Introduction

During the first quarter, the National Bank did not make changes to the monetary policy setup, keeping the key interest rate and the offered amount of CB bills at the same level. However, the prolonged uncertainty under the influence of strong external shocks affects the currency preference of households and the currency structure of savings, but also causes pressures on the currency and the foreign exchange markets. Given the increased propensity to save in foreign currency, as well as the unfounded speculations about the stability of the denar, **the National Bank took targeted measures, i.e. made changes to the reserve requirement,** in response to such tendencies. Namely, the reduction of the reserve requirement rate from denar liabilities (from 8% to 6.5%) and the simultaneous increase in the reserve requirement rate from liabilities in foreign currency (from 15% to 16.5%), which will be applied from June this year, affects the currency structure of deposits in the banking system, which is also in line with the Strategy for supporting denarization of the domestic economy. In addition to this measure, given the prolonged price pressures under the influence of the longer-term and stronger growth of import prices, which accelerates inflation, creates certain transmission effects on several price categories and affects inflation expectations, **in the beginning of the second quarter the need for monetary response was also perceived**, despite the absence of the factors on the demand side and the downward risks for the economic growth. **Thus, in April and May, the National Bank on two occasions increased the interest rate on CB bills by 0.25 percentage points, to the level of 1.75%.** Given the pronounced risks for the overall macroeconomic context, there is a need for prudent macroeconomic policies for targeted activities, to mitigate the effects of the external shocks, but taking into account the inflationary pressures. The National Bank will continue to carefully monitor the trends and potential risks and will respond accordingly in order to gradually normalize the monetary policy.

The first quarter of the year was marked by the commencement of the war in Ukraine and the deepening of the energy crisis, as new challenges for the economic recovery from the pandemic. The Russian invasion of Ukraine and sanctions against Russia have worsened the already disturbed global value chains, the energy crisis and the primary commodity markets, which caused strong price pressures and great uncertainty about the global economic prospects and the future path of economic recovery. At the same time, the war and the sanctions related thereto, tightened the global financial conditions and reduced the investors' confidence, which created a risk for the financial stability and the fiscal positions of the more vulnerable countries and the primary commodity net importing countries. Also, the pandemic remains a factor that affects the economic and inflation prospects. Namely, while in Europe the restrictions due to the pandemic are lifted and the number of cases is reduced, the current restrictions in China contribute to an additional wave of pressures on the global value chains. **Similar to other countries in the region, our country's direct trade and financial ties with Russia and Ukraine are minor, hence the military conflict would primarily have an indirect effect** through the lower growth of our major trading partners, especially the EU, and through price pressures. In addition, the deterioration of the perceptions of both the households and the corporate sector and the higher inflation will affect consumption and investments.

The current macroeconomic scenario is based on the assumptions for deteriorated global environment due to the war in Ukraine this year, slower pace of economic recovery and strong growth of the prices of primary products, intensification of the energy crisis and hampered supply channels. In the context of such circumstances, it is also assumed reduction of the confidence and the propensity to consume and invest, but also faster tightening of the financial conditions. Fiscal consolidation will continue, but at a more moderate pace, given the new needs for mitigating the economic consequences of the crisis. Regarding the pandemic, it is expected that its effect on the economy will begin to disappear from the second quarter this year, whereby the baseline scenario does not assume occurrence of new worrying variants of the coronavirus. For the next year, given the global expectations for calming of the military conflict in Ukraine and consequently stabilization in the markets of primary products, more favorable economic movements are also expected, both globally and domestically.

In such circumstances, the uncertainty and the downward risks to the forecasts in this round are significantly more pronounced and are conditioned by the duration and the intensity of the war in Ukraine, as well as by the future sanctions against Russia, especially those directed towards the energy sector. Moreover, the risk of continuation of the COVID-19 pandemic still exists, in terms of emergence of new virus strains and waves as well as the risk of faster and more rigid tightening of monetary policies in developed countries. On the other hand, possible positive risk, in the medium run, still includes the favorable effects of the NATO membership, the possible progress in the EU accession process, as well as the latest development and investment plans of the country which are not embedded in the current medium-term scenario, and whose implementation would be a stimulus for economic growth in the medium term.

Observed by individual quantitative external environment indicators important for the Macedonian economy, the foreign effective demand assessment for 2022 has been revised downwards, while for 2023 upwards. On the other hand, in the **foreign effective inflation**, upward corrections of the estimates were made for both years of forecasts, and especially for 2022. **The latest estimates for the prices of primary products in world markets have been revised upwards for 2022, while for 2023 the adjustments are mainly downward, compared with October assessments.** Thus, for 2022 significantly faster growth in the prices of primary products is expected, while for 2023 their sharper price decline is expected. However, the movements and the assessments of the prices of primary commodities are extremely volatile and are currently under the strong influence of the developments related to the Russian-Ukrainian military conflict, which creates great uncertainty about their future dynamics and effects on the domestic economy.

The current perceptions for growth of the Macedonian economy are less favorable compared to the October assessments. Namely, both this and next year, slower growth of the Macedonian economy than in 2021 is expected. **The baseline scenario from April assumes economic growth of 2.9% in 2022, followed by growth of 3.6% in 2023.** In terms of structure, for 2022, a slightly smaller positive contribution compared to the October assessments is expected from domestic demand, as well as a more negative contribution of net exports. Within the domestic demand, in this round of forecasts, just like in October, the largest positive contribution in 2022 is expected from investments, with a positive, but weaker contribution from household consumption. Namely, in conditions of increased uncertainty arising from the military conflict in Ukraine, moderately lower foreign direct investments, slower growth in foreign demand and in exports and weaker realization of public investments, the estimated growth rate of gross investments mostly results from the behavior of economic agents in the first quarter of 2022, when there was increased import of energy, raw materials and equipment and machinery, which would lead to increased inventories and higher growth of gross investments, similar to the previous quarter. The growth of private consumption will be slower, given the increased uncertainty, the rising prices and the estimates for a slight decline in the real disposable income. Public consumption is expected to make a slightly bigger negative real contribution to the growth, compared with the October perceptions. The downward revision of the estimates for the growth of foreign demand and the energy crisis will contribute to a more moderate growth of the export activity, despite the favorable effects that are expected in the metal industry under the influence of the strong growth of metal prices. In conditions of a more moderate growth of domestic demand and exports, the larger negative contribution of net exports will result from import pressures, i.e. from the deterioration of the energy trade deficit, as well as from the increased import of inventories due to the non-availability of certain basic goods and input components in the value chains, the protection against the price growth and the maintenance of the continuity of production processes. For 2023, it is still expected a positive contribution from domestic demand, as well as a negative contribution from net exports, but slightly lower than the October assessments, in line with the expectations for stabilization of the crisis and the price pressures, recovery of foreign demand and reduction of the value chain problems in the following year. **In the medium run, retention of the solid economic growth is expected, at a real rate of 4% in 2024** (in line with the October assessments).

Regarding the future price trajectory in the domestic economy, the latest forecasts point to inflation of 8.8% in 2022 and its stabilization at 3% in 2023. Inflationary pressures have a global character and mainly reflect factors on the supply side. Namely, the increase and the volatility of the prices of primary products and the other raw materials, which started as a reflection of the disturbances on the markets in conditions of a pandemic, was further strengthened by the war in Ukraine and the sanctions against Russia introduced by most of the countries in the world. In the current context, the logistic challenges for the transport that refer to increased costs would also increase price pressures. In such circumstances, in a short time period, a significant upward adjustment in the expected inflation is made in almost all countries, including in our country. The uncertainty with respect to the future price movements is extremely high. However, it is estimated that these pressures will gradually stabilize at the end of the year, so that already in the next year, significant slowdown in the price growth is expected. Consequently, **for 2023, it is expected that the inflation rate will slow down and will reduce to 3%** (expected inflation of 2% within the October scenario), in accordance with the forecasts of the international financial institutions for a global slowdown in the price growth. At the same time, no significant transmission effects from the current price growth are expected, given the estimates for slowdown of demand and neutral output gap. **In the medium run, it is expected that inflation will average around 2%, in line with the October expectations.**

In the first quarter of the year, the banks' lending activity had an important role in supporting the economy, and primarily the corporate sector, amid further accommodative nature of the monetary policy and stable banking system. Although the growth of loans accelerated in the first quarter of 2022, but more intensively in comparison with the October forecast, the expectations for 2022 are that the growth will continue until the end of the year, but at a more moderate pace, in conditions of pronounced uncertainty, slower economic growth and more moderate growth of the deposit base. Moreover, for the entire 2022, the credit growth would be 7.7% (6.4% according to the October forecast). By gradual normalization of the situation and stabilization of the expectations, stabilization of the growth of the lending activity in the forthcoming period is expected, whereby the credit growth for the period 2023 - 2024 would be 7.6% on average (unchanged compared to the October forecast). In terms of the sources of financing, and taking into consideration the reduction of the total deposits at the end of the first quarter of 2022 due to the energy crisis and the commencement of the military conflict in Ukraine, a more moderate deposit growth for the entire period of forecasts is expected. Thus, in 2022, the deposits growth will equal 5.0% (7.4% according to the October forecast), and in the next period its moderate acceleration is expected, whereby it would reach 7.5% on average, in the period 2023 - 2024 (7.8% according to the October forecast).

In conditions of escalation of the geopolitical tensions, new disturbances of the value chains and further growth of the prices of primary products in world markets, estimates for the external position of the economy, within this round of forecasts are less favorable. The medium-term forecast of the balance of payments points to a higher current account deficit for the period 2022 - 2024, mainly due to the increasing prices of all primary products, especially of the prices of energy. Within the latest forecasts, **for 2022 the current account deficit of the balance of payments is expected to increase to 8% of GDP (3.8% in the October forecasts).** The principal factor for such shifts in the current account are the movements in the trade in goods and services, in particular the deterioration of the trade deficit, with an additional contribution of the reduced services surplus. Namely, in foreign trade, growth in the export component is expected, supported by the favorable conjuncture on the world metal markets and slower, but still positive foreign effective demand. However, imports will grow faster, mainly due to the increased prices of primary products, especially energy, which leads to a significantly more negative energy balance. Such changes in the energy deficit also contribute to widening of the overall trade deficit, despite the expectations for reduction of the deficit in the non-energy balance. Also, after the full recovery from the negative pandemic shock and the high performances in transfers in the past year, slightly lower surplus in secondary income for 2022 is expected. On the other hand, the reduction of the economic activity in conditions of uncertainty would lead to less favorable economic performances of the companies with foreign capital and a corresponding narrowing of the primary income deficit. **Given the expectations for normalization of the situation in the global and domestic economy in 2023, the current account deficit is expected to narrow to 4.5% of GDP (compared to the expected 2.4% in October),** mainly due to the forecasted narrowing of the negative balance in the trade in goods and services. Moreover, narrowing of the trade deficit is expected, mainly as a result of the reduction of the energy deficit, but with a positive contribution from the non-energy component, as well as growth of the surplus in services. On the other hand, an increase in the deficit in primary income is expected, but also a slight decrease in the inflows from current transfers. For 2024, further reduction of the current account deficit to 2.3% of GDP is expected. **Regarding the financial account, financing of most of the current transactions in the period 2022 - 2024 is envisaged, mainly through the external government borrowing and foreign direct investments.** Foreign reserves adequacy indicators point to their maintenance in the safe zone during the entire period of forecasts.

Overall, the latest assessments for the growth of the Macedonian economy are less favorable relative to the October forecasting round for this and for next year, under the influence of the war in Ukraine and the energy crisis. The current scenario points to an acceleration in inflation in 2022, in conditions of strong growth of the prices of energy and primary food products in world markets, but already in the following year gradual exhaustion of the price pressures is expected, whereby the inflation rate will slow down reducing to 3%, and 2% in the medium run, in accordance with the expectations for stabilization of the prices of primary products. The external position is also assessed as less favorable relative to the October forecasts, primarily under the influence of the effects of the energy crisis, but foreign reserves would remain in the safe zone in the entire period of the forecast. **The estimates are accompanied by high uncertainty, whereby the risks are significantly downward.** Major downward source of risk currently includes the further escalation of the military conflict between Russia and Ukraine, introduction of new, tougher sanctions and the possible additional deterioration of the economic relations between the West and Russia. Additional risk factor also includes the possible stronger tightening of the monetary policy in developed countries in response to the increased inflationary pressures and inflation expectations. At the same time, the risks associated with the further course of the pandemic and the possibility of occurrence of new worrying variants of the coronavirus still exist. The National Bank is constantly monitoring developments, as well as the potential risks from the environment to the domestic economy, in order to respond adequately by adjusting policies and taking other, additional measures, if necessary.