% made an upward deviation compared to the previous projection of 2.8%. Given that in the other quarters there were no major differences in the projections, this development caused slight upward revision for the entire 2013, when foreign inflation of 3.6% is expected, instead of 3.5% as expected in January. Regarding the projections for 2014, although a slowdown in foreign effective inflation compared to 2013 is still expected, it was subject to a significant upward revision from 2% to 2.7% compared with January. The change is mainly due to the upward deviation of the inflation adjusted for the exchange rate in Serbia and in the

⁶⁷ On March 1, 2013, the so-called budget "sequester" came into force, which as an austerity policy includes spending cuts in particular categories of US federal outlays.



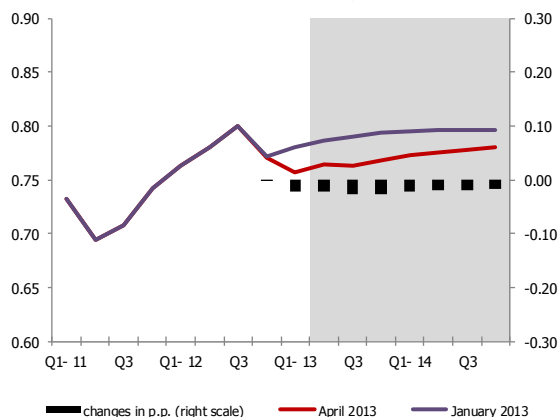
USA and the expectations for moderate inflation rather than deflation in Greece.

In 2013, the **US Dollar is expected to depreciate against the Euro** by 1.9%, contrary to previous expectations for its appreciation, while in 2014 the value of the Dollar is expected to increase compared to the January projection when depreciation was expected.

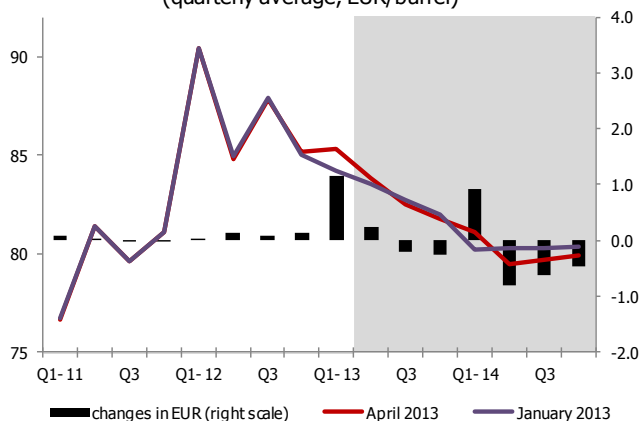
In the first quarter of 2013, the oil price on the world market was slightly higher than the January projection. Moreover, in 2013 there were no major changes in the expected pace and trajectory of oil prices. The factors that will have a downward effect on the oil price are associated with the downward revised global oil demand and expected higher production in the North Sea basin. Although the depreciated Dollar should act towards supporting oil prices, the uncertainty associated with the economic prospects of China and the recession in the euro area will limit the space for achieving higher price levels. In nominal amounts, oil prices are expected to drop from Euro 83.3 per barrel in 2013 to Euro 80 per barrel in 2014. Regarding the annual changes, this would mean a smaller decline in the price of "Brent" oil in 2013 compared with the previous projection (of -4.3% instead of -4.6%) and a higher decline in 2014 (of -4% instead of -3.4%). The sharper decline in oil prices in 2014 is in part explained by the expected greater appreciation of the Dollar.

In the first quarter of the year, **metal prices** experienced accelerated annual decline, which in part is a result of the base effect. Moreover, compared with the previous projection, almost all metals registered a higher than expected decline. Such price movements in the markets for base metals are largely explained by the slow global economic growth, increasing production of metals and relatively high

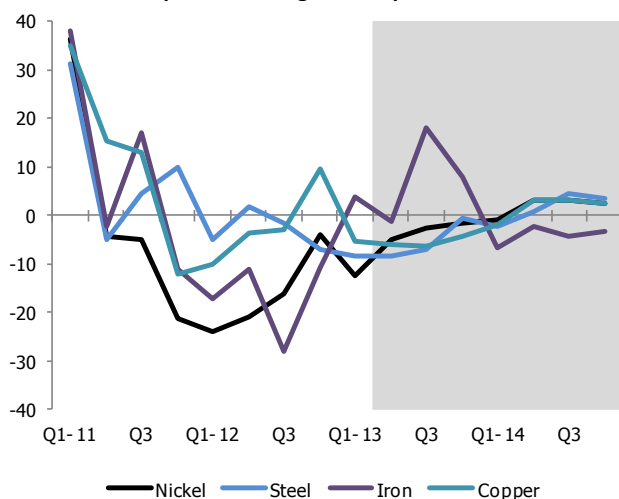
USD/EUR exchange rate



Brent oil
(quarterly average, EUR/barrel)

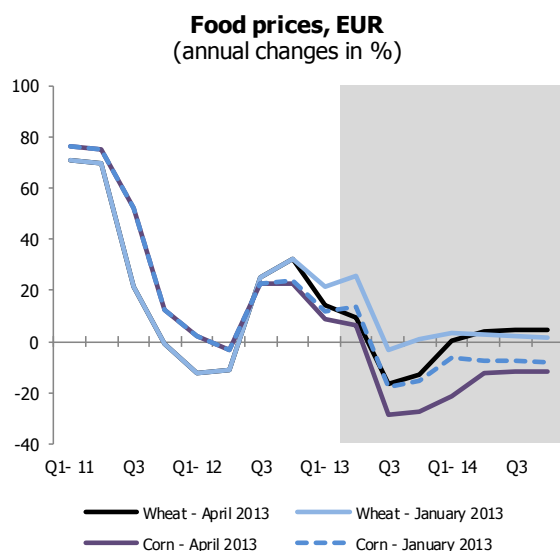


Metal prices, EUR
(annual changes in %)

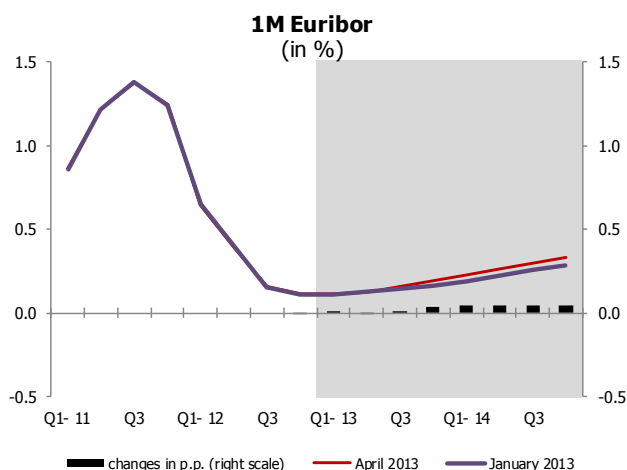




level of inventories. These factors resulted in downward revisions also of the expected annual price changes for most metals in 2013. With respect to individual types of metals, nickel prices registered a decline instead of the expected growth due to the excessive supply, while prices of copper and steel registered deeper decline due to the higher supply compared to current needs. An exception to these trends is iron, whose price is expected to increase faster than in the January projection. Generally favorable movements in metal prices are expected in 2014 (compared to 2013), with upward revisions to the price increase of copper and some downward revisions of the price changes of nickel, iron and steel. In 2014, the appreciation of the Dollar will have a downward effect on the price of metals.



In the first quarter, **food prices** registered a slower annual growth. The estimated increase in the prices of wheat and maize was lower than previously projected. Food prices are expected to continue to show more moderate growth in the first half of 2013, due to factors on the supply side, while in the second half of the year they are expected to be significantly reduced. Compared with the January projection, in 2013, a significant downward revision of the annual change in the price of wheat was made, according to which its modest annual decline is envisaged instead of the expected growth, due to current estimates of higher production from the new harvest. Similarly, the better prospects for the supply of corn and the expectations for recovery in inventories contributed to a significant downward correction of the price decline of corn. For 2014, the growth rate of the price of wheat was moderately upward revised and the rate of decline in the price of corn was significantly revised downwards, amid downward pressures from the stronger Dollar.



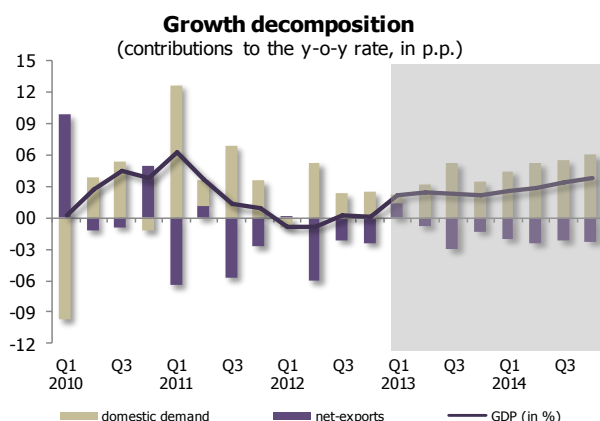
In the first quarter, **the one-month EURIBOR** minimally increased relative to the previous quarter, which is the first increase after 2011. Moreover, compared with the January projection, foreign interest rate is slightly higher and amounts to 0.12%. Current estimates include continuation of the trend of gradual increase in the interest rate over the projected period, but at somewhat higher levels than those projected in January.

4.2. Projection and effects on the monetary policy

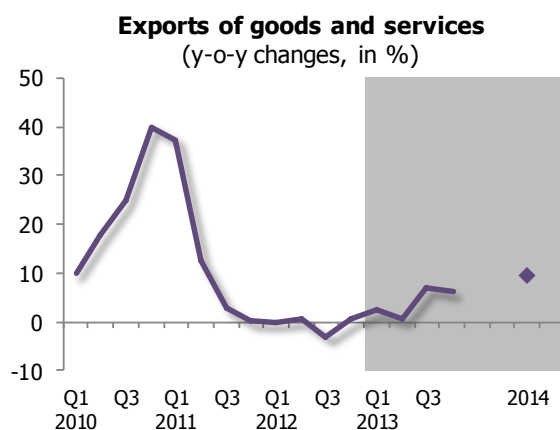
In the period between the two projections there were no significant changes in the environment for conducting the monetary policy. The situation in the external sector continues to be assessed as stable, with the foreign reserves being retained at about the adequate level throughout the projection period. Recent data on the trends in the balance of payments and the latest assumptions about the external environment do not indicate any significant change in the expected movement of the trade of goods and services. As in the January projection, the new macroeconomic scenario assumes the absence of significant import pressures by the domestic demand. Flows from remittances are unchanged relative to the January projection. Also, no significant changes are anticipated in the expected inflows of foreign direct investment, and also in this projection capital inflows are estimated at a level sufficient for covering the current account deficit and for additional accumulation of foreign reserves. The expected movement of EURIBOR, amid still unfavorable projections for the future developments in the euro area is similar to the January projection and remains well below the historical average. **As in the previous projection cycle, the risks to**



the baseline macroeconomic scenario are predominantly negative. The negative risks associated with the external environment are still present, especially after the recent events in the euro area. Additionally, the macroeconomic projections indicated the existence of downward risks in view of the future trends in exports, associated with the expected decline in metal prices. Keeping the core inflation at a high level for a longer period of time is also an additional risk for the monetary policy. These risks point to the need for constant monitoring of the possible changes in the external and domestic economic conditions in the future and timely undertaking of appropriate measures.



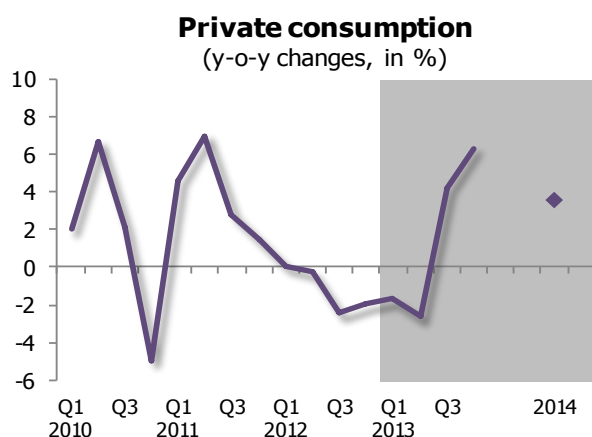
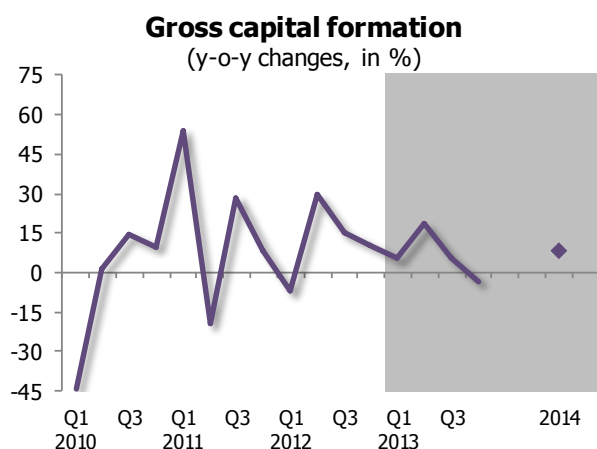
The gradual recovery of the domestic economic activity continued in the fourth quarter of 2012. However, the favorable developments in the second half of 2012 were not sufficient to offset the negative rates earlier in the year that led to a small decline in GDP of 0.3% in 2012. According to the available high frequency data for the first two months of 2013, in the first quarter of the year further growth of GDP is expected, while **for the entire 2013 the economic growth rate is projected at 2.2%. Growth is expected to accelerate to 3 % in 2014**, amid positive trends in domestic demand and boosted export activity.



Economic growth in 2013 and 2014 is, in significant part, explained by the expected moderate recovery of the export activity, after its decline in 2012. The growth of the export activity in this two-year period is associated with the announced expansion of the production capacity of the export-oriented enterprises in the country. Additionally, improvements are expected in the traditional determinants of exports, i.e. it is estimated that in 2013 and 2014 external demand will gradually



improve, which would reflect positively on the exports.

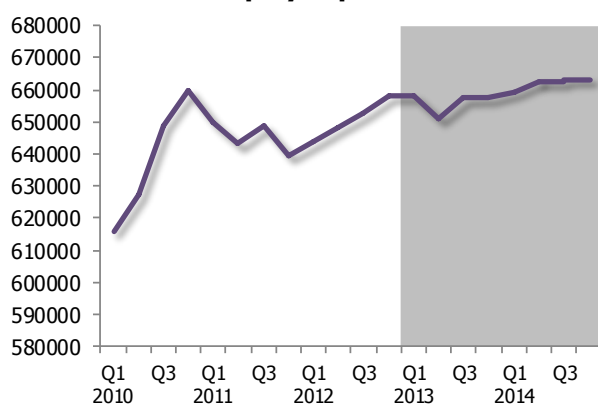
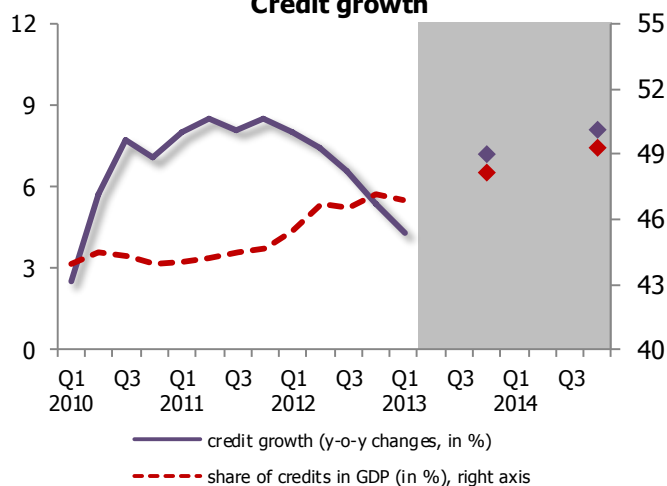


Components of domestic demand are expected to give positive contribution to the growth of the domestic economy in the projection period. Moreover, as in 2012, domestic demand growth in 2013 will be mainly driven by the increased investment activity. In 2013, continuation of the investments in construction activity are expected, which were assessed to be a major factor for the fast growth of total investments in 2012. In addition to this are the data on the first quarter of the year that point to further growth in the value of completed construction works, as well as more favorable expectations of managers in construction in terms of the orders in the first quarter. Additionally, in line with the projected acceleration of the export activity and increased production capacity, in 2013, intensified investment in machinery and equipment is expected. In terms of sources of funding, a significant portion of the new investment projects will be financed by foreign investors in line with the announced foreign direct investments. Investment activity will be further supported through planned public investments. **In view of the expected movement in private consumption, after the decline in 2012, during 2013 its recovery is expected,** in line with the estimates for gradual strengthening of consumer confidence, amid more favorable movements in real wages, and growth of pensions, which were increased at the beginning of the year⁶⁸. However, it is expected to remain at a relatively low level by the end of 2013. **In 2014, accelerated growth of domestic demand is expected, amid still high investments,**

⁶⁸ In the first quarter of the year a linear increase of all pensions in the amount of Denar 550 was made.



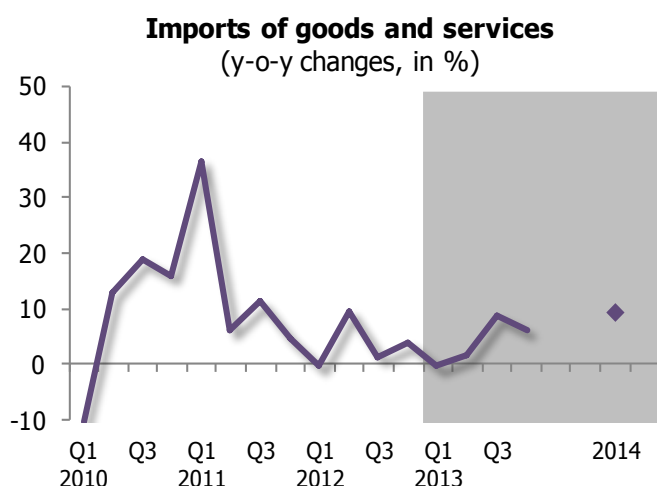
as well as a significant increase in household consumption. Favorable conditions in the export sector and new investments will lead to a significant improvement of the situation on the labor market by creating new jobs and growth in real wages that would directly influence household consumption. The expected reduction of uncertainty regarding the external environment and improving domestic economic conditions in 2014, would further expedite the propensity of households to increase consumption. In 2014 **investment growth will accelerate moderately, in conditions of stabilized domestic and external environment, increased confidence of the entities, greater willingness to take risks, and facilitated access to additional funding.** **Public consumption is expected to continue to rise, which would have a positive contribution to GDP growth throughout the projection period.**

Employed persons**Credit growth**

The intensification of economic activity during the projection period will be followed by a moderate acceleration of credit growth in 2013 and 2014. By the end of 2013, credit growth is expected to reach 7.2% (versus 5.4% in 2012), while in 2014, total loans would increase by 8.1%. The expected acceleration of credit growth is a combination of several factors. First, it is expected that the recovery of the domestic economic activity, the improvement of the financial position of the private sector and the expected reduction of the uncertainty from the external environment during the projection period will improve the perception of banks that would lead to the expansion of their credit supply. Also, new investment projects and the growth of private consumption will lead to intensification of the credit demand. Additional impetus for higher lending activity in the projection period is expected



also through the relaxation of the monetary policy made in early January by reducing the interest rate on CB bills, as well as the easing in the area of the reserve requirement. **However, the projection for the future credit growth also in this cycle of projections is accompanied by the previously pronounced negative risks** associated with the changes in the perceptions of banks regarding the creditworthiness of their customers, more pronounced effects of the process of deleveraging of foreign banks on domestic banks in their ownership, and possible further deterioration of the quality of the loan portfolio. **In 2013 and 2014, it is estimated that the deposit base, as the primary source of funding the credit growth, will further increase.** In fact, after the growth in deposits of 4.4% in 2012, in 2013 they are expected to increase by 7.6%, while in 2014, total deposits would increase by 7.8%. Such estimates are in line with the expected improvement of the financial position of the private sector in 2013, particularly in 2014.



In 2013, a moderate acceleration of the growth of imports of goods and services compared with 2012 is expected. The higher growth of imports is explained by the additional positive developments on the part of private consumption and exports, as opposed to 2012 when the growth of imports was almost entirely explained by the higher investment demand. **Further acceleration of growth is expected in 2014,** amid expected growth in the demand for investment goods and raw materials related to the announced increase in the production capacity of some export-oriented companies, but also due to further intensification of the growth of private consumption. **The contribution of net export demand throughout the projection period, with simultaneous**

**increase in exports and imports, will remain in the negative zone.**

Balance of Payment Forecast (% of GDP)						
	2009	2010	2011	2012	2013	2014
Current account	-6.8	-2.0	-3.0	-3.9	-4.2	-6.0
Balance of goods & services	-23.0	-20.0	-21.1	-23.4	-22.7	-23.9
Goods, net	-23.3	-20.5	-22.4	-23.7	-23.3	-24.6
Services, net	0.2	0.5	1.3	0.3	0.6	0.7
Income, net	-0.7	-1.4	-1.6	-2.0	-2.0	-2.4
Current transfers, net	16.9	19.4	19.7	21.5	20.6	20.3
Private transfers, net	16.4	18.9	18.7	20.9	20.0	19.7
Capital account	0.3	0.2	0.3	0.2	0.0	0.0
Financial account	5.9	1.9	6.5	4.6	4.4	7.3
FDI, net	2.0	2.2	4.5	1.5	3.0	4.5
Portfolio Investment, net	1.6	-0.8	-0.6	1.0	-1.8	-0.1
Other Investment, net	2.4	0.4	2.6	2.1	3.2	2.9

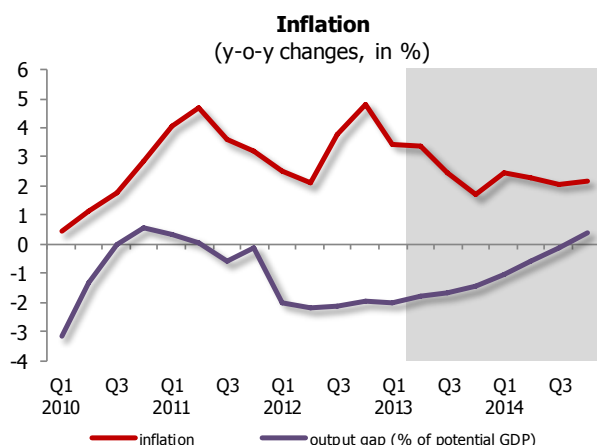
Expectations for the gradual recovery of the global economy which would pull the foreign effective demand out of the negative zone of growth later this year, as well as the expectations for higher production and export of the new industrial facilities, indicate nominal growth of the exports of goods and services. Growth is expected to be more moderate this year (3.4%), while next year it is expected to accelerate and reach 9%. Given the higher comparison basis determined by one-off factors, imports of goods and services this year will register a slightly slower rate of growth than exports, i.e. 3%, with expectations of more dynamic growth next year of 9.7%, when accelerated growth of private and investment consumption is envisaged. Most of the expected export growth will allow **narrowing of the deficit in the trade in goods and services to 22.7% of GDP in 2013**. On the other hand, the more dynamic movement of imports next year will lead to a **widening of the deficit in the trade in goods and services to 23.9% of GDP in 2014**. The projection of the trade balance for 2014 is associated with positive risks arising from possible increased activity of the new export-oriented industrial plants, relative to current expectations. An important part of this deficit will continue to be funded by the inflows of *private transfers*. However, the positive balance of payments effects associated with the uncertainty over the euro currency are gradually being exhausted due to the expectations that the amount of inflows from private transfers is expected to stabilize this year. In conditions of expected growth in the economy, it will actually mean their reduction, viewed as a percentage of GDP. The reduction of the relative importance of transfers is expected to continue next year, but much more



moderately. Hence, despite the narrowing of the deficit in the trade in goods and services, **in 2013, the current account deficit is expected to remain at around 4% of GDP, while in 2014 it is expected to widen to 6% of GDP.**

The negative current account balance in this and next year will be entirely financed by capital inflows, mainly arising from the expected foreign direct investment and planned foreign borrowing of the government and the private sector. The improvement of the global environment, the stabilization of global financial markets and improving conditions in the domestic economy are expected to contribute to more positive perceptions among investors. Consequently, this year and next year foreign direct investments will gradually increase and reach 3% and 4.5% of GDP, respectively. **The main risks** for the expected movements in the external position of the economy continue to stem from a possible slower than expected global, and therefore domestic economic recovery, which may affect the perceptions of investors and expected access to external sources of funding. Moreover, additional risks arise from possible larger outflows associated with the need for financing the parent companies.

Movements in the current and capital and financial account will allow further growth of foreign reserves and their maintaining on an adequate level. Namely, in the absence of significant changes in the main components of the balance of payments, in 2013 foreign reserves are expected to make a small increase. In 2014, flows in the capital and financial account are expected to be more favorable relative to the expected deterioration in the current account, which will contribute to further solid growth in foreign reserves.



In this and next year the growth of prices in the economy is expected to slow down gradually. **The domestic inflation rate in 2013 is expected to be reduced to 2.8%**, amid slower growth in the prices of food and energy⁶⁹ and without significant pressures from the domestic demand. **In 2014, the inflation rate will be further reduced to 2.3%**, whereby it will gradually get closer to the historical average. No significant pressures are expected from import prices or the domestic demand, despite the expectations of a strengthened economic growth. **The risks** to the projected path of inflation remain mainly associated with the future movements in the prices on the international markets and their transmission effect on domestic inflation. Additional price risk is the inability to estimate precisely the magnitude of the impact of natural disasters that occurred in the first quarter of this year and reflected on the domestic production of vegetables. Potential home-generated upward risk to inflation in 2014 is the uncertainty about the possible resuming increase in the regulated electricity prices.

4.3. Comparison with the previous projection

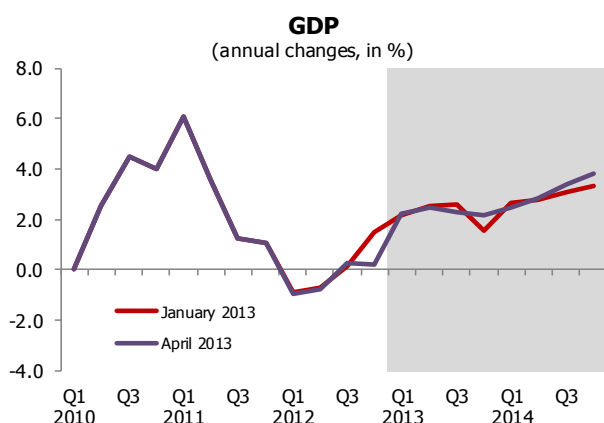
Performances and evaluations indicate unchanged expectations for the economic growth over this and the next year compared with the January projections. However, inflation this year is expected to be lower than January expectations, with the same expected rate of inflation for the next year. Recent estimates indicate a slight widening of the current deficit in this year and greater deterioration in the next year, amid lower capital inflows this year and moderately higher inflows in the next year, compared

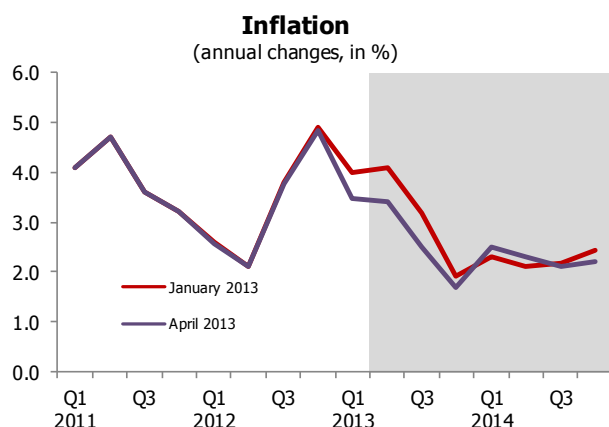
⁶⁹ With assumed monthly growth in electricity prices in June 2013 of 10%.



to the January projections. Consequently, still there are expectations of a solid, but slightly more moderate increase in foreign reserves in 2013 and 2014.

In conditions when the achievements in the real economy in 2012 are in line with the expected, and in the absence of major changes in the global environment and reviews of the determinants of the GDP components, **the expectations for GDP growth this year and next year remain unchanged, with positive growth rates of 2.2% and 3%, respectively.** As in the previous projection, domestic demand will be the main carrier of growth. However, the contribution of net exports in 2013 will be less negative, in conditions of lower expected growth in both exports and imports compared to January projections. It is still expected that investments will be the main driver of the domestic demand growth this year due to the expected government and foreign investments and export growth, with expectations for a higher volume of gross investments compared to the January projections. However, higher amounts of investments (primarily in construction) at the end of 2012, resulted in a slightly lower expected growth rate for this year. On the other hand, the performances showed further downward adjustment of private consumption in the last quarter of 2012, and thus lower performance for the year. For 2013 and 2014, expectations for personal consumption are similar as before, i.e. relatively weak growth this year and faster increase in the next year, when it is expected to be the main driver of growth. Thus, the level of private consumption was subject to moderate downward revision, amid expectations for somewhat more moderate growth in households' disposable income compared to the January projection.





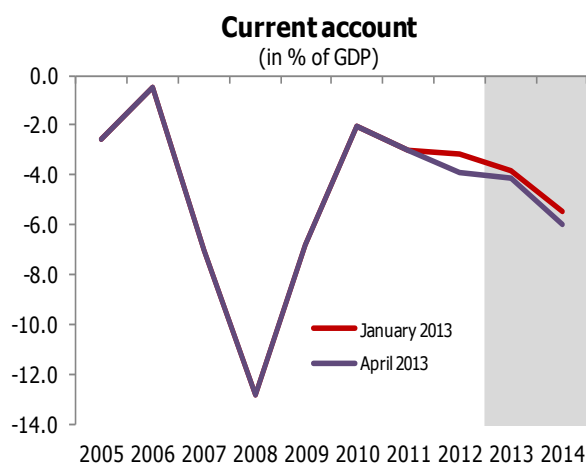
In the first quarter of 2013, the achieved inflation was lower than expected, due to the more moderate movements in the prices of food and energy. The lower price level at the end of the first quarter, and the expectations for stronger downward movement in food prices compared with the previous projection, caused **downward revisions to inflation in the following period**. Namely, it is expected that the inflation rate in 2013 will be 2.8%, as opposed to the previous expectations for a rate of 3.2%. Thus, although the projected inflation rate for 2014 is maintained at 2.3%, the expected price level is lower than the January projections. This arises from the downward revision and the lower price level for 2013, which amid the same rate of growth means lower prices also in 2014.

Regarding the current account deficit, the latest estimates point to its deepening compared with January expectations. Given the higher achievements for 2012, **the deficit for this year will be 4.2% of GDP, compared to the previously expected 3.8%, while for the next year it is revised from 5.4% to 6% of GDP**. Such revisions are due to the expectations for less favorable balance of trade in services, because of the assessments for major outflows⁷⁰, based on the higher performance at the end of 2012. Moreover, a significant downward revision of the growth rates of the export and import of goods was made, due to lower quantities earlier this year in terms of the energy balance⁷¹, which is expected to deteriorate. However, these changes do not affect the expectations for the trade balance, which is unchanged, due to the simultaneous improvement within the non-

Forecast of selected macroeconomic variables						
annual rates of change (in %)	2012		2013 forecast		2014 forecast	
	Jan. forecast	Apr. released data	Jan.	Apr.	Jan.	Apr.
GDP	0.0	-0.3	2.2	2.2	3.0	3.0
Personal consumption	-0.1	-2.0	1.3	1.5	3.6	3.6
Gross capital formation	9.7	10.8	8.0	6.4	7.4	8.3
Public consumption	1.7	3.5	0.5	1.3	0.3	0.6
Export of goods and services	-0.8	0.6	7.4	4.0	10.3	9.5
Import of goods and services	3.3	3.8	6.5	3.9	9.8	9.4
Inflation	3.3	3.3	3.2	2.8	2.3	2.3
Current account deficit (% of GDP)	-3.2	-3.9	-3.8	-4.2	-5.4	-6.0

⁷⁰ Mainly for construction and consulting and management services.

⁷¹ The changes are mainly derived from the trade in oil and oil derivatives.



energy balance in accordance with the more favorable performances in the first quarter of the year. Regarding the capital flows, expectations for 2013 are moderately lower than the January projections, while for 2014 they are expected to be moderately higher, because of the higher expected borrowing by the public sector⁷². Given these expectations, it is estimated that **the growth of foreign reserves in 2013 and 2014 will continue to be solid, but lower compared with the January projections.** Cumulatively speaking, the main factor for the revisions are the deteriorating expectations for the current account deficit.

Comparison of GDP and inflation forecasts for Macedonia from various organisations

Organisation	Month of publication	Real GDP growth, %			Inflation (average rate, %)		
		2012	2013	2014	2012	2013	2014
IMF	October 2012	1.0	2.0	3.5	2.0	2.0	2.0
World Bank	January 2013	0.0	1.0	2.5	-	-	-
European Commission	January 2013	0.8	1.7	2.2	3.3	2.0	2.3
EBRD	January 2013	-0.5	1.8	-	-	-	-
Consensus Forecasts	January 2013	0.5	1.7	2.6	3.1	2.5	2.7
National Bank of Greece	January 2013	0.0	2.0	3.2	3.3	3.8	3.2
Ministry of Finance of the R. of Macedonia	December 2012	-	2.0	-	2.8	3.5	-
National Bank of the R. of Macedonia	January 2013	0.0	2.2	3.0	3.3	3.2	2.3

Source: IMF World Economic Outlook, October 2012; World Bank Global Economic Prospects, January 2013; European Commission EU Candidate and Pre-Accession Countries, January 2013; EBRD Regional Economic Prospects, January 2013; Consensus Economics Forecasts, January 2013; NBG Macroeconomic and Financial Indicators, January 2013; Ministry of Finance of the Republic of Macedonia, Budget of the Republic of Macedonia for 2013, December 2012; and the National Bank of the Republic of Macedonia.

⁷² The assumptions for the budget deficit and its financing structure are taken from the Pre-Accession Economic Programme 2013-2015.