National Bank of the Republic of Macedonia

MONETARY POLICY AND RESEARCH DEPARTMENT

Recent Macroeconomic Indicators
Review of the Current Situation

December 2017

Recent Macroeconomic Indicators

Review of the Current Situation – Implications for the Monetary Policy

The review of the current situation aims to give an overview of the recent macroeconomic data (September- November 2017) and to make a comparison with the latest macroeconomic forecasts (October 2017). This will determine the extent to which the current situation in the economy corresponds to the expected movements of the variables in the previous round of forecasts. The review focuses on the changes in external assumptions and performance with domestic variables and the effect of these changes on the environment for monetary policy conduct.

In the period October-November, there were no major revisions regarding forecasts for global growth, expecting further strengthening of the economic activity at a global level. Regarding the negative risks around forecasts for global growth, they are similar to the October assessments and mainly refer to the possible increased protectionism worldwide, the uncertainty around the effects of Brexit, the effects from the normalization pace of the monetary policy of the central banks in the developed countries, the possible increased financial market volatility, as well as the increased geopolitical risks. The economic recovery pace of the euro area continues to intensify, whereby in the third quarter of 2017, our key trade partner registered a real GDP growth of 2.5% on an annual basis (2.3% in the previous quarter). Additionally, the latest high-frequency data and surveys of households and enterprises indicate a probable solid economic growth in the last quarter of the year. Favorable shifts are registered at the labor market in the euro area, whereby unemployment in the third quarter decreased to 9% compared to 9.1% in the previous quarter, with a tendency to further decline given the performance in October (8.8%). In terms of inflation, latest data for November indicate a slight acceleration of the annual rate to 1.5% (from 1.4% in October). This acceleration is entirely due to the intensified growth of energy prices (of 4.7%), amid slightly lower growth of food prices, alcoholic beverages and tobacco (2.2%) and stable core inflation rate of 0.9% on an annual basis. According to the latest assessments, **EURIBOR** is expected to be on the October forecasts level in 2017, while a minor downward correction was made for 2018 and 2019 in accordance to the continuation of the ECB's quantitative easing policy, although reduced in volume, without a definite date for its complete termination and given guidelines for maintaining low reference interest rates for a longer period in the future.

Observed from a viewpoint of the individual quantitative external environment indicators of the Macedonian economy, the forecasts regarding the foreign effective demand are generally unchanged, with the exception of 2018 when a minor upward revision was conducted in comparison to the October expectations. On the other hand, **foreign effective inflation** was slightly corrected upwards for the following two years. According to the latest assessments about the **euro/US dollar exchange rate**, the US dollar is expected to register a greater depreciation in the period 2018-2019 compared to the October forecasts. **Regarding the prices of primary commodities on the world markets, the comparison with October generally indicates to upward revisions of prices in 2017, divergent directions in 2018 and mostly downward revisions in 2019.** Observed by individual products, the latest assessments of **world oil prices** point to a slightly higher price growth in 2017 and 2018 and greater decline in 2019 compared to the October round. **Metal prices** are expected to register a higher increase in 2017 and 2018, whereas for 2019 expectations are less favorable compared to October, amid assessments for a slightly lower growth of the nickel price and slight decrease, instead of increase of the copper price. Global prices of **primary food products** are revised downwards in 2017 and 2018, whereby a lower growth of wheat prices and higher decline of corn prices is forecasted which would lead to lower import pressures on domestic inflation. On the other hand, in 2019, prices of these primary food products are expected to be higher compared to October. However, it should have in mind that the estimations for the prices of these commodities are extremely volatile, which creates uncertainty about the assessment of their future dynamics and effects on the domestic economy, especially in the long-term.

The comparison of the latest macroeconomic indicators of the domestic economy with their forecasted dynamics within the October forecasting round does not indicates certain deviations in individual segments of the economy. In accordance to the published estimated GDP data, after the decline in the first half of the year, economic activity in the third quarter of the year registered a minor growth, a pace which corresponds to the forecasted movement. In conditions of limited amount of available data, it is difficult to form a more precise assessment for the economic situation in the fourth quarter. However, currently available high-frequency data for October point to more favorable shifts and the survey result show retention of economic agents' confidence[1]. Regarding changes in consumer prices, the inflation rate in November was 2.2% which is slightly higher than the forecasted. However, cumulatively, the registered inflation rate of 1.3% in the period January-November 2017 is in line with the October forecast. Amid performances within the forecast, the risks regarding the inflation forecast for 2018 remain associated to the uncertainty about the expected movement in prices of primary commodities.

According to the latest available data, as of the end of November 2017, **foreign reserves** (adjusted for the price and exchange rate differentials and price changes of securities) do not register any significant changes compared to the third quarter. Observed through the factors of change, in the period October-November, the NBRM's interventions with net purchases in the foreign exchange market influenced the increase of foreign reserves, while transactions on the account of the government due to the regular servicing of external debt liabilities had almost the same effect but on the opposite direction. Given the limitation of the available external sector indicators for the fourth quarter, the ability to accurately identify the factors of changes in foreign reserves is also limited. Regarding external sector indicators, data on net purchase from currency exchange operations are available as of November, which currently point to net inflows from private transfers as forecasted. Data on foreign trade as of October point to a trade deficit which is somewhat lower than expected for the fourth quarter. The analysis of foreign reserves adequacy indicators shows that they continue to hover in a safe zone.

As for the monetary sector developments, final data as of October show growth of total deposits with banks (of 1%) on a monthly basis, following the decrease in the previous month (of 0.4%). Analyzed by sector, the growth of deposits in October was mostly due to increased corporate deposits, and relatively lower growth of household deposits. Analyzing the currency structure, the increase of total deposits was dominantly driven by foreign currency deposits, and denar deposits also have a minor positive contribution. On an annual basis, total deposits in October grew by 6.2%, which is above the forecasted growth of 3.6% for the fourth quarter of 2017, according to the October forecast which is mainly due to the higher comparative base at the end of 2016. Analyzing the credit market, in October, total loans registered a minor monthly growth of 0.1%, compared to the decline in the previous month (of 0.3%). The monthly increase in the total credit activity is entirely due to the performances in households, whereas corporate loans register a small decline which is relatively lower compared to the previous month. On an annual basis, total loans in October grew by 4.8%, while the forecasted growth for the fourth quarter was 4.6%.

In the period January-October 2017, the Budget of the Republic of Macedonia registered a deficit of Denar 11,322 million, financed from domestic sources i.e. through deposits withdrawal from the government account with the National Bank and with net issue of new government securities on the domestic market. The budget deficit constitutes 61% of the forecasted deficit in the Budget Revision for 2017.

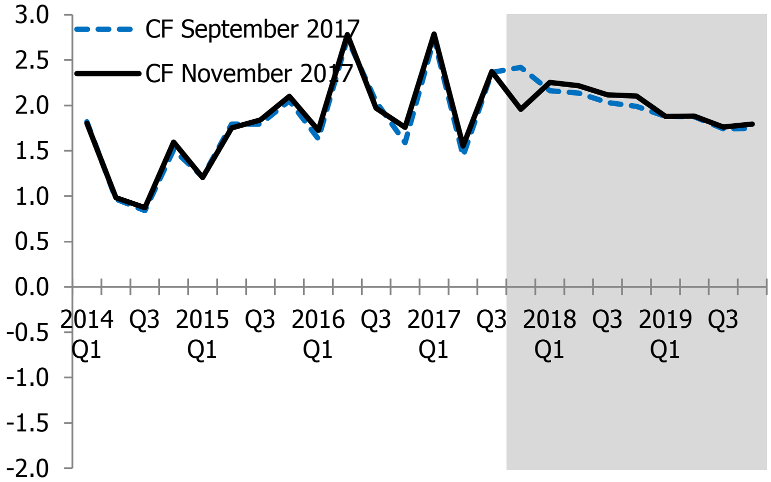
[1]After the confidence decrease in the first half of the year, there was a significant improvement in economic agents' perceptions in the third quarter and this favorable trend was also maintained during October.

The latest macroeconomic indicators and assessments indicate significant deviations in terms of the forecasted dynamics and the perceptions about the environment for conducting monetary policy and about the risks highlighted in the October forecasts are mainly unchanged. Foreign reserves (adjusted for price and exchange rate differentials and price changes of securities) do not register any significant changes compared to the third quarter. Also, foreign reserves adequacy indicators continue to hover in the safe zone. In terms of economic activity, the growth in the third quarter and generally more favorable signs from high-frequency indicators and surveys for the last quarter are in line with the expectations within the October round of forecasts for improved economic situation in the second half of 2017. Regarding inflation, recent performances are in line with the forecast, but the uncertainty associated with the expected movement of the prices of primary commodities remains a risk to the forecast for 2018. Within the monetary sector, the growth pace of total deposits in October is in line with the October forecast expectations, whereas the growth of the economic activity so far is moderately slower than the expected for the fourth quarter of the year.

Selected economic indicators/1		**2015**	**2016**						**2017**						
	2014	2015	Q1	Q2	Q3	Q4	2016	Q1	Q2	Jul.	Aug	Sep	Q3	Oct.	Nov.
I. Real sector indicators															
Gross domestic product (real growth rate, y-o-y) /2	**3.6**		**3.6**	**2.3**	**2.4**	**3.3**	**2.9**	**0.0**	**-1.3**				**0.2**		
Industrial production /3															
y-o-y	4.8	4.9	10.7	1.3	5.0	-1.8	3.4	-1.5	3.7	-2.2	-5.3	0.3	-2.4	1.3	
cumulative average	4.8	4.9	10.7	5.6	5.4	3.4	3.4	-1.5	1.2	0.7	-0.1	-0.1	-0.1	0.1	
Inflation /4															
CPI Inflation (y-o-y) /5	-0.5	-0.4	-0.1	-0.7	-0.2	-0.1	-0.2	0.5	1.2	1.2	1.9	1.7	1.6	1.9	2.2
CPI Inflation (cumulative average)	-0.3	-0.3	-0.1	-0.4	-0.3	-0.2	-0.2	0.5	0.9	0.9	1.0	1.1	1.1	1.2	1.3
Core inflation (cumulative average)	0.5	0.5	1.6	1.4	1.3	1.3	1.3	1.6	1.9	1.9	2.1	2.1	2.1	2.2	2.3
Core inflation (y-o-y)	0.5	0.5	1.6	1.3	1.1	1.1	1.3	1.6	2.2	2.3	3.0	2.7	2.7	2.9	2.9
Labor force															
Unemployment rate	28.0	26.1	24.5	24.0	23.4	23.1	23.7	22.9	22.6				22.1		
II. Fiscal Indicators															
(Central Budget and Budgets of Funds)															
Total budget revenues	145,929	161,207	40,583	41,422	43,807	43,524	169,336	42,734	43,634	15,173	14,482	14,949	44,604	15,390	
Total budget expenditures	168,063	180,632	46,218	42,729	45,953	50,506	185,406	46,301	48,377	17,567	14,564	15,218	47,349	15,657	
Overall balance (cash)	-22,134	-19,425	-5,635	-1,307	-2,146	-6,982	-16,070	-3,567	-4,743	-2,394	-82	-269	-2,745	-267	
Overall balance (in % of GDP) /1	-4.2	-3.5	-0.9	-0.2	-0.4	-1.2	-2.7	-0.6	-0.8	-0.4	0.0	0.0	-0.4	0.0	
III. Financial indicators /6															
Broad money (M4), y-o-y growth rate	**10.5**	**6.8**	**6.2**	**2.5**	**4.0**	**6.1**	**6.1**	**4.2**	**7.8**	**7.4**	**6.5**	**6.4**	**6.4**	**6.2**	
Total credits, y-o-y growth rate	**10.0**	**9.5**	**8.4**	**3.5**	**2.5**	**0.9**	**0.9**	**0.0**	**4.4**	**4.9**	**5.1**	**4.3**	**4.3**	**4.8**	
Total credits - households	11.8	12.9	13.0	8.8	7.3	7.0	7.0	6.6	9.5	9.8	10.0	9.8	9.8	9.3	
Total credits - enterprises	8.6	7.1	5.1	-0.5	-1.2	-3.8	-3.8	-5.2	0.0	0.8	1.0	-0.5	-0.5	0.9	
Total deposits (incl. demand deposits), y-o-y growth rate	**10.4**	**6.5**	**6.2**	**2.3**	**4.0**	**5.7**	**5.7**	**4.2**	**7.6**	**7.3**	**6.1**	**6.0**	**6.0**	**6.1**	
Total deposits - households	8.9	4.1	3.1	0.2	1.2	2.5	2.5	1.8	6.5	5.4	5.7	5.6	5.6	5.3	
Total deposits - enterprises	15.7	13.0	16.0	5.6	11.3	13.4	13.4	8.8	10.8	11.4	6.2	5.6	5.6	7.2	
Interest rates /7															
Interst rates of CBBills	3.25	3.25	3.25	4.00	4.00	3.75	3.75	3.25	3.25	3.25	3.25	3.25	3.25	3.25	
Lending rates															
denar rates (aggregated, incl. denar and denar with f/x clause)	7.5	7.1	6.7	6.6	6.6	6.5	6.6	6.4	6.3	6.2	6.2	6.1	6.2	6.1	
f/x rates	6.3	5.9	5.6	5.5	5.4	5.2	5.4	5.1	5.0	4.9	4.9	4.8	4.9	4.8	
Deposit rates															
denar rates (aggregated, incl. denar and denar with f/x clause)	3.7	2.9	2.5	2.5	2.5	2.5	2.5	2.3	2.2	2.1	2.1	2.1	2.1	2.2	
f/x rates	1.4	1.3	1.1	1.1	1.0	1.0	1.0	0.9	0.9	0.8	0.8	0.8	0.8	0.8	
IV. External sector indicators															
Current account balance (millions of EUR)	**-43.2**	**-187.0**	**-48.2**	**-209.4**	**108.1**	**-115.5**	**-265.0**	**-140.1**	**-95.5**	**60.4**	**66.4**	**48.2**	**174.9**		
Current account balance (% of GDP)	-0.5	-2.1	-0.5	-2.2	1.1	-1.2	-2.7	-1.4	-0.9	0.6	0.7	0.5	1.7		
Trade balance (millions of EUR) /8	**-1757.9**	**-1713.6**	**-373.2**	**-501.5**	**-391.4**	**-511.3**	**-1777.4**	**-435.1**	**-450.8**	**-134.1**	**-152.6**	**-99.2**	**-385.9**	**-154.8**	
Trade balance (% og GDP)	-20.5	-18.9	-3.8	-5.1	-4.0	-5.2	-18.0	-4.3	-4.4	-1.3	-1.5	-1.0	-3.8	-1.5	
import (millions of EUR)	-5504.5	-5801.1	-1356.6	-1557.7	-1540.0	-1652.4	-6106.7	-1583.7	-1721.8	-550.0	-537.5	-561.3	-1648.9	-620.0	
export (millions of EUR)	3746.6	4087.6	983.3	1056.2	1148.6	1141.1	4329.3	1148.6	1270.9	415.8	385.0	462.2	1263.0	465.2	
rate of growth of import (y-o-y)	10.5	5.4	3.3	4.9	10.2	3.0	5.3	16.7	10.5	6.5	5.5	9.2	7.1	16.1	
rate of growth of export (y-o-y)	15.8	9.1	5.3	1.4	10.5	6.4	5.9	16.8	20.3	2.9	8.9	18.2	10.0	20.0	
Foreign Direct Investment (millions of EUR)	**197.4**	**202.8**	**129.3**	**41.4**	**20.1**	**126.1**	**316.9**	**111.6**	**-10.8**	**4.7**	**-8.3**	**-46.6**	**-50.2**		
External debt															
Gross external debt (in milllions of EUR)	5992.3	6290.5	6813.1	6861.2	7488.7	7216.6	7216.6	7791.4	7781.3						
public sector	2846.8	2933.7	3279.1	3282.8	3890.9	3445.3	3445.3	3819.9	3740.9						
public sector/GDP (in %)	33.2	32.4	33.7	33.8	40.0	35.4	34.9	37.4	36.6						
private sector	3145.5	3356.9	3534.0	3578.4	3597.8	3771.2	3771.2	3971.6	4040.4						
Gross external debt/GDP (in %)	70.0	69.4	70.1	70.6	77.0	74.2	73.5	76.3	76.2						
Gross official reserves (millions of EUR) /9	**2,436.5**									**2,273.3**	**2,275**	**2,271**		**2,301**	**2,274**

/1 While calculating the relative indicators, the annual GDP from the official announcement of SSO is used. For 2017, the projected level from the NBRM projections from October 2016 is used.
/2 Preliminary data for 2015. Estimated data for 2016.
/3 The changes of Index of industrial production are according to base year 2010=100.
/4 CPI calculated according to COICOP 2016=100.
/5 Inflation on annual basis corresponds to end-year inflation (December current year/December previous year)
/6 The calculations are based on the New Methodology for compiling standard forms of the monetary balance sheets and surveys and the new accounting plan (in force since 01.01.2009).
/7 As of January 2015 data for active and passive interest rates are compiled according to the new methodology of NBRM.
/8 Trade balance according to foreign trade statistics (on c.i.f. base).
/ 9The data from 2008 include accrued interest. The latest available data on gross official reserves are preliminary data.

Foreign effective demand
(annual changes in %)



Source: "Consensus Forecast" and NBRM calculations.

In 2017, expectations for foreign effective demand remain unchanged compared to the October forecasts...

...i.e. it is still expected that the growth will reach 2.2% on an annual basis.

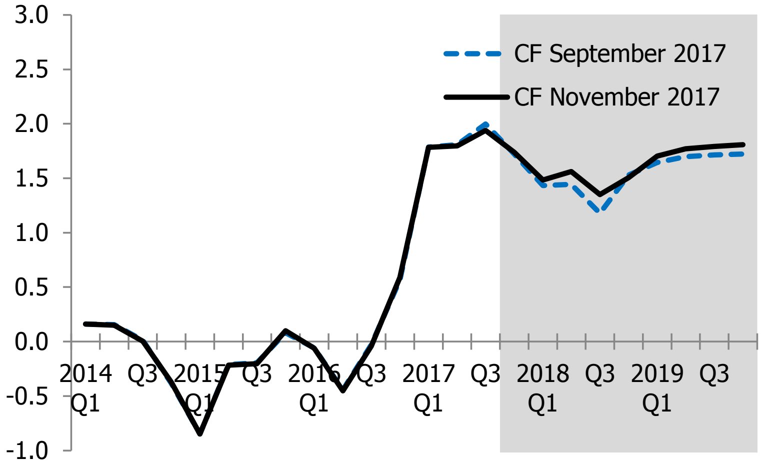
On the other hand, the foreign effective demand was slightly revised downwards in 2018...

...whereby its growth is expected to reach 2.2% (2.1% in October)...

...largely as a result of the expectations for a stronger economic growth in Germany.

In 2019, the October estimations for growth in foreign effective demand of 1.8% were retained.

Foreign effective inflation
(annual rates in %)



Source: "Consensus Forecast" and NBRM calculations.

Expectations for foreign effective inflation for 2017 are unchanged compared to the October forecasts, expecting a growth rate of 1.8%.

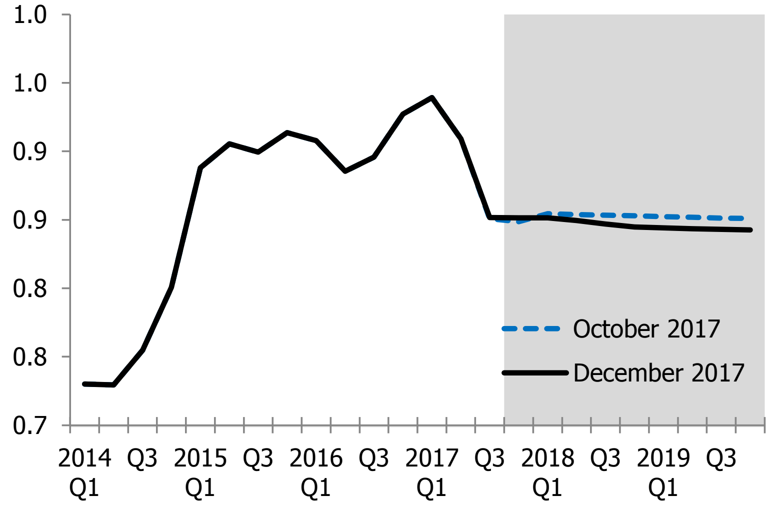
On the other hand, the foreign effective inflation was slightly revised upwards for 2018 and 2019...

...whereby an annual growth of 1.5% and 1.8%, respectively is currently expected (compared to the expected in October of 1.4% and 1.7%, respectively).

...largely as a result of the expectations for higher growth of prices in Serbia[2].

[2] Inflation in Serbia has been adjusted for the changes in the exchange rate.

EUR/USD exchange rate



Source: "Consensus Forecast" and NBRM calculations.

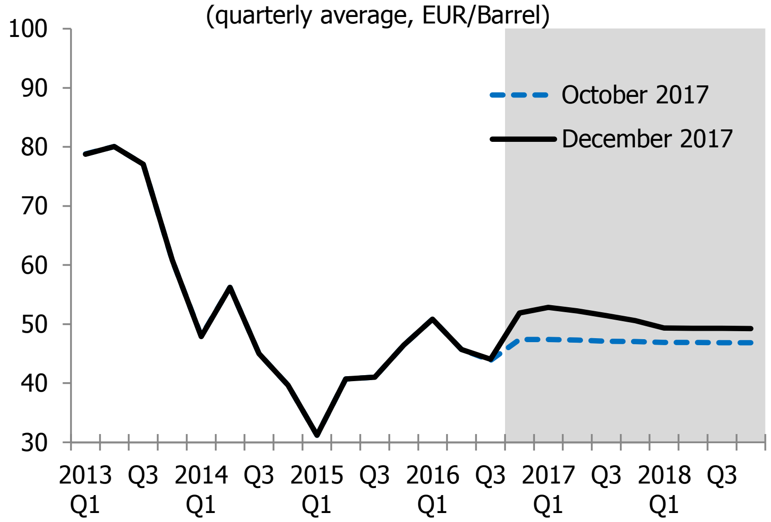
Latest expectations for the euro/US dollar exchange rate for 2017 point to slightly lower depreciation of the US dollar value against to the euro in the October forecasts...

...whereby the decline of its value is expected to amount to 1.8% (1.9% in October).

On the other hand, a greater depreciation of the US dollar against the euro than the one forecasted in October is expected for 2018 and 2019.

...which is mostly due to the reduced political risks and favorable economic performances and forecasts for the euro area, amid gradual decrease of the volume of ECB's quantitative easing after December 2017.

Brent oil
(quarterly average, EUR/Barrel)



Source: IMF, World Bank and NBRM calculations.

The latest oil price estimations for 2017 and 2018 were revised upwards compared to the October forecasts...

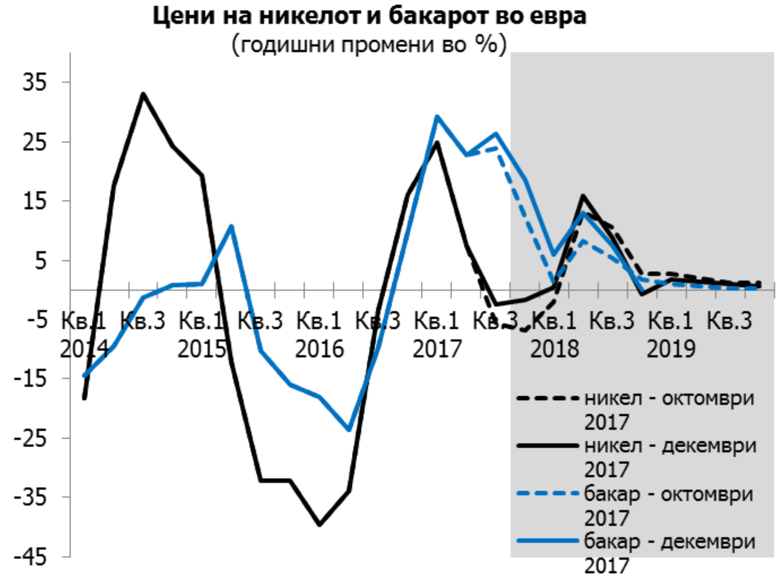
...whereby a higher price increase is expected, especially in 2018 compared to the forecasted in October...

...mostly due to the agreement of the OPEC states and Russia to support the agreement for the reduction of oil production[3].

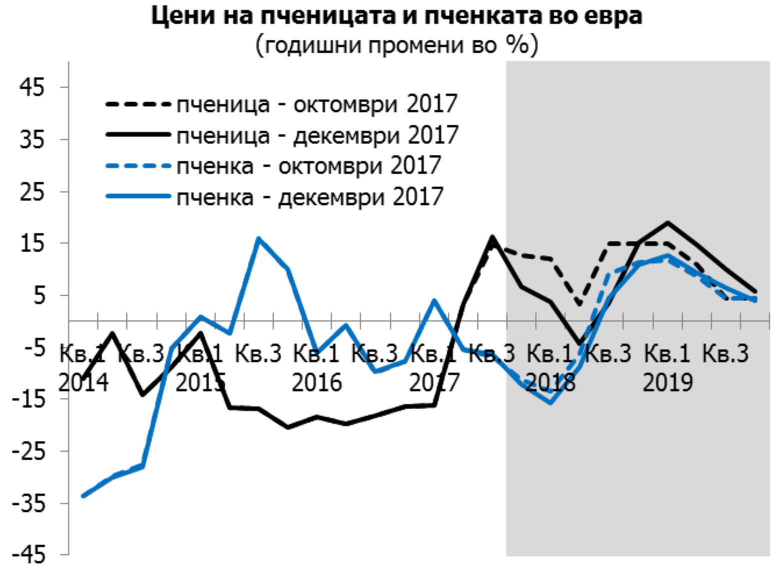
On the other hand, a downward revision was made for 2019...

...expecting a greater oil price reduction than the one forecasted in October.

[3] On 30 November 2017, the OPEC Member States and Russia made a decision to extend the measure for reduction of oil production for nine additional months i.e. until the end of 2018, which aims to reduce the inventories of this fuel globally. Also, other oil producing countries that are not OPEC Member States, including Russia supported the extension of the agreement, decreasing oil production by 1.8 million barrels per day until December 2018. Additionally, Nigeria and Libya also joined in the measure, countries that previously were not part of the agreement.



Source: IMF, World Bank and NBRM calculations.



Source: IMF, World Bank and NBRM calculations.

In 2017 and 2018, metal prices were revised upwards...

...expecting a slightly higher growth of the nickel and copper prices compared to the October forecasts...

...which is mostly due to the expectations for increased demand of these metals by the automobile industry[4].

On the other hand, metal price forecasts were slightly revised downwards in 2018...

...expecting minor growth in the nickel price and similar price level of copper as in 2018.

Expectations for stock exchange prices of corn and wheat[5] for 2017 and 2018 were revised downwards...

...expecting a slightly smaller growth of the price of wheat and greater decline of corn price...

...which is largely due of the expectations for an increased level of wheat production in Russia and the expectations for an increased level of corn production in the United States.

Prices of food products have been revised upwards for 2019, expecting a higher growth of wheat and corn prices.

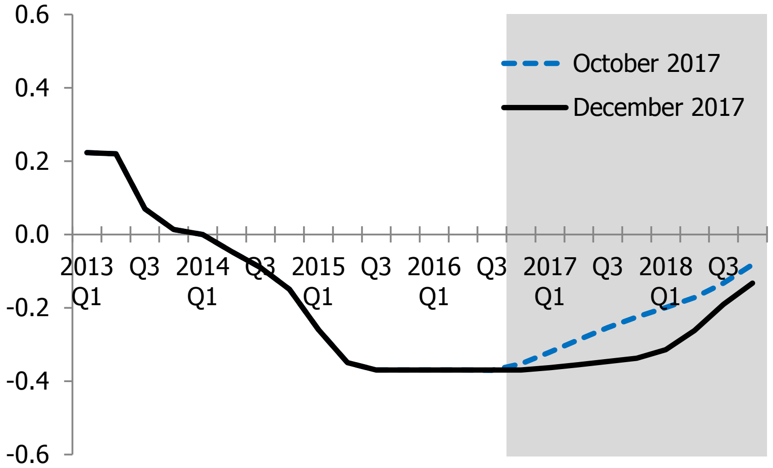
In 2017, expectations for the movement of one-month EURIBOR are unchanged compared to the October forecasts...

...which is forecasted to average -0.37%.

Foreign interest rate was slightly revised downwards to -0.35% and -0.22%, respectively for 2018 and 2019 compared to the forecasted rates of -0.27 and -0.15%, respectively.

[4] http://www.scmp.com/business/commodities/article/2116772/goldman-lifts-copper-price-forecast-us7050-china-expected-drive
http://pubdocs.worldbank.org/en/743431507927822505/CMO-October-2017-Full-Report.pdf
[5] The October 2017 forecasts started to use a new series of data on wheat prices released by the World Bank, instead of the current IMF series. Due to the differences between the two series, in order to ensure consistency, series of data released by World Bank is used amid comparing both forecasts.

1-month Euribor
(quarterly average, in %)

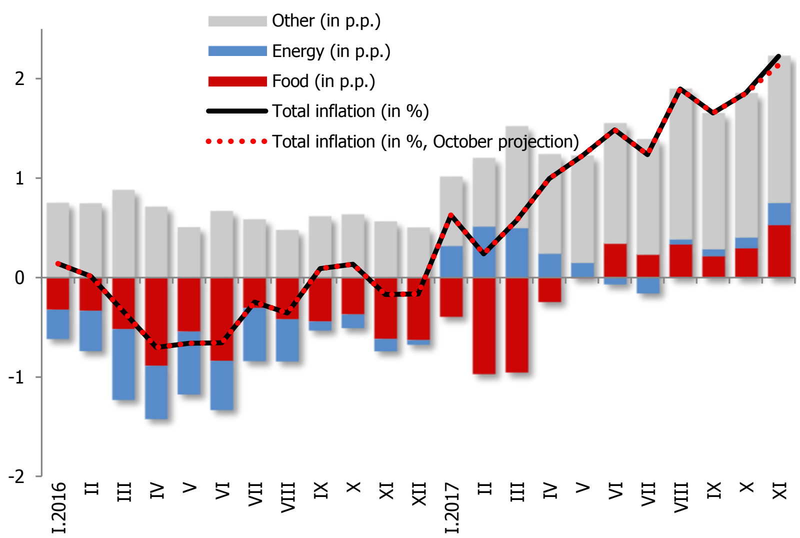


Source: NBRM calculations.

...amid continuing the ECB's quantitative easing program after December 2017, although at a reduced volume, and efforts to maintain the current stimulative interest rate policy for a longer period after the completion of the purchase of assets[6].

[6] At the ECB's regular meeting in October, the European Central Bank, decided to maintain the current interest rate, and continue the ECB's quantitative easing program until September 2018 with a reduced volume (Euro 30 billion monthly).

Inflation rate
(annual impacts to inflation, in p.p.)

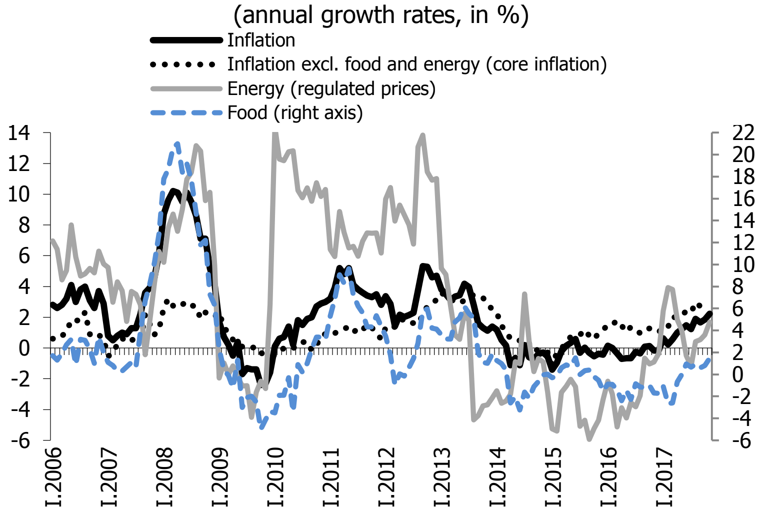


Source: SSO and NBRM.

In November 2017, domestic consumer prices registered a monthly increase of 0.2%[7] (monthly increase of 0.3% in October)...

...amid growth of energy prices and core inflation and simultaneously unchanged food prices.

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



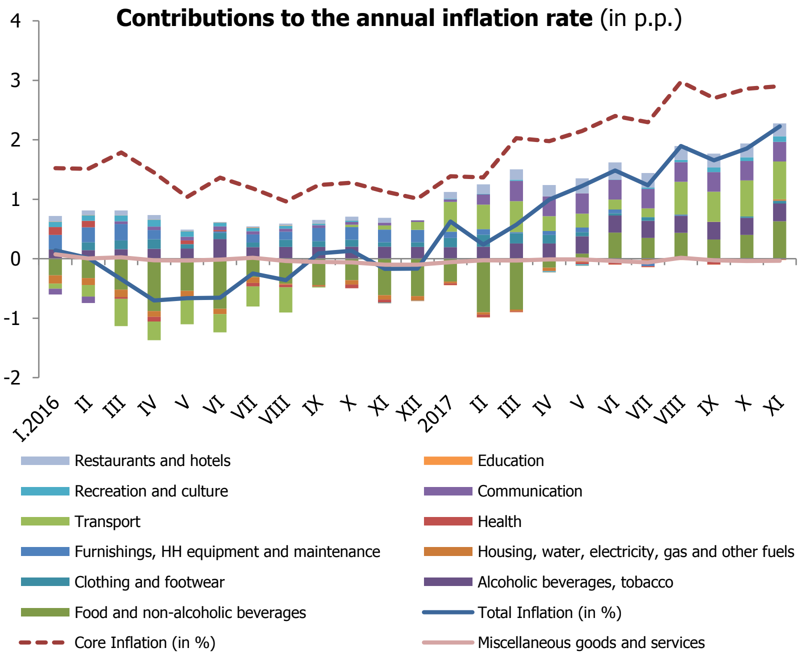
Source: State statistical office and NBRM calculations.

The annual inflation rate in November was 2.2% (compared to 1.9% in October), amid increase of all three price components, but still with the largest contribution of core inflation. Compared to the October round of forecasts, annual inflation for November is slightly above the expectations.

Analyzed by individual price categories, there is an upward deviation in energy prices, in food the deviation is downward, whereas core inflation is generally within expectations.

Analyzed cumulatively for the period January-November 2017, the inflation rate of 1.3% is in line with the forecasted in the October round of forecasts.

[7]Observed by group products, meat and liquid fuels and lubricants have the highest positive contribution in the monthly growth of prices in November.

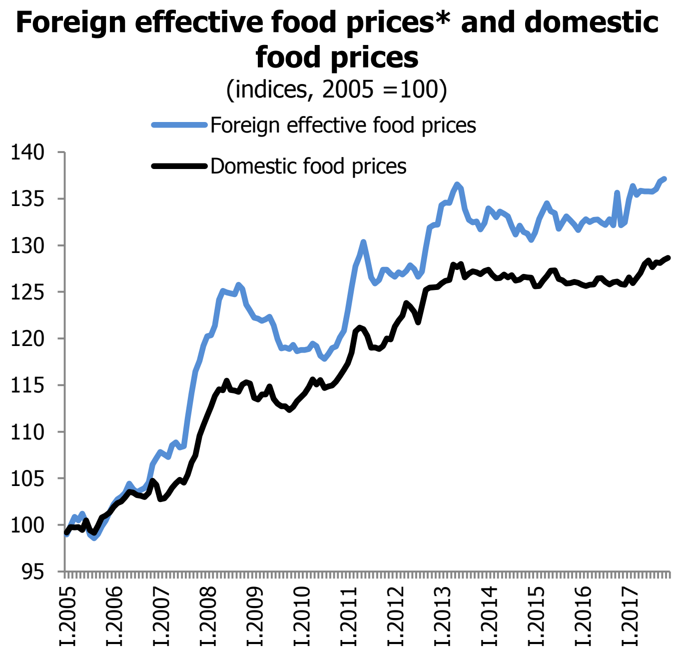


Source: SSO and NBRM.

Core inflation rate in November amounted to 0.1% on a monthly basis (compared to 0.3% in October), whereas on an annual basis it amounted to 2.9% (same as in October).

Core inflation structure in November is similar to the previous month. The annual growth in November is connected to the price growth in most categories within the core inflation, from which prices of air transport, catering services and accommodation, communications and tobacco[8] have the highest positive contribution.

Regarding the expected price movements of external input assumptions, the inflation forecast has been revised in different directions.

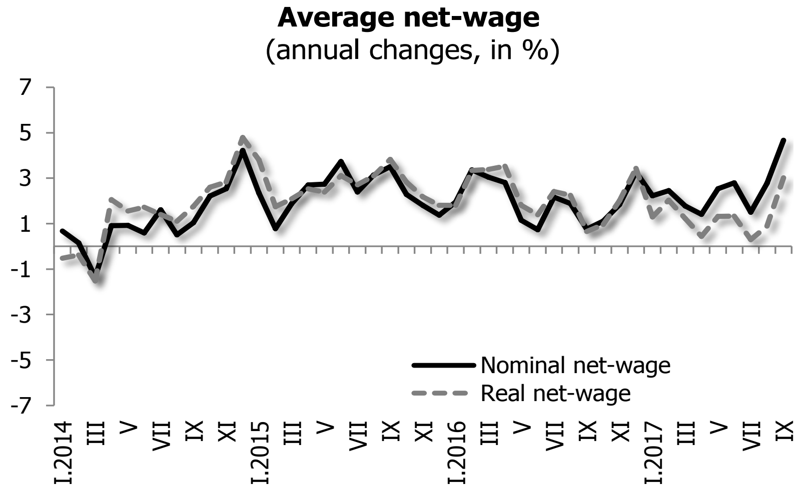


* Foreign effective food prices are calculated as weighted sum of food prices in countries that are major trade partners with Macedonia.
Source: State statistical office, Eurostat and NBRM calculations.

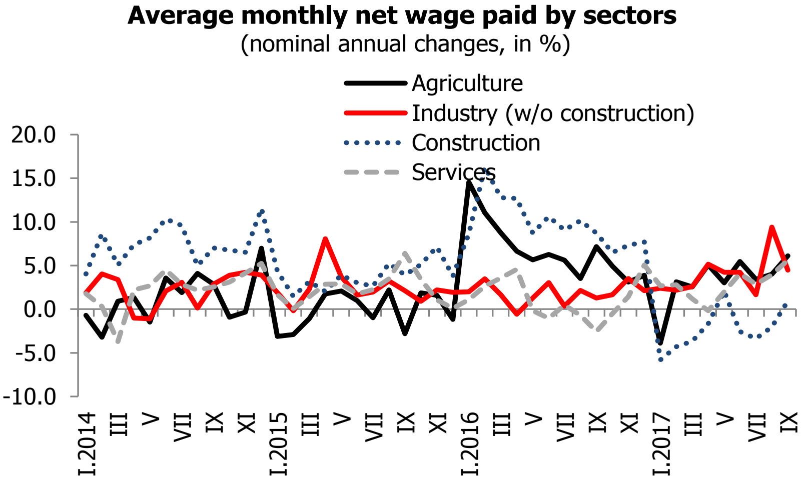
The latest oil prices estimations for 2018 indicate a higher growth compared to the expectations of the October round of forecasts. On the other hand, expectations in grain prices are somewhat pessimistic i.e. it is expected that wheat prices will grow slowly, while corn prices are expected to register a greater decline compared to the expected in October.

Amid performances generally in line with the forecast and external assumptions revised in divergent directions, it is assessed that the risks to inflation forecast for 2018 are currently balanced. The uncertainty around the forecasted movement of the world prices of primary commodities, primarily oil prices continues to remain the main risk to the inflation forecast.

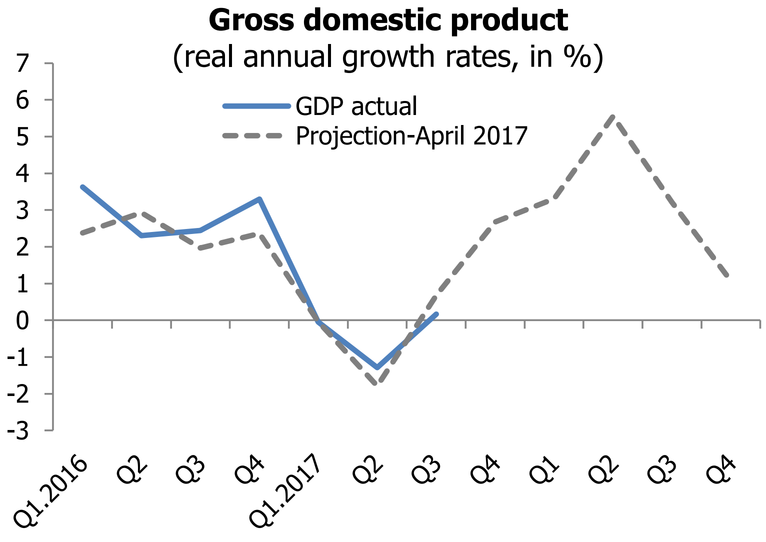
[8] The annual growth of tobacco prices in November is a combination of the increase in the price of a certain type of cigarettes in April and June 2017. In July 2017, the cigarette excise increased (from 1 July 2017 to 1 July 2023 the excise duty will increase by 0.20 denars/piece each year) which did not reflect on the monthly changes in tobacco prices.



Source: SSO.



Source: SSO.



Source: SSO and NBRM projections.

In September 2017, the average net wage registered a nominal annual growth of 4.7%, which is an acceleration of the growth of 1.9 percentage points compared to the last month's growth, which is partially connected to the minimum wage[9]. Observed by activities, higher wages are paid in almost all activities[10], and the highest growth is in the sectors "art, entertainment, recreation", "processing industry" and "mining and quarrying".

Amid increase in the consumer prices in September, the **real wages increased by 3.0%.**

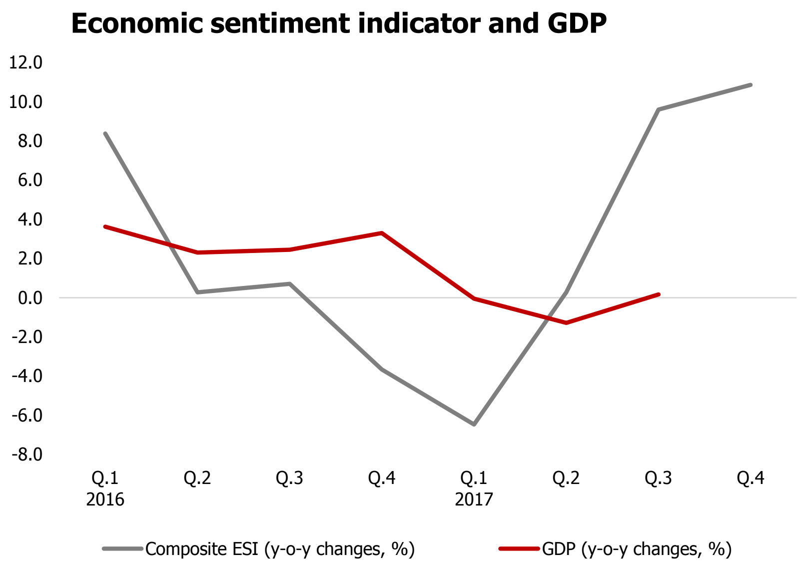
Net wages in the third quarter of the year are higher than expected for this quarter within the October forecast.

After the unfavorable movements during the first half of the year, an annual growth of real GDP was registered in the third quarter of 2017, a shift that is in line with the expected pace in the October round of forecasts. The growth rate in the third quarter was 0.2% and is somewhat lower than the forecasted growth rate (0.7%).

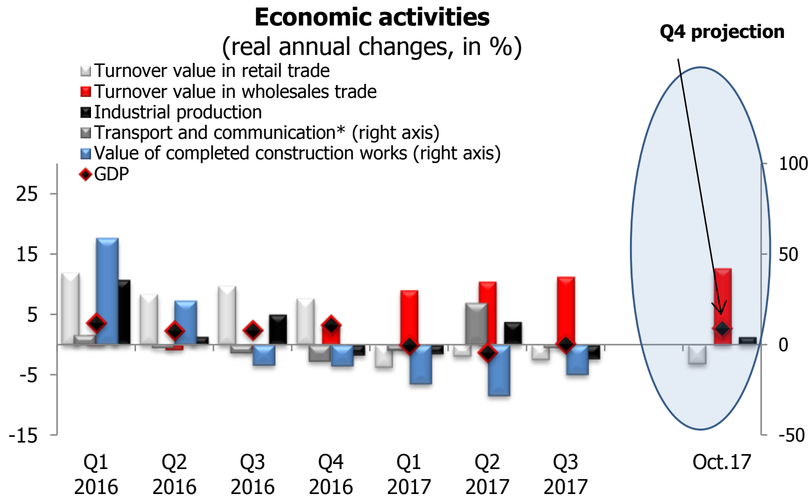
Growth structure observed in terms of the demand does not generally deviate from the October forecast. Thus, the growth in the third quarter was driven by the domestic demand and exports, while imports made a negative contribution. Analyzed by components, the exports made the highest contribution to the GDP growth, and is also in line with the forecast. The growth of domestic demand is driven by private consumption, which in the third quarter of the year registered a relatively high growth, whereas the remaining two components - gross-investments and public consumption registered a decline.

Analyzed by production, the growth in the

[9]In 19 September 2017, the Assembly of the Republic of Macedonia adopted the amendment to the Minimum wage law of the Republic of Macedonia. Pursuant to the amendments, starting with the wage payment for September 2017, the amount of the minimum wage in the Republic of Macedonia in all sectors in the economy is set at Denar 17.300 in gross amount i.e. Denar 12.000 in net amount.
[10] Decline in wages in September is registered in "professional, scientific and technical activities".



Ouarter four is only for October and November 2017
Source: State statistical office and European



*Simple average of annual growth rates of the different types of transport and the telecommunications.
Source: SSO and NBRM calculations.

third quarter is driven by trade, and agriculture and real estate activities have a higher value added. All the remaining activities registered a decline in the value added.

The high-frequency data indicate an economy growth in the last quarter of the year. However, the largest portion of indicators are only available for the first month of the quarter with increases the uncertainty around the assessment based on these information. **Regarding the perceptions of economic agents for the economic situation[11], surveys conducted in the period October-November indicate retention of the economic confidence in entities.**

October data for each economic sector indicate to more favorable movements compared to the third quarter. In October, **industrial output increased by 1.3% on an annual basis, compared to the decline of 2.4% in the third quarter.** Such favorable development are a reflection of the favorable developments in the energy sector and processing industry, whereas mining production was reduced.

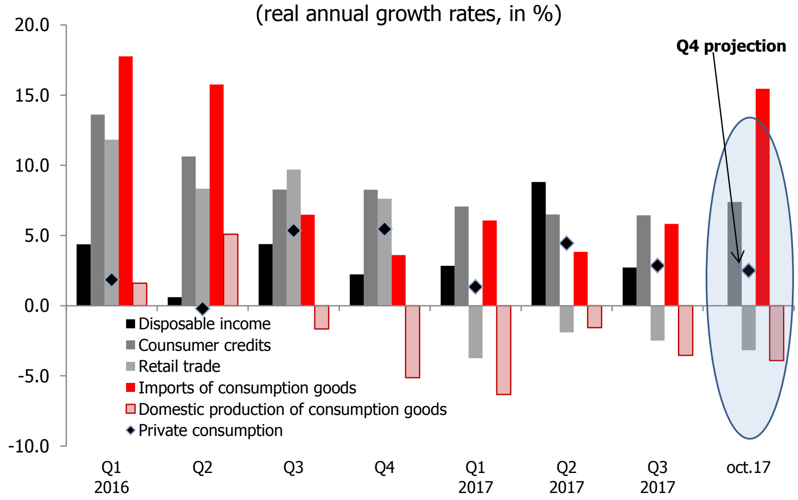
Observed by individual sectors within the processing industry, the growth is mainly due to the production growth where the largest foreign export facilities produce (machinery and equipment, electric equipment). On the other hand, production in the largest portion of traditional activities registers a decline in October, with the highest negative contribution from metal production and production of clothes.

The increase of the **total trade** turnover continued in the first month of the last quarter of the year with a moderate pace acceleration mainly reflecting the shifts in wholesale trade. The turnover in retail trade also continued to decrease in October, but at a slower pace.

Available indicators for **aggregate demand** indicate more favorable developments in the

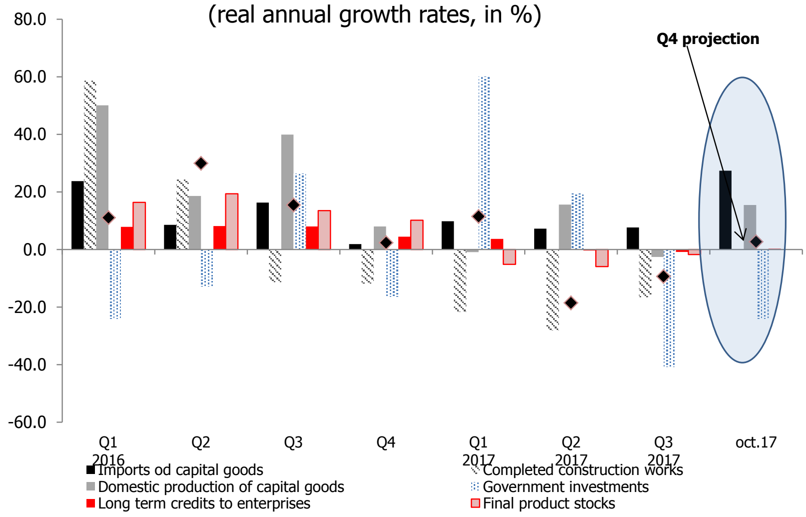
[11] It refers to the surveys conducted by the European Commission to measure the economic confidence of entities in an economy. The composite indicator o economic confidence is obtained as a weighted average from the confidence indicators for consumers and confidence indicators for individual economic secto (construction, industry, retail trade and services).

Indicative variables for private consumption
(real annual growth rates, in %)



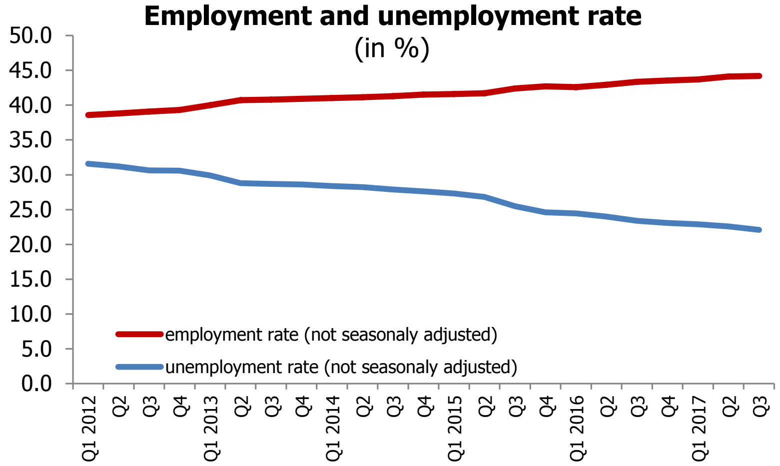
Source: SSO and NBRM calculations.

Indicative variables for investments
(real annual growth rates, in %)



Source: SSO and NBRM calculations.

Employment and unemployment rate
(in %)



Source:SSO, LFS

fourth quarter. Favorable developments in some disposable income components and stable growth of lending to households indicate to the continuation of the **private consumption** growth in the fourth quarter. Import of consumer goods also registers an increase. Regarding indicators, decrease is registered in retail trade (but at a slower pace) and in the production of consumer goods.

Regarding **investments** indicative categories in October, growth is registered in domestic production of capital goods, import of working assets and long-term lending to enterprises, whereas government capital investments register a decline.

Data on foreign trade indicate potential widening of the deficit in the fourth quarter.

Budget performance as of October suggests annual growth of public consumption in the fourth quarter amid upward shifts in costs for salaries and transfers for health care.

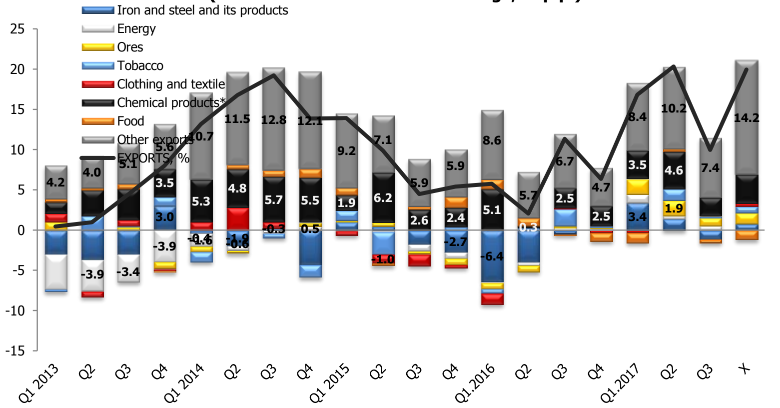
The favorable labor market developments also continued in the third quarter of 2017...

...given the further decline in the unemployment rate, which was reduced to 22.1% in the third quarter (22.6% in the second quarter of 2017)...

...and annual increase in the number of employed persons of 2.1% [12].

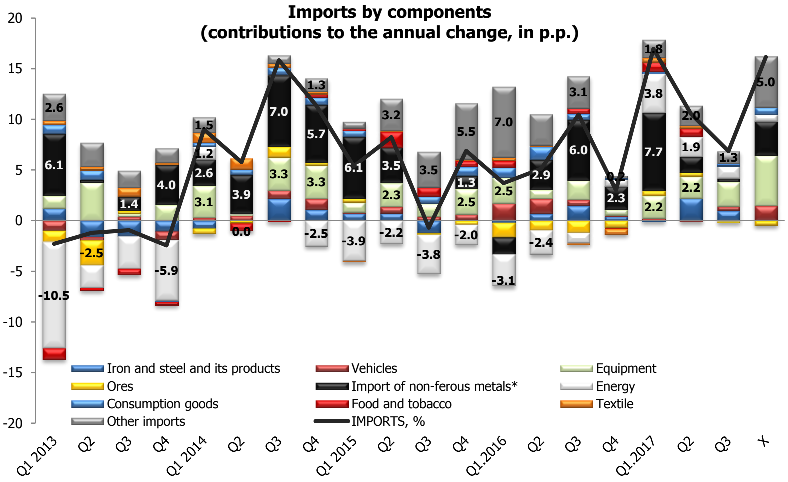
[12] Processing industry and transport made the largest contribution to the employment growth.

Exports by components
(contributions to the annual change, in p.p.)



Source: NBRM.

Imports by components
(contributions to the annual change, in p.p.)



Source: NBRM.

In October 2017, the foreign trade deficit increased by 6% on an annual basis, amid more intensified increase in the import than the export component.

Export of goods in October registered an annual growth of 20% due to the increase of export in all components, except in food export which registered a decline.

Compared to the October forecast, the export in October is higher than expected for the fourth quarter, mainly due to the more intensified deviation in export of new export oriented facilities and better performances in the remaining export segments.

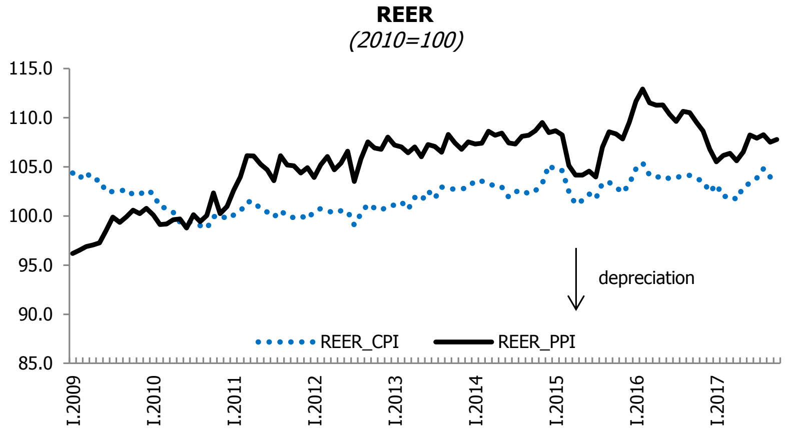
Export of food and ore is an exception where a moderate downward deviation is registered.

Import of goods in October 2017 increased by 16% on an annual basis, reflecting the increase in the import in all components except ores.

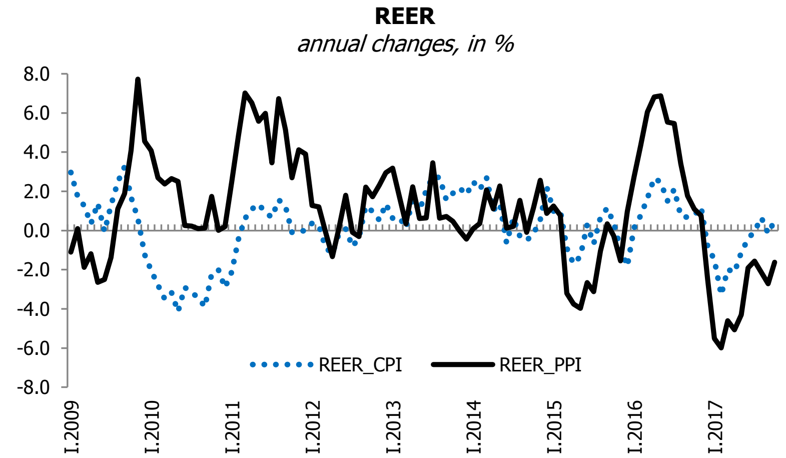
Import of goods in October 2017 is slightly higher than expected for the fourth quarter with the October forecast, amid upward deviations in almost all import components except in import of energy, metal industry and ores where downward deviations were registered.

The performances of the foreign trade components indicate a likelihood of a moderately lower than forecasted trade deficit in the fourth quarter of 2017, according to the

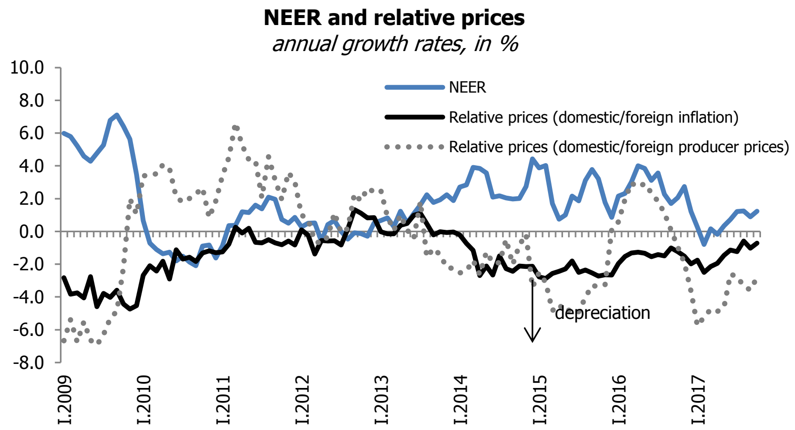
April forecast.



Source: NBRM.



Source: NBRM.

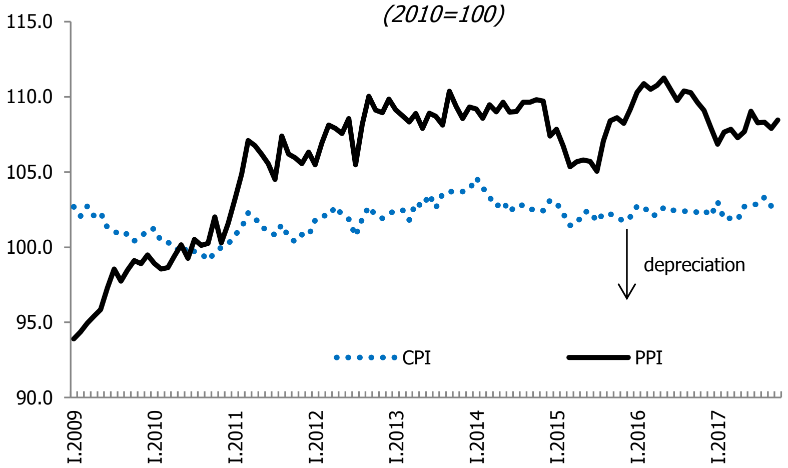


Source: NBRM.

In October 2017, **price competitiveness indicators of the domestic economy registered divergent movements. Namely,** the REER index deflated by consumer prices registered a moderate appreciation of 0.5%, while the REER index deflated by producer prices depreciated by 1.6%.

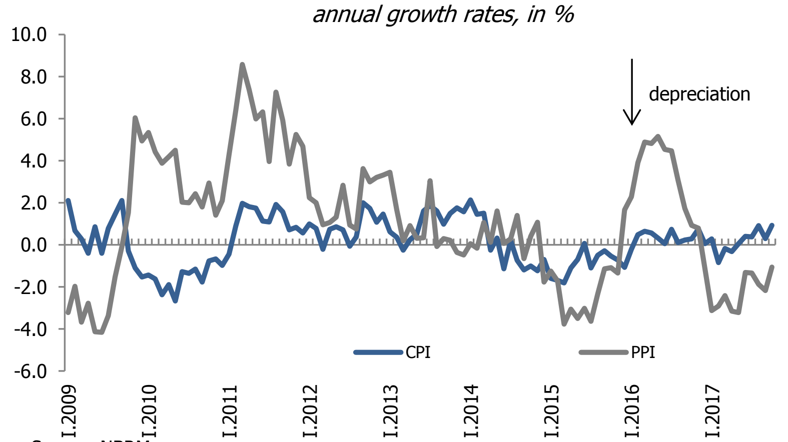
These developments are due to favorable movements in relative prices, and the relative prices of industrial products decreased by 2.8%, while the relative cost of living registered a moderate decrease of 0.7%. At the same time, the NEER acted in the opposite direction, recording a moderate appreciation of 1.2% on an

REER, excluding primary commodities
(2010=100)



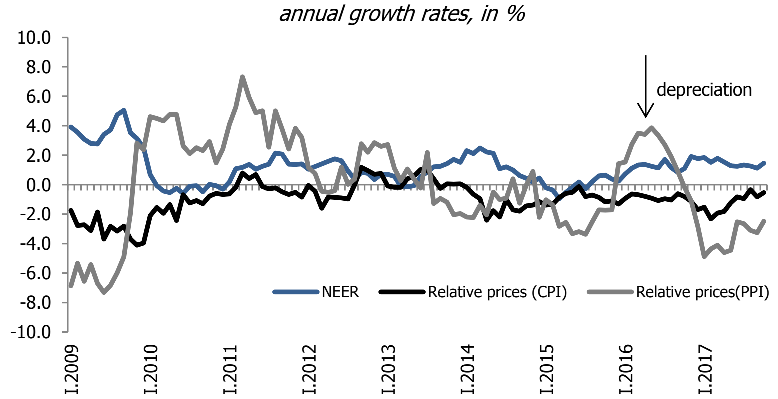
Source: NBRM.

REER, excluding primary commodities
annual growth rates, in %



Source: NBRM.

NEER and relative prices, excluding primary commodities
annual growth rates, in %



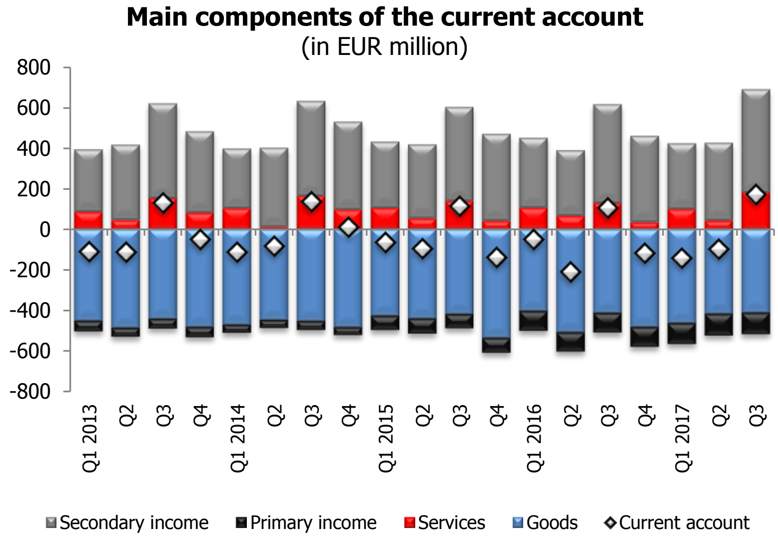
Source: NBRM.

annual basis, mostly as a result of the depreciation of the Turkish lira and the US dollar.

In August 2017, the analysis of **REER indices, as measured using weights based on the foreign trade without primary commodities**[13], also shows similar movements. The REER deflated by consumer prices registered moderate appreciation of 0.9%, while the REER deflated by producer prices depreciated by 1.1%.

On an annual basis, the relative consumer prices and the relative producer prices decreased by 0.5% and 2.5%, respectively. The NEER has appreciated by 1.5% on an annual basis.

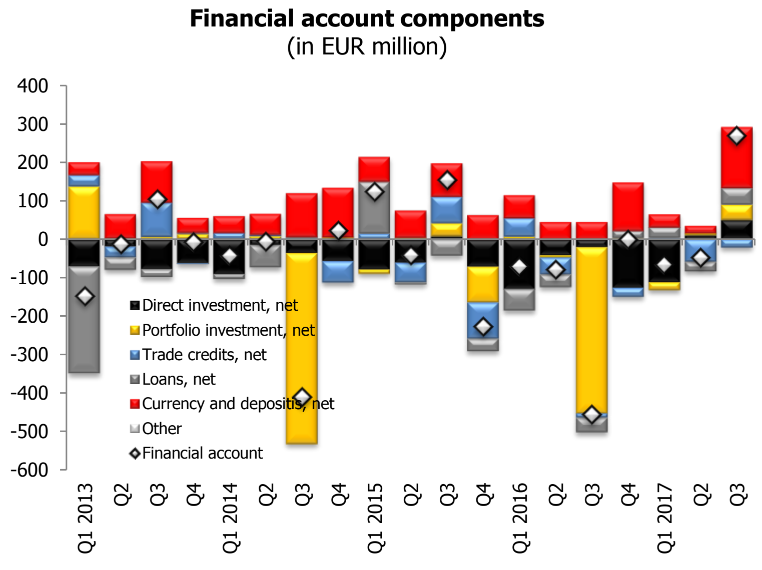
[13] Primary commodities not included in the calculation are: oil and oil derivatives, iron and steel, ores and imported raw materials for the new industrial facilities in the free economic zones.



Source: NBRM.

In the third quarter of 2017, the current account registered a surplus of Euro 174.9 million (or 1.7% of GDP), which is higher than expected according to the October forecast.

The positive deviation is due to the improved performance in the balance of services, whereas the goods deficit is greater than the forecasted. The remaining two components, primary and secondary income are in line with the expectations according to the October forecast.



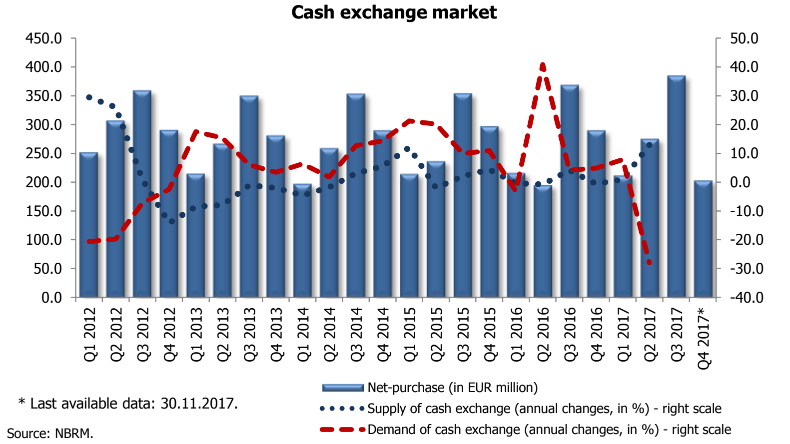
Source: NBRM.

In the third quarter, the financial account registered net outflows of Euro 269.8 million (or 2.6% of GDP), which is a minor downward deviation compared to the October forecast i.e. higher than expected net outflows for the third quarter[14].

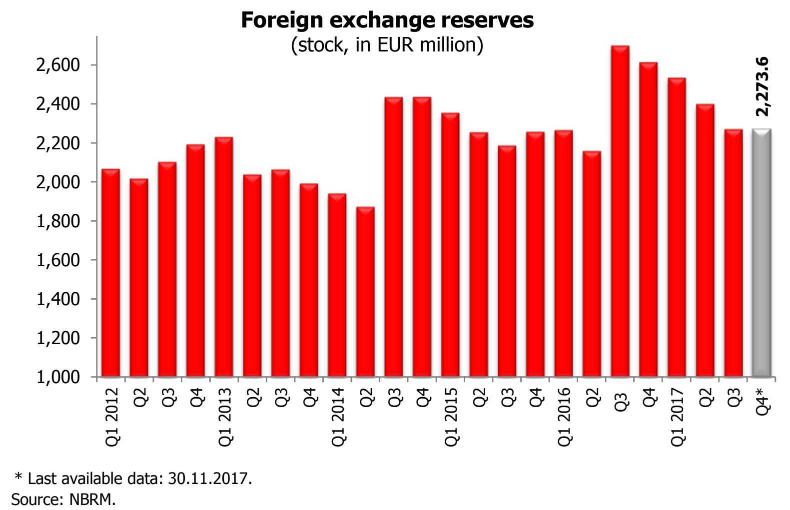
More significant downward deviations are registered in direct investments, registering net outflows compared to the forecasted net inflows for the third quarter. Also, performances in portfolio investments and long-term loans are lower compared to the expected for the third quarter. The downward deviations in these financial account components are mostly mitigated by the favorable movements in trade credits, which register net inflows instead of the forecasted net outflows.

Recent data on currency exchange operations as of 30 November 2017 indicate annual increase of the supply and decline of demand for foreign currency.

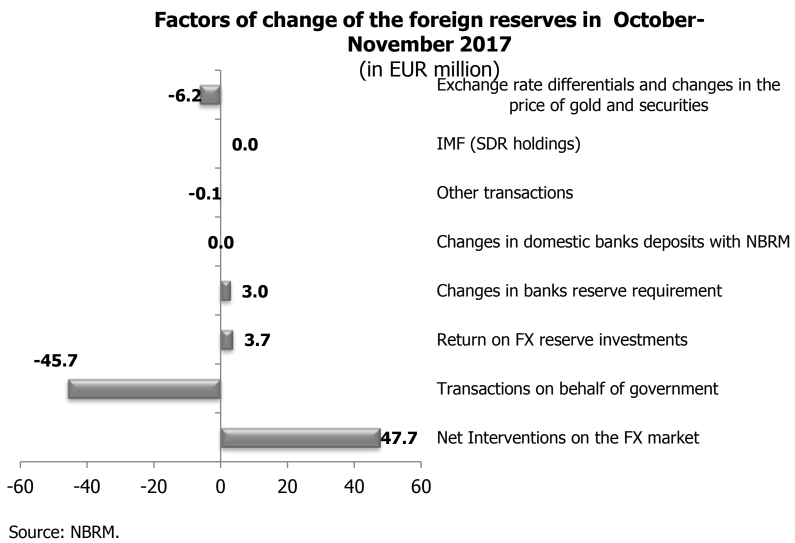
[14] According to the new methodology for compilation of the balance of payments BPM6, the terms net inflows and net outflows denote net incurrence of liabilities and net acquisition of financial assets, respectively.

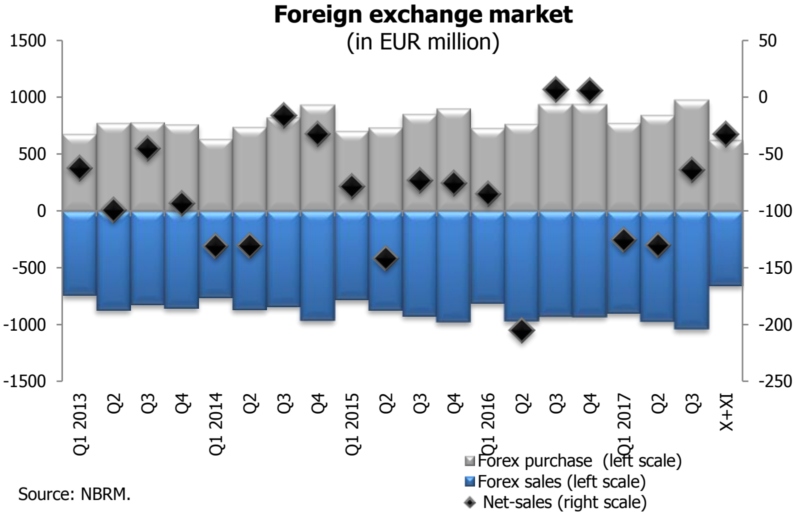


The net purchase on the currency exchange market registered in the period October-November 2017 was Euro 203.1 million, which is an annual increase of 6%.

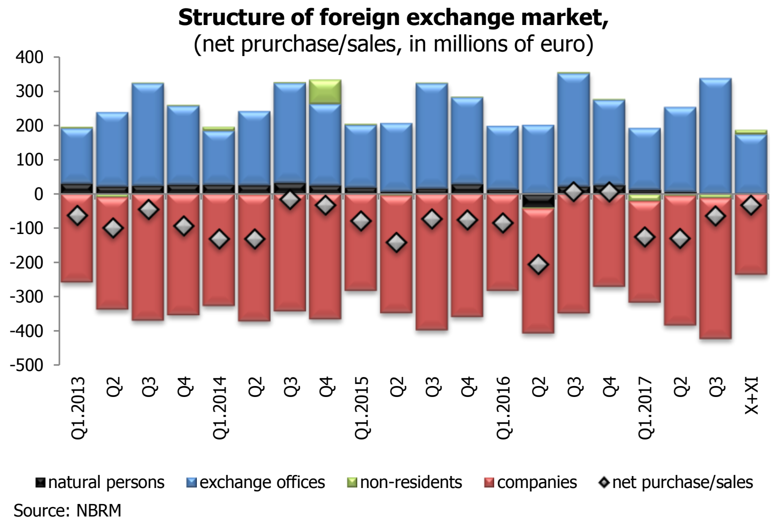


As of 30 November 2017, gross foreign reserves stood at Euro 2,273.6 million, which almost is an unchanged level compared to the end of the third quarter of 2017 (minor growth of Euro 2.3 million). The positive effect on foreign reserves by the NBRM's intervention on the currency market was mostly offset by the transactions on the account of the government. The remaining flows had a moderate impact on the changes in foreign reserves in the observed period.





In the period October-November 2017, the foreign exchange market of banks reported a net sale of foreign currency of Euro 32.2 million, contrary to the small net purchase registered in the same period last year. This annual change is a result of the faster growth in the demand for relative to the supply of foreign currency.



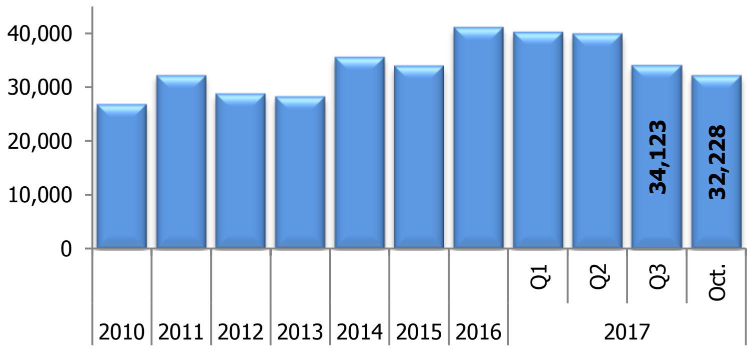
Sector-by-sector analysis shows that such changes are mostly due to the reduced net sales of companies.

The situation regarding the monetary instruments in October is lower compared to the end of the third quarter, which is in line with the expectations for creating liquidity through the monetary instruments in the last quarter of 2017, according to the October forecast.

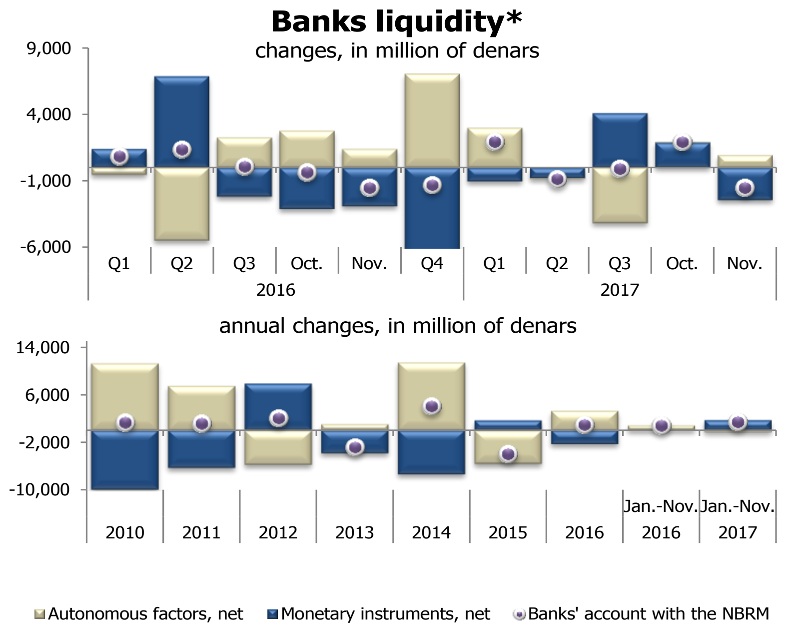
Net foreign assets of the NBRM in October increased compared to the end of September, versus expectations for significant decline in the fourth quarter, as forecasted in October. Total government deposits registered a monthly growth in October compared to the expected decline during the last quarter.

In October, the reserve money registered an increase compared to the end of the third quarter, but moderately weaker compared to the forecasted for the last quarter. The monthly increase completely derives from the increase of total liquid assets of banks, whereas currency in circulation registered a moderate decrease, contrary to the expectations for an increase in both categories according to the October forecast.

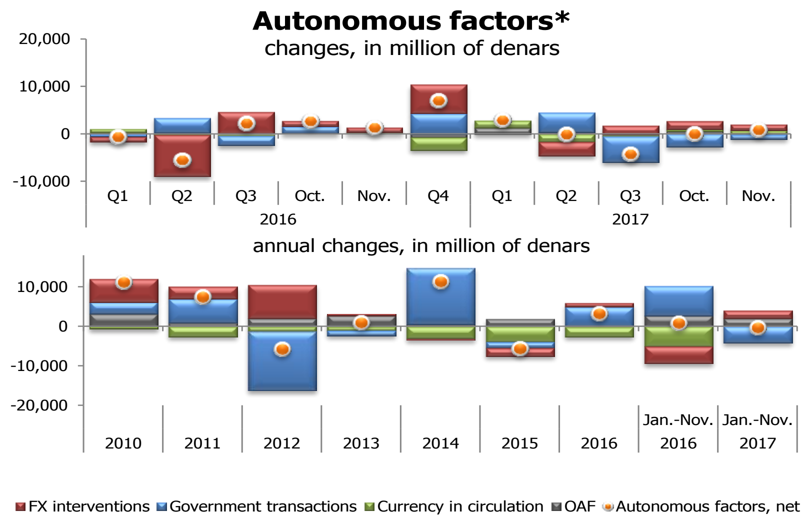
Monetary policy instruments
(in MKD million)



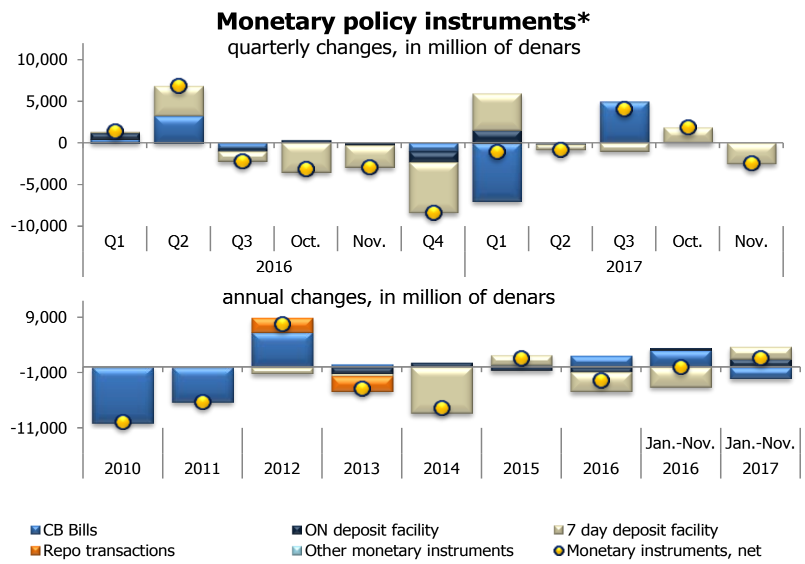
Source: NBRM.



Source: NBRM.
* positive change: liquidity creation, negative change: liquidity withdrawal

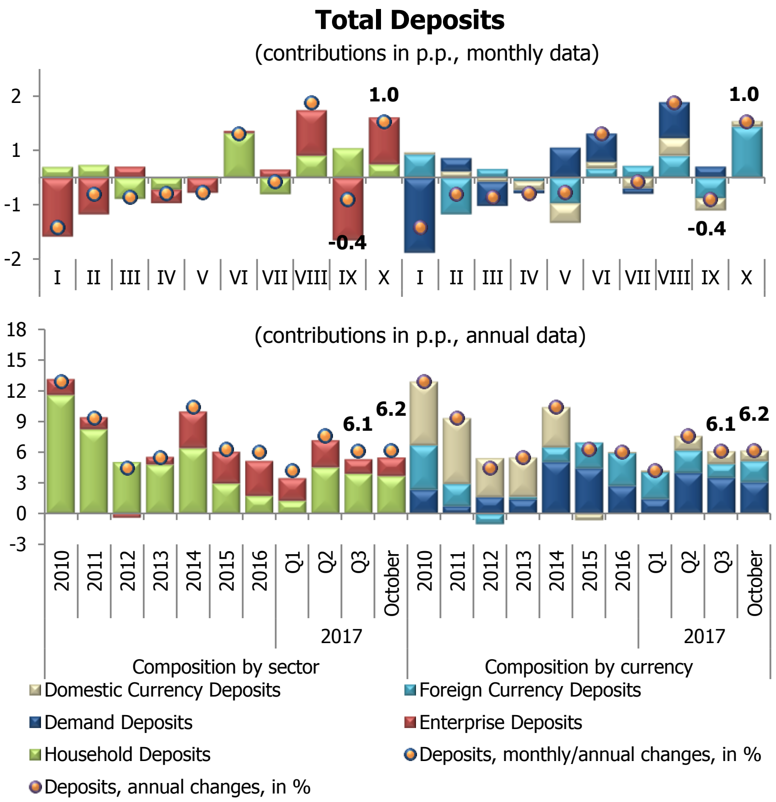


Source: NBRM .
* positive change: liquidity creation, negative change: liquidity withdrawal



Source: NBRM .
* positive change: liquidity creation, negative change: liquidity withdrawal

According to operational liquidity data, in November, the liquidity of the banking system registered a moderate decrease on a monthly basis. The decline in liquidity entirely arises from the increased interest of banks to place part of the excess liquid assets in short-term seven-day deposits with the NBRM. On the other hand, autonomous factors acted towards a moderate increase of the liquidity of the banks, dominantly influenced by the currency in circulation and NBRM's foreign currency interventions with net purchase, whereas government denar deposits registered a minor growth, thus acting towards a decrease in the liquidity of the banking system.



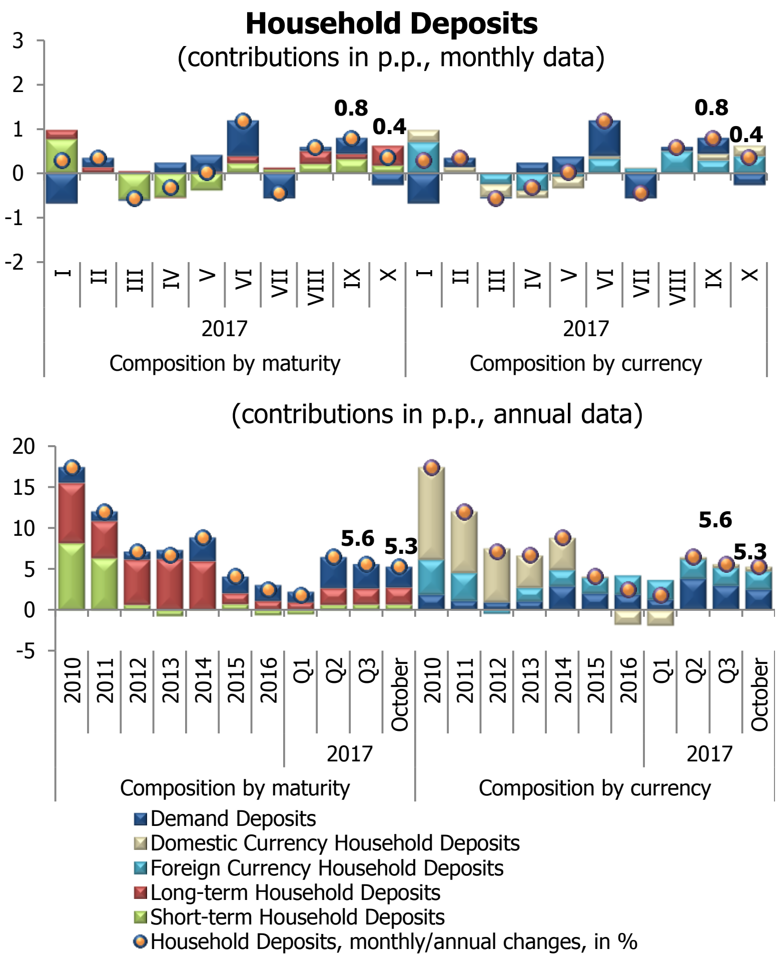
Source: NBRM.

In October 2017, total deposits in the banking sector increased on a monthly basis, despite the decrease in the previous month. Analyzed by sector, the monthly increase (of 1.0%) in October was mostly due to corporate deposits and relatively smaller growth of household deposits. In terms of currency structure, the growth of deposits in October is dominantly driven by foreign currency deposits and denar deposits also had a positive contribution on the monthly growth of total deposits.

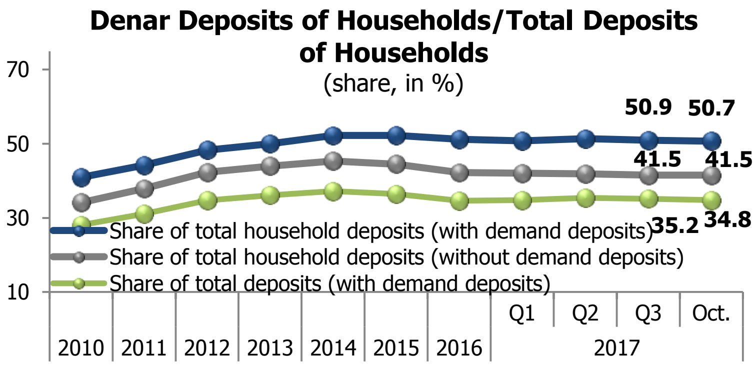
The growth pace in total deposits in October is in line with the expectations of the October forecast.

In October, the annual growth rate of total deposits was 6.2% (6.1% in September), which is above the forecasted growth for the fourth quarter of 2017 (of 3.6%) in October forecast. On an annual basis, the growth of total deposits in October it terms of currency is mostly due to the growth of foreign currency deposits. Analyzed by sectors, the annual deposits growth is mostly due to the growth of household deposits.

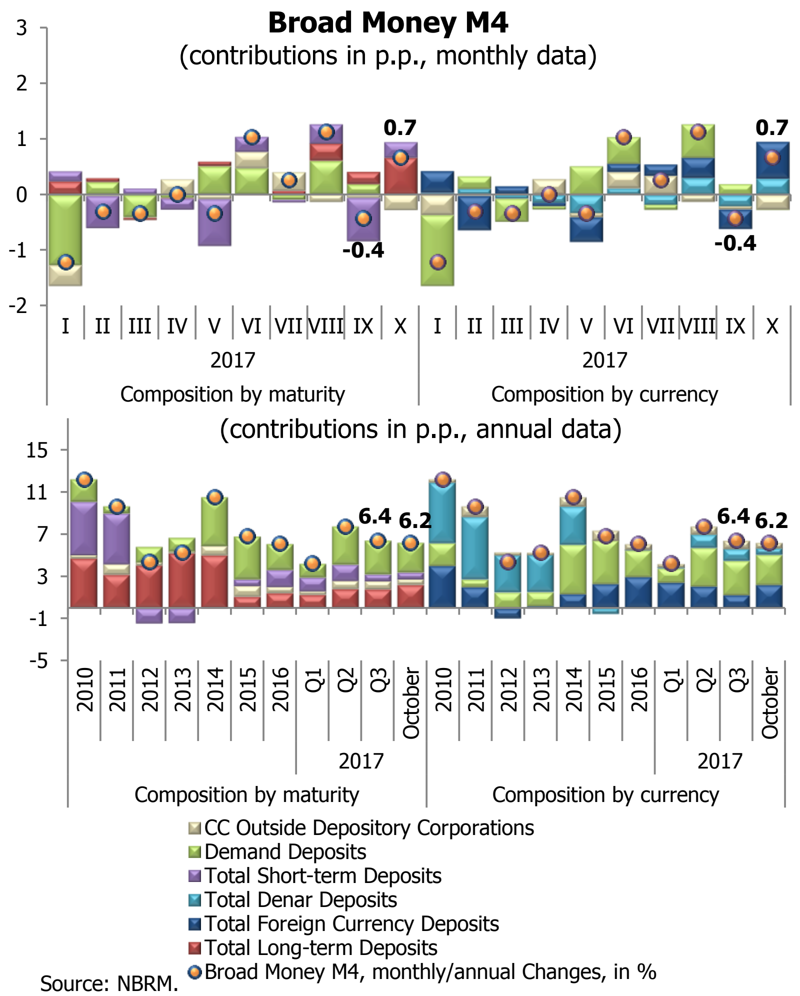
The growth of household deposits decelerated in October and was reduced to 0.4%. The decelerated growth pace of household deposits was dominantly influenced by demand deposits, which decreased in October compared to the growth in the previous month. Analyzing by currency, the monthly increase in household deposits is mostly due to the intensified growth of foreign currency deposits, but denar deposits also made a moderate positive contribution to the monthly growth. According to the maturity structure, the annual growth of household deposits is driven by the growth of long-term and short- term deposits, whereas demand deposit have a negative contribution. With the performances in October, the share of denar deposits (with demand deposits) in the total household deposits was 50.7% and registered a minor decline compared to the previous month (50.9%).



Source: NBRM.

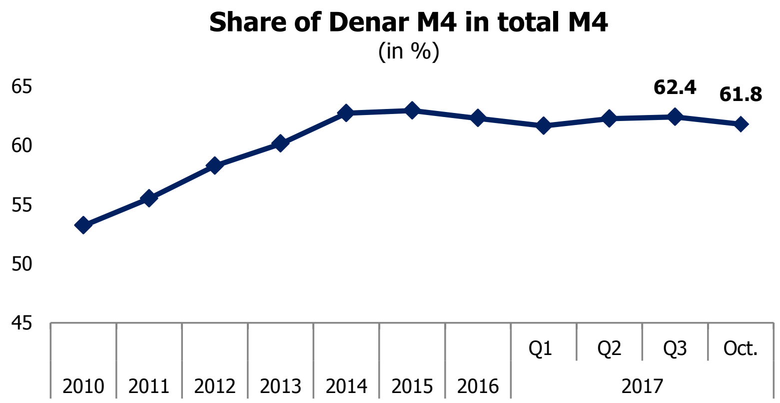


Source: NBRM.

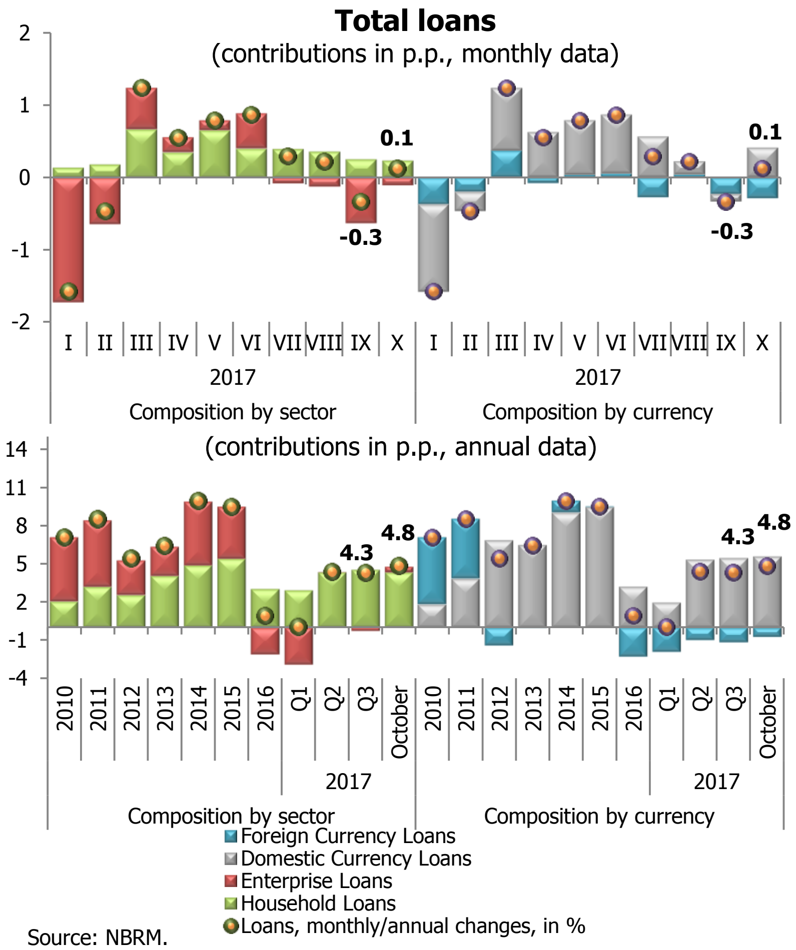


Source: NBRM.

In October, broad money M4 registered monthly increase, after the decline registered in the previous month. The monthly growth of the broadest money supply (of 0.7%) is mostly due to the increase in the total deposits, amid moderate decrease in the currency in circulation. **On annual basis, the broad money has increased by 6.2% (6.4% in September), which is above the forecasted growth of 4.1% for the fourth quarter of 2017.** Dynamically, the annual growth of broad money slightly decelerated in October, mostly influenced by the pace of domestic currency deposits, and demand deposits to a lesser extent. With the performances in October, the share of the denar part in the total money supply decreased compared to the previous month (from 62.4% to 61.8%).



Source: NBRM.

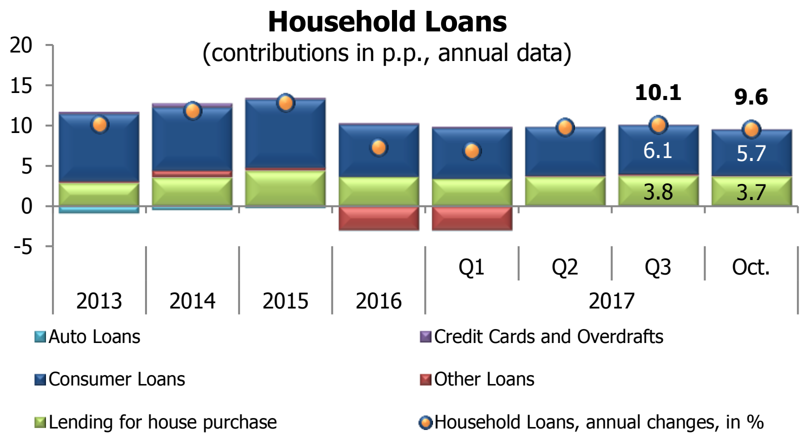


Source: NBRM.

In October, total loans to the private sector registered a minor growth, unlike the decline in the previous month. Analyzed by sector, the monthly increase in the total lending activity (of 0.1%) is entirely due to the performances in households, while corporate loans registered a minor decline which is relatively lower compared to the previous month.

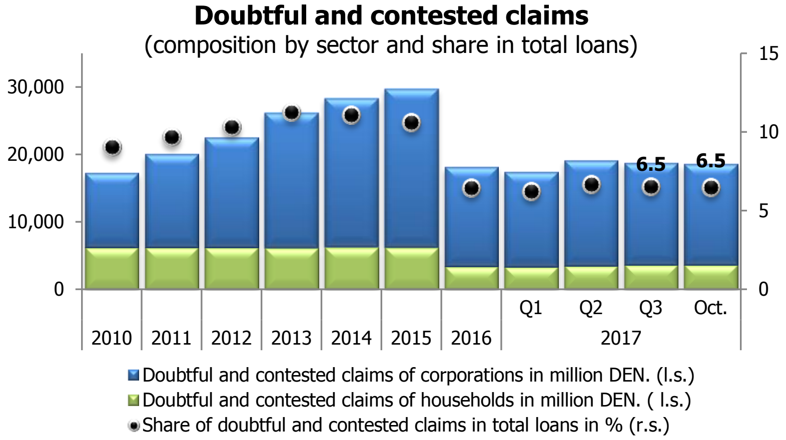
The growth pace of total loans is slower compared to the expectations with the October forecast.

On an annual basis, total loans in October grew by 4.8%, which is above the forecasted (growth of 4.6%) for the fourth quarter of 2017. Observing the currency, the annual growth of total loans also in October 2017 stems from the growth of denar loans, amid continued annual decline in foreign currency loans.



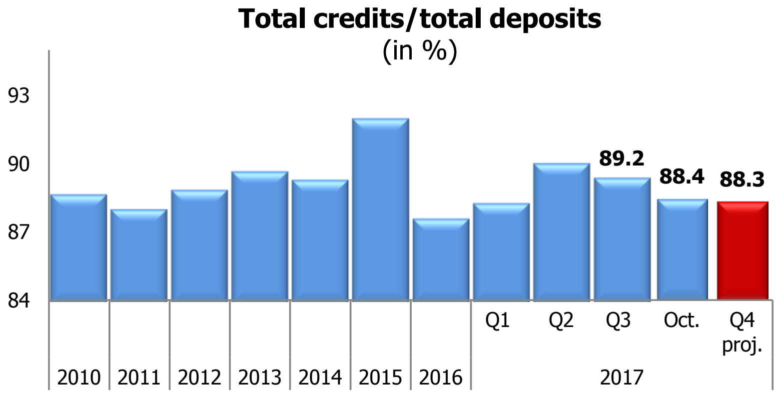
Source: NBRM.

The growth of household loans in October moderately decelerated on an annual basis, mainly due to the deceleration of the growth in consumer loans.



Source: NBRM.

In October, **the share of doubtful and contested claims in total loans** remained at 6.5%.

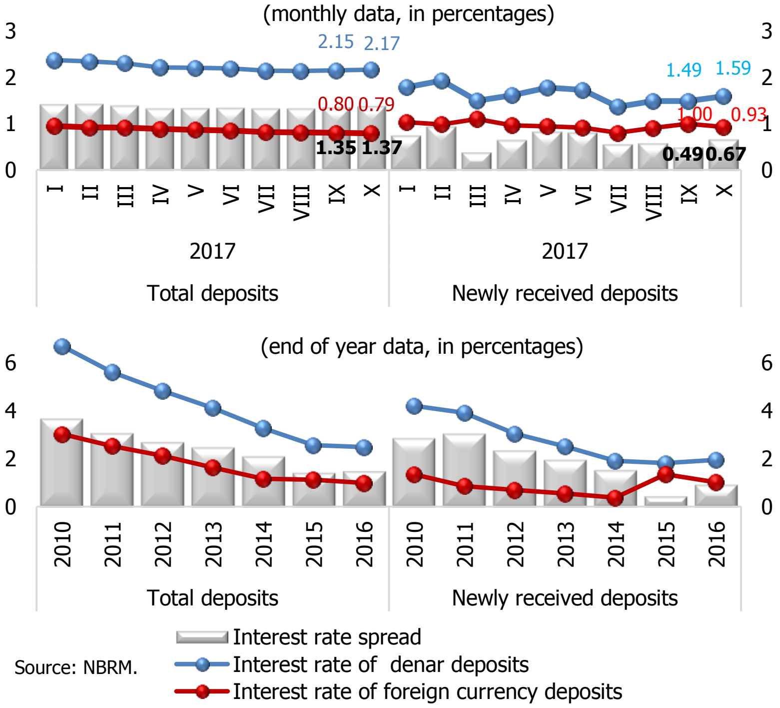


Source: NBRM.

Utilization of the deposit potential for lending to the private sector in October decreased on a monthly basis, from 89.2% to 88.4%. October performance is insignificantly higher compared to the expectations for the fourth quarter of 2017, according to the October forecast.

Total deposits interest rates

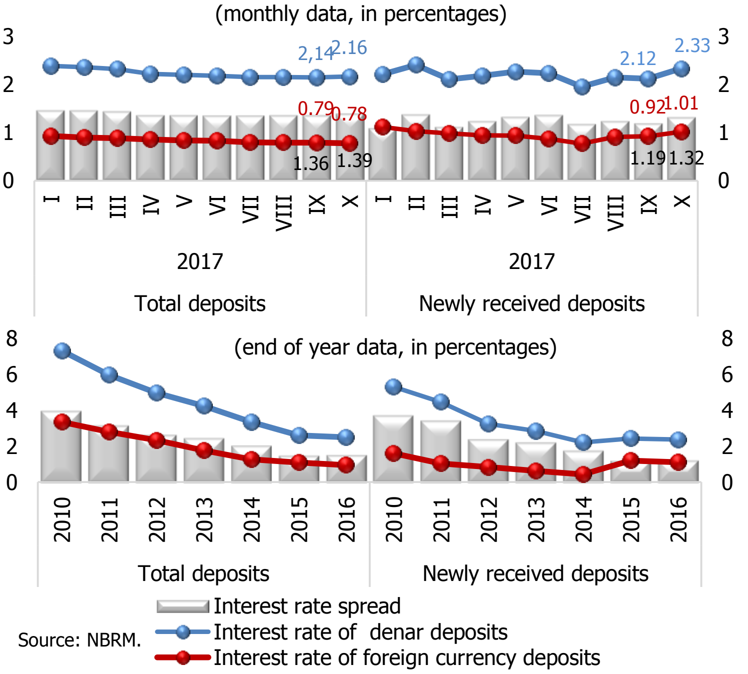
(monthly data, in percentages)



In October, the interest rates on total deposits registered no significant change compared to the previous month, whereby the interest rate spread between the interest rates on denar and foreign currency deposits remained relatively stable and amounted to 1.4 percentage points. In the newly accepted total deposits, the interest rate spread between denar and foreign currency deposits moderately increased from 0.49 percentage points to 0.67 percentage points, amid growth of interest rates on newly accepted denar deposits and decrease in the interest rates of foreign currency deposits. However, regarding the interest rates on the newly accepted deposits, it should have in mind that they characterize with variable movements[15].

Households` deposits interest rates

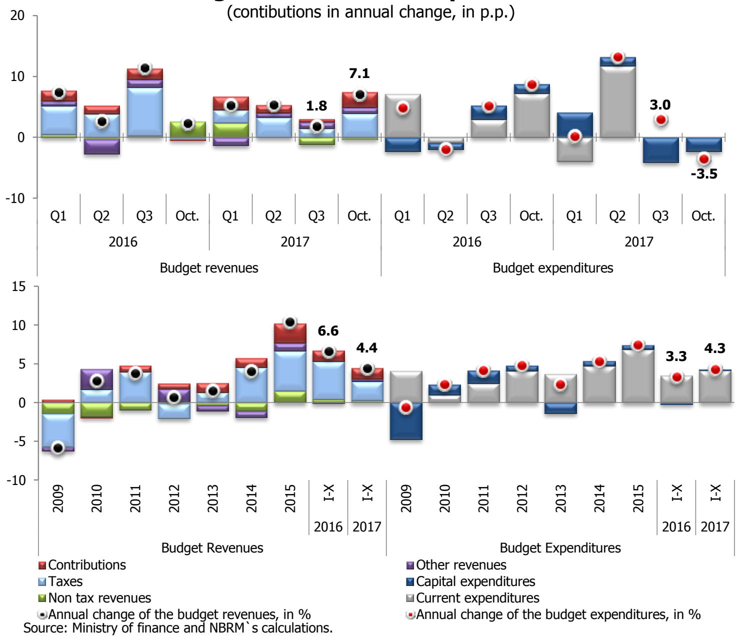
(monthly data, in percentages)



In October, the **interest rates on household deposits** registered minor changes compared to the previous month, whereby the interest rate spread between denar and foreign currency interest rates increased from 1.36 percentage points to 1.39 percentage points. Regarding newly accepted household deposits, interest rates on newly accepted denar and foreign currency deposits registered an increase which caused widening of the interest rate spread from 1.19 percentage points to 1.32 percentage points.

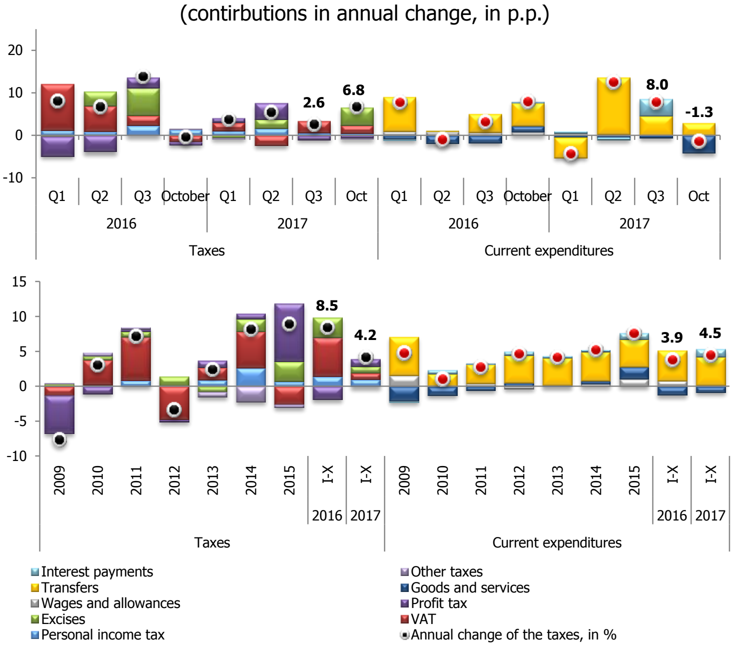
[15] Volatility of interest rate on newly accepted deposits results from the fact that they have been driven by the volume of newly accepted deposits (which can vary from month to month) and their interest rate.

Budget revenues and expenditures
(contibutions in annual change, in p.p.)



Source: Ministry of finance and NBRM`s calculations.

Taxes and current expenditures
(contirbutions in annual change, in p.p.)



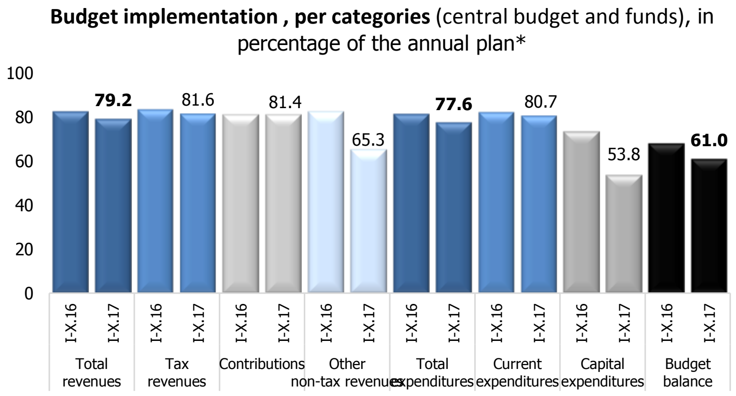
Source: Ministry of finance and NBRM`s calculations.

The total budget revenues realized in the Budget of the Republic of Macedonia (central budget and budget of funds) in October 2017, grew by 7.1% while performances in total revenues is lower by 3.5% on an annual basis. The higher budget revenues are mostly due to the improved performances in taxes and contributions, whereas the lower performance of budget revenue was a reflection of the lower performances in capital and current expenditures.

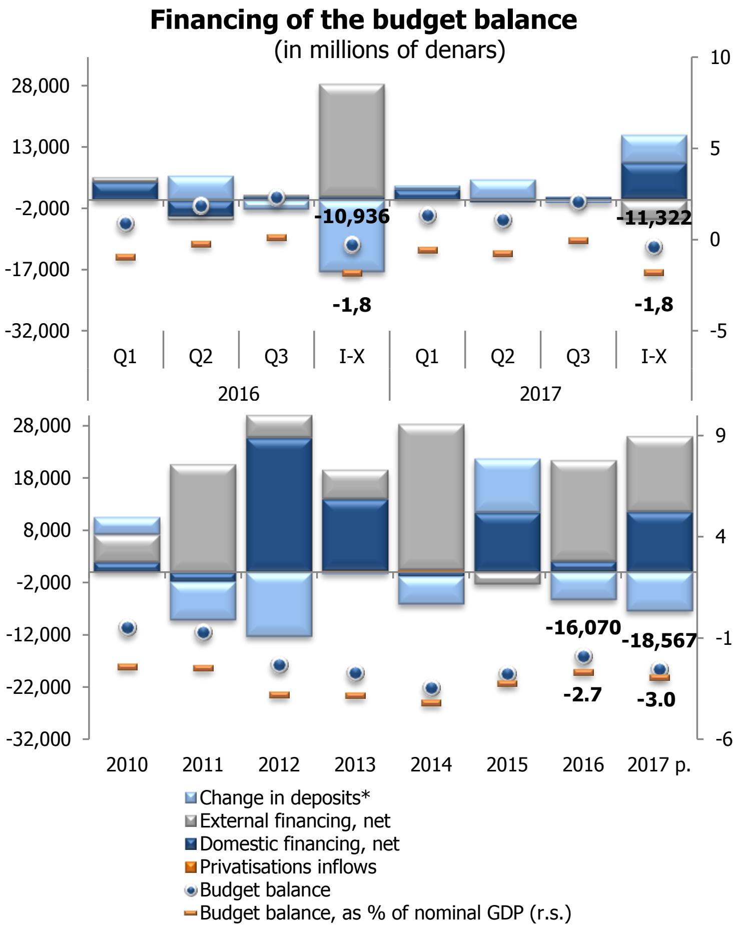
Cumulatively, in the period January October 2017, total budget revenues increased by 4.4% compared to the same period in the previous year, which is mostly due to the increased tax performances, while other budget revenue categories also had positive but minor contribution. In the period January-October 2017, the budget expenditures increased by 4.3% on an annual basis, which is mostly due to the higher current expenditures, and to a lesser extent, from capital expenditures.

In October, total inflows of taxes in the Budget of the RM were higher by 6.8% on an annual basis, where excise duties and inflows from VAT had the dominant contribution to the growth. On the other hand, current expenditures in October decreased by 1.3% on an annual basis, which is mostly due to the lower performances in “goods and services” category.

Cumulatively, in the period January-October, inflows from taxes increased by 4.2% on an annual basis which almost equally arises from performances in inflows from profit tax, personal income, inflows from VAT and excise duties. Regarding the current expenditures, the growth rate in the analyzed period was 4.5% on an annual basis with a dominant contribution of transfers.



*for 2016, figures are calculated compared to realized Budget for 2016.
Source: Ministry of Finance and NBRM's calculations.



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

In the period January-October 2017, the realized budget revenues constituted 79.2% of the forecasted for 2017 under the Budget Revision[16]. Analyzed by individual categories of budget revenues, performances in taxes and contributions was 81.6% and 81.4%, respectively, while the performance in the category other non-tax revenues[17] was 65.3%.

Analyzing budget expenditures, in the period January-October 2017, 77.6% of the planned expenditures for 2017 were realized, where performance in current expenditures was 80.7%, while the performances in capital expenditures was lower and amounted to 53.8%.

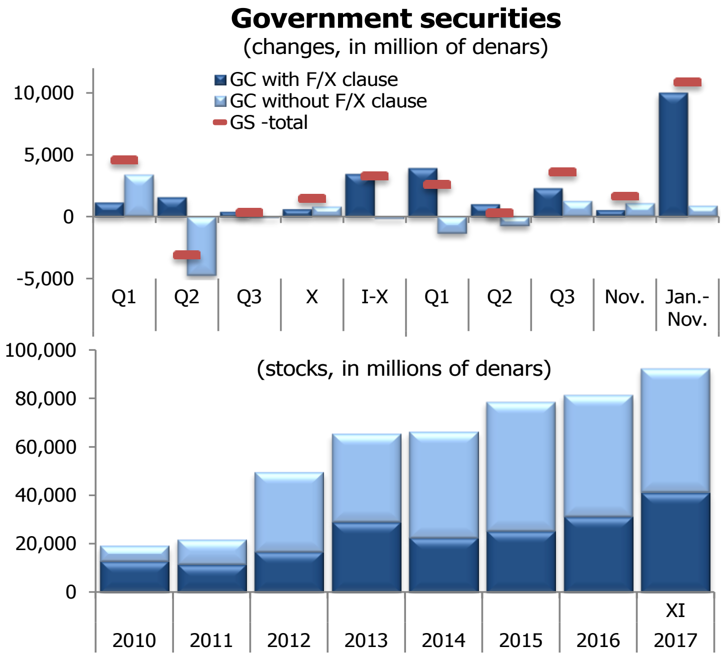
In the period January-October 2017, the Budget of the Republic of Macedonia registered a deficit of Denar 11,322 million, which is 1.8% of the nominal GDP[18]. In the period January-October 2017, the realized budget deficit constituted 61% of the deficit forecasted for 2017 under the Budget Revision.

The deficit in the period January-October 2017 was financed by domestic sources, through net issuance of new government securities and deposits withdrawal on the account of the government with the National Bank.

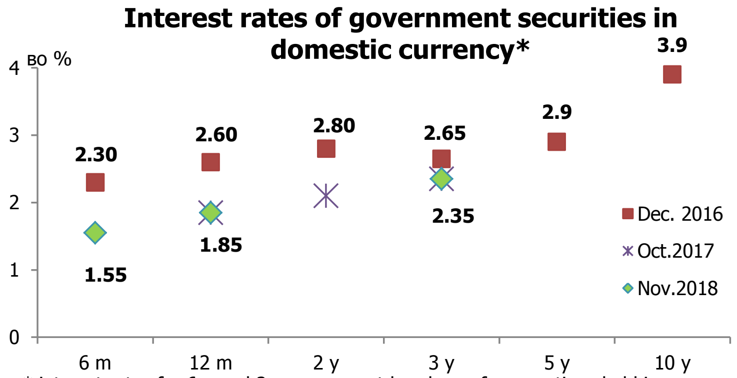
[16]The comparison is made with the Budget Revision for 2017 from August 2017 and the reallocation of the budget assets among budget users from November 2017.

[17]Other non-tax revenues include non-tax revenues, capital revenues, donations from abroad and revenues of recovered loans.

[18]The analysis of nominal GDP for 2017 uses the NBRM October forecasts.

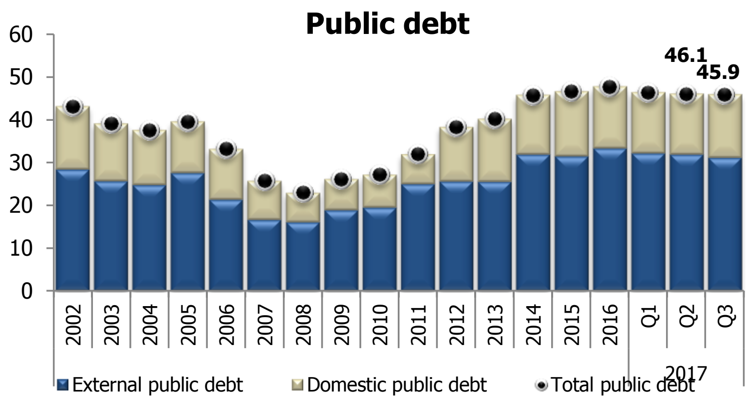


Source: MoF.



* interest rates for 6m and 2y government bonds are from auctions held in November 2016, while interest rates for 3y and 5y government bonds are from auctions held in September 2015 and November 2014, respectively.

Source: Ministry of Finance.



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

The stock of issued government securities in the domestic market amounted to Denar 92,262 million at the end of November 2017 and compared to the end of third quarter is higher by Denar 4,414 million. On a cumulative basis, for the period January-November 2017, government securities increased by Denar 10,891 million, constituting 94.7% of the amount forecasted for 2017[19].

In November 2017, the interest rates on government securities remained unchanged compared to the previous month[20]. Interest rates decreased compared to the end of the previous year. Namely, in November, the interest rates on treasury bills with maturity of 6 and 12 months are lower by 0.75 percentage points in May. Regarding government bonds, the decrease in interest rates of two-year government bonds amounts to 0.7 percentage points, whereas interest rates of three-year government bonds are lower by 0.3 percentage points compared to the last auction (September 2015).

At the end of the third quarter of 2017, total public debt[21] was 45.8% of GDP[22], which is a decrease of 0.3 percentage points compared to the previous quarter. The change is entirely due to the decrease in the external debt (from 31.9% to 31% of GDP), amid moderate increase of internal debt (from 14.3% to 14.8% of GDP). Total government debt decreased by 0.2 percentage points compared to the previous quarter, and a minor decline (0.1 percentage points of GDP) on a quarterly basis was registered in the debt of public enterprises.

[19] The comparison is made with the annual plan for domestic debt with the Budget Revision for 2017 from August 2017.
[20] At the auctions of government securities in November, there was an offer of 6-month treasury bills without FX clause, 12-month treasury bills without FX clause, 3-year government bonds without FX clause and 15-year government bonds with FX clause.
[21] The public debt is defined under the Law on Public Debt (Official Gazette of the Republic of Macedonia No. 165/14) according to which it is the sum of the government debt and the debt of public enterprises established by the state or municipalities, municipalities within the city of Skopje and the city of Skopje, and companies that are entirely or predominantly owned by the state or by the municipalities, the municipalities within the city of Skopje and the city of Skopje, for which the Government has issued a state guarantee.
[22] The analysis of nominal GDP for 2017 uses the NBRM October forecasts.

Annex 1

Timeline of the changes in the setup of the monetary instruments of the NBRM and selected supervisory decisions adopted in the period 2013 - 2017

January 2013

- A Decision amending the Decision on the reserve requirement (adopted in November 2012) came into force, allowing reduction of the reserve requirement base of banks for the amount of new loans to net exporters and domestic producers of electricity, as well as for the investments in debt securities in domestic currency without a currency clause, issued by the aforementioned companies. This decision fully exempts the banks from allocating reserve requirement for liabilities based on debt securities issued in local currency with an original maturity of at least two years. The Decision will apply throughout 2014, after which, depending on the results, the need for further application will be reconsidered.

- A Decision on reducing CB bill interest rate was adopted to cut the policy rate from 3.75% to 3.5%. At the same time, the interest rate on seven-day deposit facility and on overnight deposit facility was cut from 2% to 1.75% and from 1.0% to 0.75%, respectively.

March 2013

- A Decision on credit risk management was adopted, which applies from 1 December 2013.

July 2013

- A Decision reducing CB bill interest rate was adopted to cut the policy rate from 3.5% to 3.25%. At the same time, the interest rate on seven-day deposit facility was cut from 1.75% to 1.5%.

- A Decision amending the Decision on reserve requirement was adopted, which reduces the reserve requirement rate for banks' liabilities in domestic currency from 10% to 8% and increases the reserve requirement rate for liabilities in foreign currency from 13% of 15%. In addition, the amendments stipulate a reserve requirement rate of 0% for banks' liabilities to nonresident financial companies with contractual maturity of over one year, as well as for all liabilities to nonresidents with contractual maturity of over two years. A rate of 13% still applies to short-term liabilities to nonresident financial companies in foreign currency with contractual maturity of up to one year. To maintain the reserve requirement in denars and in euros relatively stable, the amendments increase the reserve requirement in euros that is fulfilled in denars from 23% to 30%.

October 2013

- A Decision amending the Decision on banks' liquidity risk was adopted. This decision reduces the proportion of time deposits assumed to outflow from banks, from 80% to 60%, and applies from 1 December 2013. This amendment makes more room for long-term bank lending to the real sector.

November 2013

- A Decision amending the Decision on reserve requirement was adopted, which exempts the NBRM from paying reserve requirement remuneration (previously, this remuneration equaled 1% for denar reserve requirement and 0.1% for euro reserve requirement). The Decision is being applied since 1 January 2014.

- A Decision on CB bills was adopted, which introduces a methodology for determining the potential demand for CB bills. In accordance with the established mechanism, if there is a higher demand than the potential across the overall banking system, banks that bid higher amounts of their own liquidity potential will be required to place this difference in seven-day deposits.

February 2014

- A Decision on reducing interest rate on seven-day deposit facility from 1.5% to 1.25% was adopted.

April 2014

- A Decision amending the Decision on the methodology for determining the capital adequacy was adopted, introducing two amendments in the current decision that are expected to contribute positively to the credit support of the commercial banks to the corporate sector. Namely, with this Decision (and in accordance with the amendments to the new EU Regulation no. 575/2013 on prudential requirements for credit institutions and investment companies), performance guarantees or warranties that guarantee completion of works, stand out as items with low-intermediate risk, and therefore take lower conversion factor (20%), instead of 50% as it has been so far. That would mean that in the calculation of capital adequacy, smaller part of these off-balance sheet items would be treated as balance sheet items, which could affect the improvement of capital adequacy and encourage lending to the corporate sector. There is another innovation motivated by the international practice of establishing funds by low-risk entities (central governments or multilateral development banks) whose main goal is funding development projects. These projects are mostly funded through one or more commercial banks, which also contribute funds by dividing the exposure into a defined ratio between the bank and the fund or by providing guarantees or other similar instruments used by the fund (warranty provider) to guarantee coverage of part of the credit risk in the event of default by the debtor. In order to cover these cases, this decision also introduces a more favorable regulatory treatment of the funds established by one or several central governments, multilateral development banks or public institutions. These funds will take 0% risk weight, and the requirement will be that the funding is executed by payment in stakes, i.e. on-balance sheet and off-balance sheet activities to be covered by the fund's equity.

September 2014

- In order to further channel banks' excess liquidity to the non-financial sector, in September the NBRM revised the mechanism for transfer of the demand for CB bills, which is above the banks' potential into another instrument, i.e. seven-day standing deposit facility. According to these changes, for the seven-day standing deposit facility that banks are obliged to allocate if on the CB bills auctions they demand an amount higher than the potential[23], an interest rate of 0% is determined. For the other assets that banks will voluntarily place into a seven-day standing deposit facility the regular interest rate will apply.

September 2014

- The National Bank of the Republic of Macedonia Council adopted the Decision amending the Decision on the reserve requirement, which extends the application of the non-standard measure for reduction of the base for the reserve requirement of commercial banks for the amount of new loans extended to net exporters and domestic producers of electricity. The main objective of the Decision is to provide further support to the two systemically important sectors of the economy. The current implementation of this measure has generated positive effects on the dynamics of lending and thus the overall economic growth, contributing to a reduction of the cost of funding of companies from both sectors, although with lower intensity than the potential. In such circumstances, and given the data that indicate some uncertainty about the pace of lending to the corporate sector in the next period, this Decision envisages continued application of this non-standard measure until 31 December 2015.

October 2014

- A Decision on reducing the interest rate on overnight deposit facility from 0.5% to 0.5% and on seven-day deposit facility from 1.25% to 0.5% was adopted.

March 2015

- A Decision on reducing the interest rate on overnight deposit facility from 0.5% to 0.25% and on seven-day deposit facility from 1% to 0.5% was adopted.

- The National Bank Council adopted the Decision amending the Decision on CB bills, which introduces a new manner of establishing the bids of banks at the auctions of CB bills. According to the Decision, the amount of supply of individual bank is calculated by applying its appropriate percentage share in the total supply of treasury bills, reduced by the amount of past due CB bills of the Macedonian Bank for Development Promotion AD Skopje. In order to ensure operational efficiency in conducting auctions of this type and greater transparency toward banks, before the auction the NBRM shall inform the banks on the maximum offer that can be submitted by each bank. This opportunity for setting the supply of banks is expected to stabilize the demand at the level of the amount offered, which eliminates the need for calculation of potential demand and subsequently it repeals the obligation for mandatory seven-day deposits for banks when demand at the auction exceeds the potential demand.

April 2015

- A new Decision on the credit of last resort which, besides the current possibility of approving credit of last resort to banks against a collateral of debt securities, foreign currencies and banks' claims on the National Bank, introduces the possibility of extending this credit also against pledging banks' claims on customers. This modality of the credit of last resort is planned to be activated if the bank does not have debt securities and foreign currencies. The Decision specifies the types of claims that are acceptable for the National Bank as collateral for the credit of last resort.

[23] For the method of determining the potential demand for CB bills see the Decision on CB bills, Official Gazette of the Republic of Macedonia No. 166/13).

June 2015

- The National Bank Council adopted preventive measures for managing capital flows of the Republic of Macedonia to the Republic of Greece. Preventive measures pertain to restriction of capital outflows from residents of the Republic of Macedonia (natural persons and legal entities) to Greek entities based on newly concluded capital transactions, but not to a restriction of the outflows based on incoming payments for capital transactions already concluded. These measures limit capital outflows only to the Republic of Greece and to entities from the Republic of Greece (such as outflows for founding of a company, investing in securities, investing in documents for units in investment funds, investing in investment gold, financial credits, long-term loans, etc.) but not to block or in any way to impede current and future commercial operations with entities from the Republic of Greece. Current transactions remain free. Also, in order to maintain the security of foreign investors regarding the exercising of their rights to their property in the Republic of Macedonia, outflows based on realized dividends have not been restricted either. Furthermore, in order to secure the funds that domestic banks have in the banks in the Republic of Greece, Macedonian banks are required to withdraw all loans and deposits from banks based in the Republic of Greece and their branches and subsidiaries in the Republic of Greece or abroad, regardless of the agreed maturity. However, in order to allow smooth functioning of payment operations for the transactions that are not prohibited, an exception to this requirement has been made for the funds on the current (correspondent) accounts with those banks. Existing prudential and supervisory measures and limits for banks to investments in securities including Greek securities are supplemented by explicit ban on all residents to invest in Greek securities. Those are temporary protective measures, introduced to prevent the threat of any significant outflows of capital from the Republic of Macedonia to the Republic of Greece to cause significant disturbance to the equilibrium in the balance of payments and undermine the stability of the financial system.

August 2015

- The National Bank Council adopted the Decision on amending the Decision on reserve requirements that reduces the reserve requirement rate for the bank liabilities to natural persons in domestic currency with contractual maturity of over one year from 8% to 0%, with these liabilities obtaining the same treatment as the liabilities with maturity over two years, for which rate of 0% since 2012 has been applied. Having in mind that the amendment releases the banks from the reserve requirement for the natural persons' denar deposits with maturity exceeding one year, this measure is expected to have adequate influence toward larger supply of denar savings products with stimulative interest rates.

- The National Bank Council adopted the Decision on amending the Decision on CB bills that envisages adjustment of the mechanism of participation at the CB bills auction of the National Bank, where the main criterion will be the individual share of the banks in the total liabilities in domestic currency without currency clause of the banking system. With these amendments, the National Bank continues to support the natural persons' savings in domestic currency and on a longer run, which creates room for the banks for active credit support to the private sector.

December 2015

- The Council adopted the Decision amending the Decision on the methodology for determining the capital adequacy, introducing measures to slow the growth of long-term consumer loans. The measure increases capital requirements for banks on long-term consumer loans with maturity equal to or longer than eight years. Thus, the risk weight for claims on consumer loans with a contractual maturity equal to or longer than eight years, increases from 75% i.e.

100% to 150%. To avoid major shocks in the market of consumer lending, yet the growth rates to be reduced to a moderate level, this measure is aimed only at newly approved long-term consumer loans, i.e. loans with maturity equal or longer than 8 years approved after 1 January 2016. At the same time, this decision introduces higher capital requirement (risk weight of 75%) for the increase of overdrafts and credit cards in relation to 31 December 2015. The aim of this decision is to prevent the possibility of changeover to this type of borrowing as a result of the measure to decelerate consumer loans. Also, this Decision facilitates the access of legal entities. Namely, the capital requirement for guarantees issued by banks is reduced, which guarantees payment based on a certain business relationship of the client and banks' claims backed by commercial property that meets certain conditions. This way allows banks to allocate lower amount of capital for credit and guarantee operations with legal entities, including small and medium enterprises, which can cause reduction in the cost of banks and therewith, of clients for this type of operation.

- The National Bank Council adopted the Decision on amending the Decision on credit risk management, which requires starting from 1 January 2016, and by June 30 2016 to write-off all claims that have been fully booked for more than two years, and where the bank has identified and fully covered the credit risk of default at least two years before. According to the existing regulations, banks are required to fully reserve claims where the client defaulted at least 1 up to 5 years if there is a specific collateral, and the new measure requires from banks to write them off two years after their full provisioning. In addition, banks will still be allowed and required to take actions to collect these claims, although they are written off. The measure does not incur additional costs for banks since claims which are fully provisioned are written off, at least two years before.

- The National Bank Council decided to extend the application of the non-standard measure to reduce reserve requirement base in denars of commercial banks for the amount of newly approved loans to net exporters and domestic producers of electricity for two more years, until the end of 2017.

- On 29 December 2015, the Decision on introducing special protective measures adopted by the National Bank Council on 28 June 2015 due to the debt crisis in Greece at that time, ceased being valid. The measures were adopted to protect against any disruptions in the balance of payments or the stability of the financial system of the Republic of Macedonia due to any significant capital outflows from Macedonia to Greece. They were temporary for a period of up to six months, with a possible extension of their application. The protective measures served their purpose and prevented major capital outflows from the Republic of Macedonia, yet not disturbing the business of domestic companies with Greek companies. They delivered equilibrium in the balance of payments and stability of the domestic banking system. The situation in Greece has been stabilizing for quite some time. The lenders continued to financially support Greece, which, in turn, pledged to apply economic and social reforms, and austerity measures. Therefore, after the expiry of six-month validity period of the protective measures on 28 December 2015, since 29 December 2015, this decision is no longer in use.

May 2016

- At the regular meeting of the NBRM's Operational Monetary Policy Committee held on 3 May 2016, it was decided the interest rate on CB bills to be increased by 0.75 percentage points, from 3.25% to 4%. The decision to tighten the monetary policy is a reaction to the increased demand for foreign currency and pressures on banks' deposit base, which were entirely due to the deteriorating expectations of economic agents, caused by the unstable political situation in the country. Thus, the change in the interest rate is a response to the action of factors of non-economic nature.

- The National Bank Council adopted the Decision on reserve requirement, which increased the reserve requirement rate for banks' liabilities in domestic currency with FX clause. The measure has been aimed at further encouraging the process of denarization of deposits in the domestic banking system. Given the negligible market share of these liabilities in the banks' balance sheets, the changes are exclusively for further maintenance of low propensity of the economic agents for placing this type of deposits in domestic commercial banks.

- In order to maintain and increase deposits in the domestic banking system, the National Bank Council reviewed and improved the terms for placing foreign currency deposits of domestic banks at the National Bank and adopted the Decision on foreign currency deposit with the National Bank of the Republic of Macedonia. Accordingly, starting from 13 May 2016, the banks can place foreign currency deposits at the central bank at higher interest rates compared to the current negative interest rates that prevail in the international financial markets. It is expected that this measure will contribute to reduce the cost of domestic banks, which would accordingly contribute to higher interest rates on the deposits of their clients, domestic legal and natural persons.

October 2016

- In the regular meeting held on 25 October 2016, the NBRM's Operational Monetary Policy Committee decided not to offer additional foreign currency deposits that banks would place in the NBRM.

December 2016

- At the regular meeting of the NBRM's Operational Monetary Policy Committee, held on 13 December 2016, the Committee decided to cut CB bill interest rate by 0.25 percentage points, to 3.75%, and to increase the supply of CB bills at the 14 December auction from Denar 22,000 million to Denar 23,000 million.

- The National Bank Council adopted the Decision on amending the Decision on the methodology for determining the capital adequacy. This Decision is part of the compliance process of the domestic regulations with the reforms of the international capital standard Basel 3, as well as with the provisions of the European Regulation 575/2013 on prudential requirements for credit institutions and investment firms, in the part of the structure of the banks' own funds. The most significant amendments relate to the strengthening of the quality of own funds, both in terms of their structure and in terms of the criteria that should be met by certain positions in order to be a part of the banks' own funds. In this context, the own funds continue to be divided into Tier 1 and Tier 2 capital, **but the new Decision changes the structure of the Tier 1 capital, which is divided into Common Equity Tier 1 capital and Additional Tier 1 capital.** The Common Equity Tier 1 capital includes capital positions with the highest quality (equity capital and reserves) which are fully and readily available to cover risks and losses during the bank's operation. The new own funds component, the Additional Tier 1 capital, includes instruments which, among other things, contain a clause for their transformation into instruments of the Common Equity Tier 1 capital or for their write-off on temporary or permanent basis (reduction in the value of their principal), if the so-called critical event occurs. **The amendments to the Decision on the capital adequacy replace current restrictions in terms of size and ratio of individual elements of the own funds with the statutory prescribed minimal rates for the Common Equity Tier 1 capital, Tier 1 capital and own funds,** i.e. 4.5% for the Common Equity Tier 1 capital, 6% for the Tier 1 capital and 8% for the own funds of the risk-weighted assets. Thus, the greatest importance is given to the Common Equity Tier 1 capital positions (shares, reserves, retained undistributed profit), as capital positions with the highest quality.

January 2017

- At its regular meeting held on 10 January 2017, the NBRM's Operational Monetary Policy Committee decided to cut CB bill interest rate by 0.25 percentage points, to 3.5%, and to increase the supply of CB bills from Denar 23,000 million to Denar 25,000 million.

February 2017

- At its regular meeting held on 14 February 2017, the NBRM's Operational Monetary Policy Committee decided to cut CB bill interest rate by 0.25 percentage points, to 3.25%, and the supply of CB bills to be unchanged, at the level of Denar 25,000 million.

- At the regular meeting of the NBRM Council held on 27 February 2017, several decisions arising from the amendments to the Banking Law from October 2016 were adopted, for compliance with the Basel Capital Accord, the so-called Basel 3, as well as with the relevant European regulations. Pursuant to the amendments to the Banking Law made in October 2016, the banks are required to maintain adequate amount of capital to cover the so-called capital conservation buffers. The Law prescribes four capital buffers: (1) capital conservation buffer maintained at 2.5% of the risk weighted assets; (2) countercyclical capital buffer which can be up to 2.5% of the risk weighted assets, and more depending on other systemic factors/indicators, (3) capital buffer for systemically important banks which ranges from 1% to 3.5% of the risk weighted assets, and (4) systemic risk buffer which can range from 1% to 3% of the risk weighted assets. Pursuant to the provisions of the Banking Law on this basis, the Council adopted the following decisions:
- <u>The Decision on the Methodology for Identifying Systemically Important Banks</u>, which prescribes the manner of identifying the systemically important banks, i.e. the banks the operations of which are important for the stability of the entire banking system. In addition, the amount of the capital conservation buffer that the systemically important banks should meet depending on the level of system importance, has been set. Also, the Decision on the Methodology for Developing Recovery Plan for Systemically Important Banks, that requires systemically important banks to submit a Recovery Plan to the National Bank, was adopted at today's session.
- <u>The Decision on the Methodology for Determining the Rate of Countercyclical Capital Buffer for Exposure</u> in the Republic of Macedonia. This capital buffer aims to limit the risks arising from high credit growth, so it is introduced in case of high credit growth, on the basis of prescribed criteria.
- <u>The Decision on the Methodology for Determining the Maximum Distributable Amount,</u> envisaging restriction of the bank's earnings distribution, if it fails to maintain adequate amount of capital buffers. The capital buffers can be covered only by the highest quality capital positions, i.e. Common Equity Tier 1 capital.
- <u>The Decision on the Methodology for Managing Leverage Risk</u>, which is a standard of the Basel Capital Accord, Basel 3, and the European banking regulations, which introduces the leverage ratio, as a correlation between the capital and activities of the bank. Banks in RM register extremely low indebtedness, and the purpose of introduction of this standard at the international level was protection against possible excessive borrowing by banks, in terms of satisfactory level of capital adequacy.

March 2017

- At its regular meeting held on 14 March 2017, the NBRM's Operational Monetary Policy Committee decided to increase the supply of CB bills from Denar 25,000 million to Denar 30,000 million.

July 2017

- At its regular meeting held on 11 July 2017, the NBRM's Operational Monetary Policy Committee decided to reduce the supply of CB bills from Denar 30,000 million to Denar 27,500 million.

August 2017

- At its regular meeting held on 8 August 2017, the NBRM's Operational Monetary Policy Committee decided to reduce the supply of CB bills from Denar 27,500 million to Denar 25,000 million.