# National Bank of the Republic of Macedonia

MONETARY POLICY AND RESEARCH DEPARTMENT

## Recent Macroeconomic Indicators
## Review of the Current Situation

August 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 (January – July 2017) and to make a comparison with the latest macroeconomic projections (April 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.***

**The latest estimates for the global economic growth are unchanged relative to the April forecasts, whereby further gradual acceleration in the global economic activity is further expected.** Regarding the risks surrounding these estimates, they are assessed as balanced in the short run, while in the long run they remain downward and mainly related to the possible financial market instability (due to the political situation in the US and the negotiations about the Brexit), the possible slowdown in the economic growth in China, the faster normalization of the monetary policy in the US which would lead to tighter global financial conditions, the increased protectionism, as well as the geopolitical risks. In terms of economic growth in the euro area, as our most significant partner, the initial preliminary announcements show an acceleration in the economic activity in the second quarter of 2017, so that the GDP growth equals 2.1% on an annual basis, i.e. 0.6% on a quarterly basis (1.9%, i.e. 0.5%, respectively in the previous quarter). Such performances are higher than the April expectations for annual growth of 1.7% in the second quarter. The available data and the surveys on the economic sentiment of both economies and households in the second quarter indicate growth supported by all demand components. At the same time, on the labor market, positive developments continued, so that unemployment rate decreased to 9.1% in June 2017 (9.2% in the previous month). The inflation rate in July 2017 in the euro area, according to preliminary estimates, was stable and amounted to 1.3% on an annual basis, while core inflation continued to grow at slightly accelerated pace and in July it amounted to 1.2% (1.1% in June). Taking into account the more favorable indicators of the economic activity, on the one hand, but still the insufficiently strong core inflation, on the other, at the meeting held on 20 July 2017, the ECB left the current accomodative monetary policy unchanged, retaining the possibility of reaction through the non-standard measures (increase in the volume and / or in the duration) in case of less favorable inflation prospects. Hence, the expectations for the future trend of **Euribor** in 2017 and 2018 are kept in the negative zone throughout the entire forecast horizon and are lower than those in the April forecast.

**Observed from a viewpoint of the quantitative external environment indicators of the Macedonian economy, the forecasts regarding the foreign effective demand** indicate more favorable expectations, i.e. faster growth in this and in the next year relative to the April forecasts. Having in mind the **foreign effective inflation,** the latest estimates for 2017 indicate a minimal downward correction compared to the April forecasts, while for 2018 the estimates are unchanged. Regarding the euro / US dollar exchange rate, current expectations compared to April are in the direction of lower value of the US dollar against the euro. Regarding the **prices of primary commodities on the world markets,** the estimates for 2017 are mainly revised downward, while for 2018 prices register an upward correction relative to the April forecasts. Thus, regarding the **world oil prices,** in 2017 a somewhat lower growth compared to the April forecast is expected, while for 2018 prices are expected to stabilize, instead of the previously forecasted decline. **Metal prices** have downward revision for 2017, and for 2018 more favorable developments than those with the April forecast are expected. Thus, regarding the nickel price, the growth was considerably corrected downward in 2017, while for 2018 the growth is faster compared to the April forecasts. In 2017, the copper price is expected to register a slightly lower growth than previously envisaged, and for 2018 growth is expected contrary to expectations for price stabilization. The **world prices of the**

**primary food products** are still expected to grow and as a result of this, to create pressures also on the domestic inflation. In comparison with the April forecasts, the latest estimates indicate higher growth of the wheat price in both years, while the corn price is now expected to register lower growth for 2017, and higher in 2018 compared to April. However, one should bear in mind the exceptional variability of estimations for these primary commodities prices 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 with their projected dynamics within the April forecasting round indicates certain deviations in individual segments of the economy.** The estimated GDP data for the first quarter are below the expectations for economic growth, despite the downward revision in the last April forecast, indicating lower starting point and downward risks to the GDP forecast of 2.5% for the entire 2017. The available high-frequency data indicate favorable developments, thereby seen as a whole the situation in the economy in the second quarter of the year would be better compared to the previous quarter. **In terms of inflation, in July, a positive inflation rate was measured, which is within the forecast.** In conditions of performances within the forecast and amid downward revision of part of the external input assumptions for 2017, currently, balance of the risks surrounding the inflation forecast of 1.3% for the entire 2017 is estimated. The uncertainty around the forecasted movement of world prices of primary commodities remains the main risk surrounding the inflation forecast.

**Recent available foreign reserves data (adjusted for the effects of price and exchange rate differentials and price changes of securities), as of July 2017, indicate decline.** According to the analysis of change factors, the fall in reserves is mostly due to the transactions for the account of the Government, due to the servicing of the regular liabilities to abroad[1]. Available data from the external sector for the third quarter of the year are quite limited, only data on the currency exchange market in July indicate performances close to the expected. Regarding the balance of payments, April and May data give indications of improved performances in the current and the financial transactions compared to the April forecast. Foreign trade statistics confirm this conclusion, and show somewhat lower trade deficit in the second quarter, amid simultaneously higher export and import component. 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 June** show moderate monthly growth of total deposits (of 0.8%), unlike the moderate decline in the previous months. Analyzed by sector, the monthly growth of total deposits in June is almost entirely the result of the growth of household deposits, which corresponds to the budget payments based on denationalization bonds and liabilities based on subsidies, but corporate deposits also register moderate monthly growth. In terms of currency structure, monthly increase was registered in both components, amid more significant growth in Denar deposits. On an annual basis, total deposits in June grew by 7.6%, which is below the forecasted growth of 8.4% for the second quarter of 2017. Analyzing the credit market, in June, total loans registered monthly growth of 0.9%, at a similar pace as in the previous month (0.8%). The increase in total loans in June stems from the higher performances in both sectors (enterprises and households). On an annual basis, total loans grew by 4.4%, which is above the expected growth (of 3.2%) for the second quarter of the year, according to the April forecast. If we exclude the regulatory effect, the annual growth rate of total loans is 5.8% and is above the forecasted annual growth of 4.5% for the second quarter of 2017.

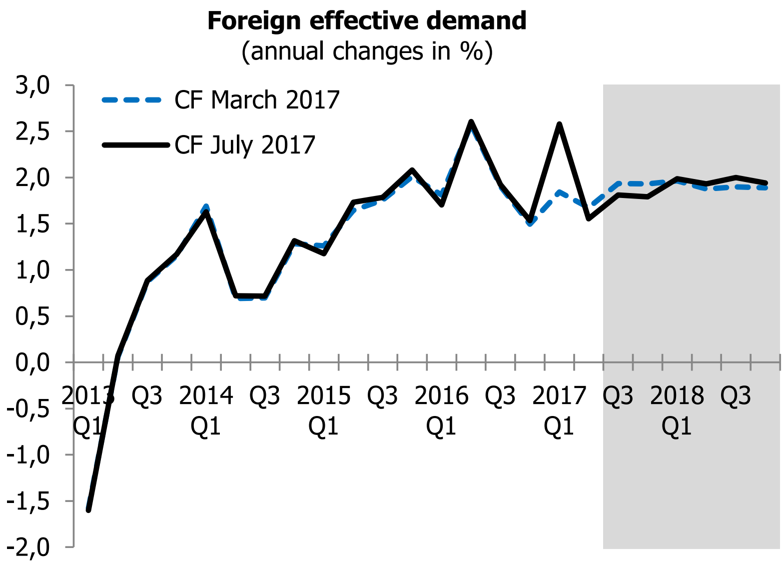
In the first six months of the year, the Budget of the Republic of Macedonia registered a deficit of Denar 8,306 million, financed from domestic sources through withdrawal of deposits from the government account with the National Bank and net issue of new government securities. The budget deficit constitutes 44.6% of the envisaged deficit in the Budget for 2017.

[1] In July, the regular repayment of part of the loan to Deutsche Bank was realized, as well as the annual interest on two Eurobonds.

**The latest macroeconomic indicators and assessments indicate certain deviations relative to the forecasted dynamics in individual segments in the economy, but the perceptions about the environment for conducting monetary policy and about the risks highlighted within the April forecasts are mainly unchanged.** Foreign reserves (adjusted for price and exchange rate differentials and price changes of securities) registered a decline in July 2017, sharper than expected with the April forecast, but the foreign reserves adequacy indicators continue to move in the safe zone. However, the downward deviation in the foreign reserves imposes a need for greater vigilance. In terms of economic activity, the currently available indicators indicate an improvement of the performances with the GDP in the second quarter. However, the lower starting point, as a result of the downward deviation in the first quarter of the year, indicates a potentially lower rate of economic growth for the entire 2017 compared to the April forecast. Regarding inflation, performances in the first seven months are in line with the forecast, while the expected movement of the external assumptions mainly underwent downward correction, however given their volatility, the risks surrounding the inflation projection for 2017 are assessed as balanced. Within the monetary sector, data on total deposits in June indicate positive developments, but they are still below the expected with the April forecasts. On the other hand, the growth pace of credit activity exceeded the expectations for the second quarter of the year, according to the April forecasts, whereby in June, the growth of total loans is almost equally driven by both sectors (enterprises and households).

| Selected economic indicators/1 | | 2015 | 2016 | | | | | | | | 2017 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2014 | 2015 | Jan. | Feb. | Mar. | Q1 | Q2 | Q3 | Q4 | 2016 | Jan. | Feb. | Mar | Q1 | Apr. | May | Jun. | Q2 | Jul. |
| **I. Real sector indicators** | | | | | | | | | | | | | | | | | | | |
| **Gross domestic product (real growth rate, y-o-y) /2** | 3,6 | | | | | 2,4 | 2,9 | 2,0 | 2,4 | 2,4 | | | | 0,0 | | | | | |
| **Industrial production /3** | | | | | | | | | | | | | | | | | | | |
| y-o-y | 4,8 | 4,9 | 8,0 | 15,2 | 8,9 | 10,7 | 1,3 | 5,0 | -1,8 | 3,4 | -2,6 | -1,3 | -0,9 | -1,5 | -1,9 | 9,2 | 4,0 | 3,7 | |
| cumulative average | 4,8 | 4,9 | 8,0 | 11,7 | 10,7 | 10,7 | 5,6 | 5,4 | 3,4 | 3,4 | -2,6 | -1,9 | -1,5 | -1,5 | -1,6 | 0,6 | 1,2 | 1,2 | |
| **Inflation /4** | | | | | | | | | | | | | | | | | | | |
| CPI Inflation (y-o-y) /5 | -0,5 | -0,4 | 0,1 | 0,0 | -0,3 | -0,1 | -0,7 | -0,2 | -0,1 | -0,2 | 0,6 | 0,2 | 0,6 | 0,5 | 1,0 | 1,2 | 1,5 | 1,2 | 1,2 |
| CPI Inflation (cumulative average) | -0,3 | -0,3 | 0,1 | 0,1 | -0,1 | -0,1 | -0,4 | -0,3 | -0,2 | -0,2 | 0,6 | 0,4 | 0,5 | 0,5 | 0,6 | 0,7 | 0,9 | 0,9 | 0,9 |
| Core inflation (cumulative average) | 0,5 | 0,5 | 1,5 | 1,5 | 1,6 | 1,6 | 1,4 | 1,3 | 1,3 | 1,3 | 1,4 | 1,4 | 1,6 | 1,6 | 1,7 | 1,8 | 1,9 | 1,9 | 1,9 |
| Core inflation (y-o-y) | 0,5 | 0,5 | 1,5 | 1,5 | 1,8 | 1,6 | 1,3 | 1,1 | 1,1 | 1,3 | 1,4 | 1,4 | 2,0 | 1,6 | 2,0 | 2,1 | 2,4 | 2,2 | 2,3 |
| **Labor force** | | | | | | | | | | | | | | | | | | | |
| Unemployment rate | 28,0 | 26,1 | | | | 24,5 | 24,0 | 23,4 | 23,1 | 23,7 | | | | 22,9 | | | | | |
| **II. Fiscal Indicators** | | | | | | | | | | | | | | | | | | | |
| (Central Budget and Budgets of Funds) | | | | | | | | | | | | | | | | | | | |
| Total budget revenues | 145.929 | 161.207 | 12.918 | 12.926 | 14.739 | 40.583 | 41.422 | 43.807 | 43.524 | 169.336 | 12.584 | 13.310 | 16.840 | 42.734 | 15.053 | 15.356 | 13.225 | 43.634 | |
| Total budget expenditures | 168.063 | 180.632 | 14.606 | 15.695 | 15.917 | 46.218 | 42.729 | 45.953 | 50.506 | 185.406 | 14.723 | 14.845 | 16.733 | 46.301 | 15.082 | 17.089 | 16.202 | 48.373 | |
| Overall balance (cash) | -22.134 | -19.425 | -1.688 | -2.769 | -1.178 | -5.635 | -1.307 | -2.146 | -6.982 | -16.070 | -2.139 | -1.535 | 107 | -3.567 | -29 | -1.733 | -2.977 | -4.739 | |
| Overall balance (in % of GDP)/1 | -4,2 | -3,5 | -0,3 | -0,5 | -0,2 | -0,9 | -0,2 | -0,4 | -1,1 | -2,6 | -0,3 | -0,2 | 0,0 | -0,6 | 0,0 | -0,3 | -0,5 | -0,7 | |
| **III. Financial indicators /6** | | | | | | | | | | | | | | | | | | | |
| **Broad money (M4), y-o-y growth rate** | 10,5 | 6,8 | 4,5 | 5,4 | 6,2 | 6,2 | 2,5 | 4,0 | 6,1 | 6,1 | 6,7 | 5,1 | 4,2 | 4,2 | 5,9 | 6,4 | 7,8 | 7,8 | |
| **Total credits, y-o-y growth rate** | 10,0 | 9,5 | 8,6 | 8,7 | 8,4 | 8,4 | 3,5 | 2,5 | 0,9 | 0,9 | 0,6 | -0,3 | 0,0 | 0,0 | 0,6 | 1,5 | 4,4 | 4,4 | |
| Total credits - households | 11,8 | 12,9 | 12,6 | 12,8 | 13,0 | 13,0 | 8,8 | 7,3 | 7,0 | 7,0 | 7,1 | 6,7 | 6,6 | 6,6 | 6,5 | 6,7 | 9,5 | 9,5 | |
| Total credits - enterprises | 8,6 | 7,1 | 5,5 | 5,8 | 5,1 | 5,1 | -0,5 | -1,2 | -3,8 | -3,8 | -4,4 | -5,9 | -5,2 | -5,2 | -4,2 | -2,8 | 0,0 | 0,0 | |
| **Total deposits (incl. demand deposits), y-o-y growth rate** | 10,4 | 6,5 | 4,3 | 5,3 | 6,2 | 6,2 | 2,3 | 4,0 | 5,7 | 5,7 | 6,7 | 5,0 | 4,2 | 4,2 | 6,3 | 6,4 | 7,6 | 7,6 | |
| Total deposits - households | 8,9 | 4,1 | 3,6 | 3,5 | 3,1 | 3,1 | 0,2 | 1,2 | 2,5 | 2,5 | 2,9 | 2,8 | 1,8 | 1,8 | 3,4 | 5,5 | 6,5 | 6,5 | |
| Total deposits - enterprises | 15,7 | 13,0 | 6,4 | 11,8 | 16,0 | 16,0 | 5,6 | 11,3 | 13,4 | 13,4 | 15,9 | 9,0 | 8,8 | 8,8 | 12,0 | 7,9 | 10,8 | 10,8 | |
| **Interest rates /7** | | | | | | | | | | | | | | | | | | | |
| Interst rates of CBBills | 3,25 | 3,25 | 3,25 | 3,25 | 3,25 | 3,25 | 4,00 | 4,00 | 3,75 | 3,75 | 3,50 | 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 | 6,8 | 6,7 | 6,7 | 6,7 | 6,6 | 6,6 | 6,5 | 6,6 | 6,4 | 6,4 | 6,3 | 6,4 | 6,3 | 6,3 | 6,2 | 6,3 | |
| f/x rates | 6,3 | 5,9 | 5,7 | 5,7 | 5,6 | 5,6 | 5,5 | 5,4 | 5,2 | 5,4 | 5,1 | 5,1 | 5,0 | 5,1 | 5,0 | 5,0 | 5,0 | 5,0 | |
| 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 | 2,5 | 2,5 | 2,5 | 2,4 | 2,3 | 2,3 | 2,3 | 2,2 | 2,2 | 2,2 | 2,2 | |
| f/x rates | 1,4 | 1,3 | 1,1 | 1,1 | 1,1 | 1,1 | 1,1 | 1,0 | 1,0 | 1,0 | 1,0 | 0,9 | 0,9 | 0,9 | 0,9 | 0,9 | 0,8 | 0,9 | |
| **IV. External sector indicators** | | | | | | | | | | | | | | | | | | | |
| **Current account balance (millions of EUR)** | -43,2 | -187,0 | 13,1 | -21,7 | -50,1 | -58,7 | -219,4 | 100,3 | -125,6 | -303,3 | -7,1 | -58,5 | -57,6 | -123,1 | -29,1 | -40,4 | | | |
| *Current account balance (% of GDP)* | -0,5 | -2,1 | 0,1 | -0,2 | -0,5 | -0,6 | -2,2 | 1,0 | -1,3 | -3,1 | -0,1 | -0,6 | -0,6 | -1,2 | -0,3 | -0,4 | | | |
| **Trade balance (millions of EUR)/8** | -1757,9 | -1713,6 | -65,8 | -131,6 | -175,8 | -373,2 | -501,5 | -391,4 | -511,3 | -1777,4 | -117,4 | -138,1 | -166,1 | -421,6 | -152,9 | -178,1 | -119,3 | -450,3 | |
| *Trade balance (% og GDP)* | -20,5 | -18,9 | -0,7 | -1,3 | -1,8 | -3,8 | -5,1 | -4,0 | -5,2 | -18,0 | -1,1 | -1,3 | -1,6 | -4,1 | -1,5 | -1,7 | -1,2 | -4,4 | |
| import (millions of EUR) | -5504,5 | -5801,1 | -354,1 | -477,5 | -525,0 | -1356,6 | -1557,7 | -1540,0 | -1652,4 | -6106,7 | -442,2 | -517,7 | -599,5 | -1559,4 | -550,9 | -609,0 | -526,1 | -1686,1 | |
| export (millions of EUR) | 3746,6 | 4087,6 | 288,3 | 345,9 | 349,2 | 983,3 | 1056,2 | 1148,6 | 1141,1 | 4329,3 | 324,8 | 379,6 | 433,4 | 1137,8 | 398,0 | 430,9 | 406,8 | 1235,8 | |
| rate of growth of import (y-o-y) | 10,5 | 5,4 | -4,2 | 16,6 | -1,7 | 3,3 | 4,9 | 10,2 | 3,0 | 5,3 | 24,9 | 8,4 | 14,2 | 15,0 | 4,1 | 14,7 | 5,8 | 8,2 | |
| rate of growth of export (y-o-y) | 15,8 | 9,1 | -1,7 | 15,2 | 2,6 | 5,3 | 1,4 | 10,5 | 6,4 | 5,9 | 12,7 | 9,7 | 24,1 | 15,7 | 8,0 | 21,2 | 22,4 | 17,0 | |
| **Foreign Direct Investment (millions of EUR)** | 197,4 | 202,8 | 29,9 | 54,9 | 47,8 | 132,7 | 52,2 | 28,2 | 141,0 | 354,0 | -7,8 | 52,1 | 63,9 | 108,2 | 29,7 | 22,1 | | | |
| **External debt** | | | | | | | | | | | | | | | | | | | |
| Gross external debt (in milllions of EUR) | 5992,3 | 6290,5 | | | | 6816,2 | 6886,6 | 7513,4 | 7253,2 | 7253,2 | | | | 7780,8 | | | | | |
| public sector | 2846,8 | 2933,7 | | | | 3279,4 | 3283,1 | 3891,1 | 3445,5 | 3445,5 | | | | 3819,8 | | | | | |
| public sector/GDP (in %) | 33,2 | 32,4 | | | | 33,2 | 33,3 | 39,5 | 34,9 | 34,9 | | | | 37,2 | | | | | |
| private sector | 3145,5 | 3356,9 | | | | 3536,8 | 3603,6 | 3622,3 | 3807,7 | 3807,7 | | | | 3961,0 | | | | | |
| Gross external debt/GDP (in %) | 70,0 | 69,4 | | | | 69,1 | 69,8 | 76,2 | 73,5 | 73,5 | | | | 75,7 | | | | | |
| **Gross official reserves (millions of EUR)/9** | 2.436,5 | | 2.246,9 | 2.253,4 | 2.266,3 | | | | | | 2.557,1 | 2.563,0 | 2.534,4 | | 2.496,0 | 2.448,5 | 2.399,9 | | 2.273,2 |

/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.



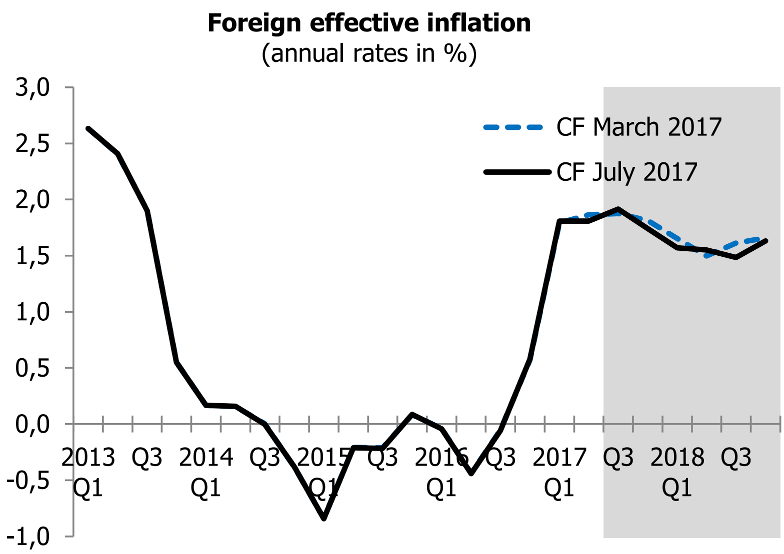

Source: "Consensus Forecast" and NBRM calculations.

**Compared to April, the foreign effective demand was minimally revised upwards throughout the entire projection period.**

**Thus, its growth in 2017 is now expected to be 1.9%, compared to the April estimate of 1.8%...**

...which is mainly due to the expectations for higher economic growth in most countries, and mostly of Germany.

**In 2018, foreign demand is also revised upwards and is expected to grow by 2%, compared to 1.9% in April.**




Source: "Consensus Forecast" and NBRM calculations.

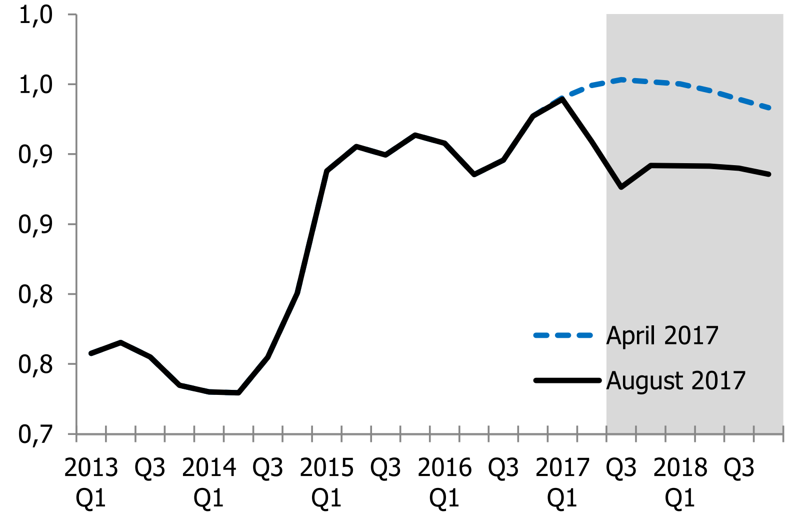
**On the other hand, the foreign effective inflation has undergone a minimal downward revision in 2017...**

...which is estimated to amount to 1.8%, unlike the April forecast of 1.9%...

...which is mainly due to the estimates for lower imported inflation from Germany and France.

**In contrast, the foreign inflation forecast for 2018 is unchanged compared to April, whereby it is still expected to stand at 1.6%.**

**EUR/USD exchange rate**



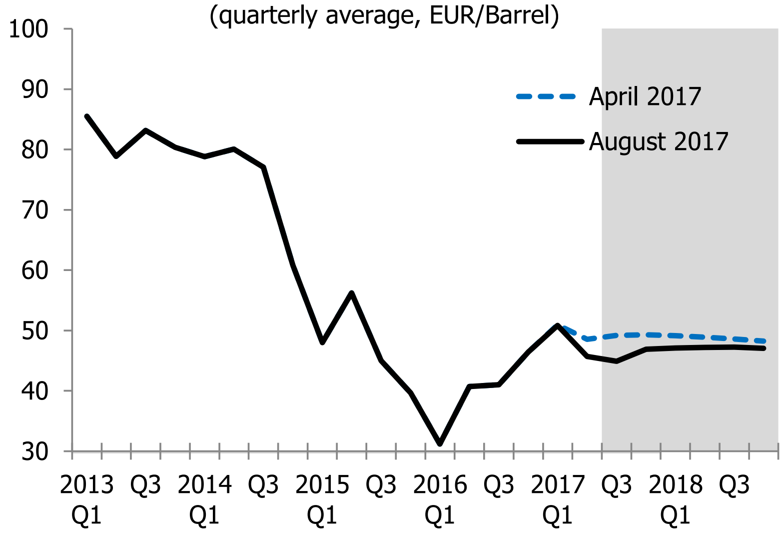

Source: "Consensus Forecast" and NBRM calculations.

**The latest expectations for the euro / US dollar exchange rate indicate lower values of the US dollar against the euro than those in the April forecasts...**

...so that the parity of the previous year is expected to be maintained for 2017, despite previous expectations for appreciation of the US dollar, while for 2018, a greater depreciation of the US dollar against the euro is expected compared to the April forecasts...

...which is due to the more favorable economic performance than expected in the euro area, despite the weaker economic growth in the US compared to expectations, coupled with the further internal political uncertainty and external political tensions of the US[2].

**Brent oil**
(quarterly average, EUR/Barrel)




Source: IMF and NBRM calculations.

**Recent expectations for oil price[3] suggest a slower growth for 2017 compared to the growth forecasted in April...**

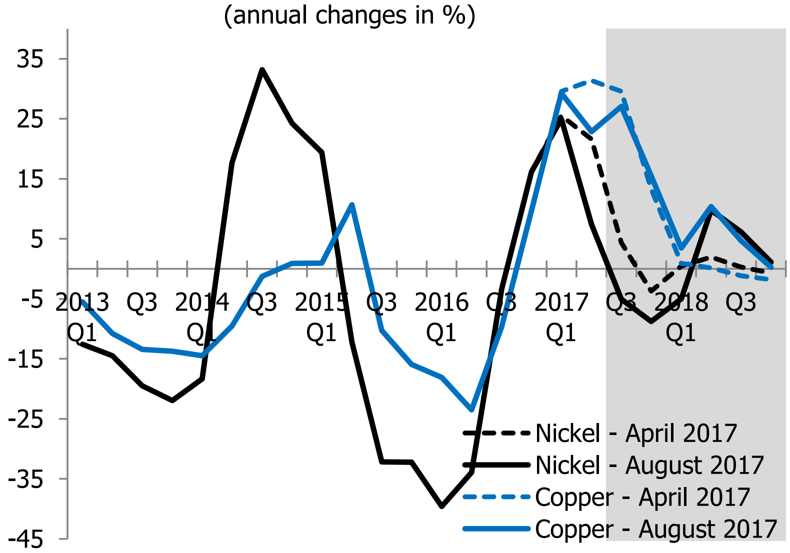
...largely as a result of the expectations for an increase in the production in the United States, despite the measures taken to limit global production[4].

**On the other hand, for 2018, the expectations for oil price were slightly corrected upwards relative to the April forecasts...**

...i.e. unchanged price level is expected compared to 2017, in contrast to the previously forecasted slight fall in prices in April.

[2] On 2 August 2017, the law on new sanctions against Russia was signed.
[3] For the analysis of prices of oil, metals and primary food products, reports of the IMF, World Bank, FAO, OPEC, the ECB and the specialized international economic portals are used.
[4] On 25 May 2017, the OPEC Member States made a decision to extend the agreement for reduction of oil production for nine more months (March 2018), which aims to reduce the inventories of this fuel globally. Also, 11 oil producing countries that are not OPEC Member States, including Russia, are expected to support the extension of the agreement, whereby 1.8 million barrels less per day should be produced until March 2018.

**Nickel and copper prices in EUR**
(annual changes in %)




Source: IMF and NBRM calculations.

**In 2017 the copper price denominated in euros has been slightly revised downwards, while prices denominated in US dollars have been corrected upwards relative to the April forecasts...**

...largely as a result of the expectations for lower growth of the industrial output of China and the expectations for unchanged exchange rate of the US dollar against the euro, despite previous expectations for appreciation of the US dollar.

**On the other hand, nickel prices in 2017 have been considerably revised downwards, now expecting much slower growth of prices contrary to the forecasted growth in April...**

...largely due to the expectations for larger supply on the market, primarily due to the abolition of part of the export restrictions on the nickel producers in Indonesia[5].

**In 2018, the forecasts of copper and nickel prices show a slight increase, despite the April estimates for their stabilization.**

**Changes in the expectations for the prices of part of the primary food products go in different direction, whereby the stock exchange prices of wheat have been revised upwards for 2017...**

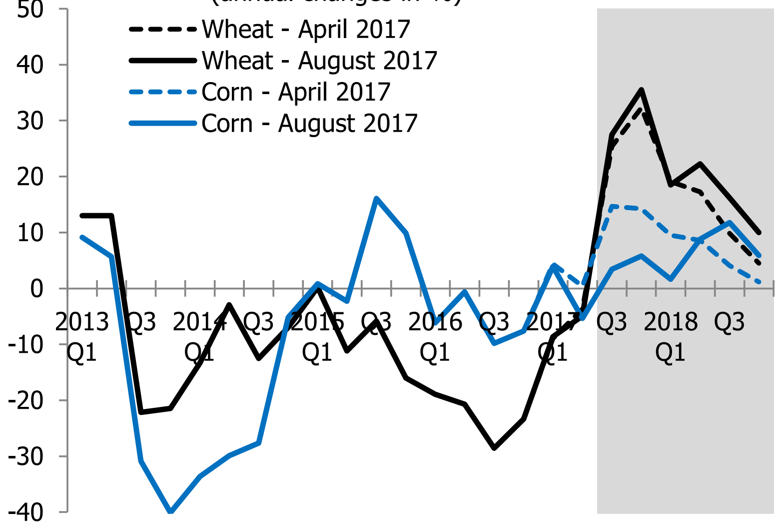
...i.e. higher growth is now expected compared to the April forecasts...

...mostly due to the smaller production expectations as a result of the droughts in Europe and Australia.

**On the other hand, for 2017, the growth of the corn price has been revised downwards relative to the April forecasts...**

[5] In August 2017, the Government of Indonesia proposed to give licenses for export of nickel to two companies in total value of 2 million tons.

**Wheat and corn prices in EUR**
(annual changes in %)



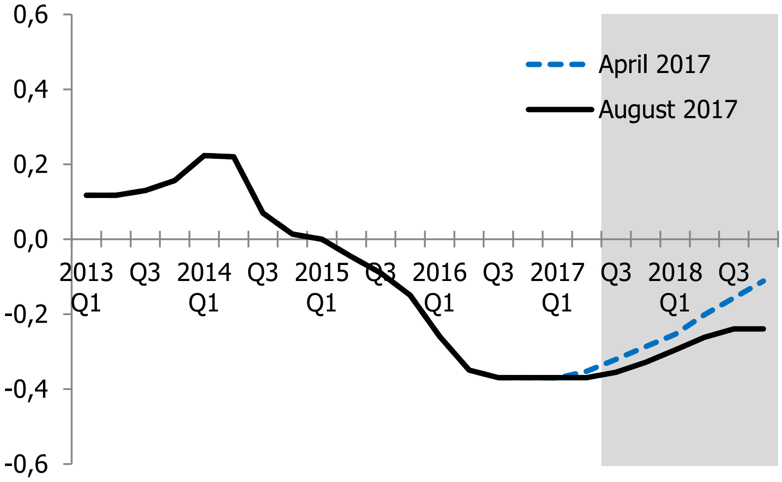

Source: IMF and NBRM calculations.

...largely due to the expectations for increased production in Argentina, Brazil and South Africa.

**The expectations for wheat and corn prices in 2018 are revised upwards...**

...whereby they are expected to register higher growth compared to that forecasted in April.

**1-month Euribor**
(quarterly average, in % )




Source: "Consensus Forecast" and NBRM calculations.

**In 2017, there were no major changes in the expectations about the movement of the foreign interest rate...**

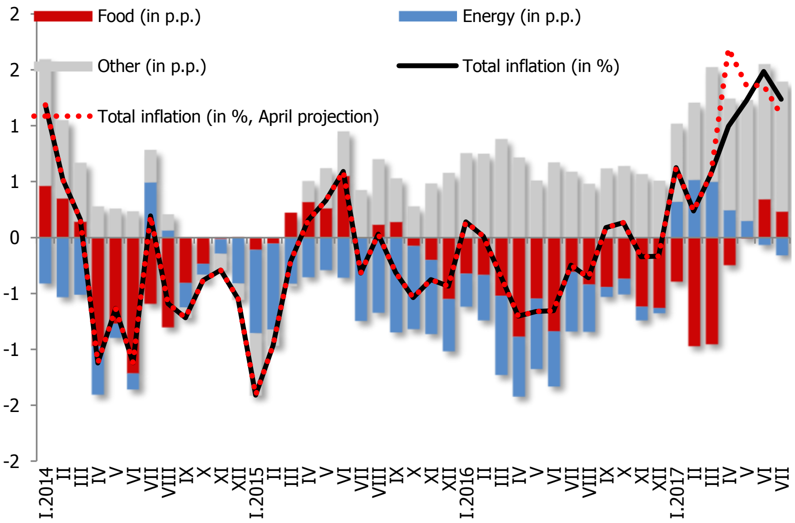
...whereby similar average level of -0.36% (-0.33% in April) is forecasted, amid a continuation of the Quantitative Easing Program of the ECB by the end of the year.

For 2018, slight downward revision of the average one-month Euribor to -0.26%, versus the forecasted -0.18% in April was made...

...largely due to the indications of a possible continuation of the Quantitative Easing Program of the ECB after December 2017.

**Inflation rate**

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



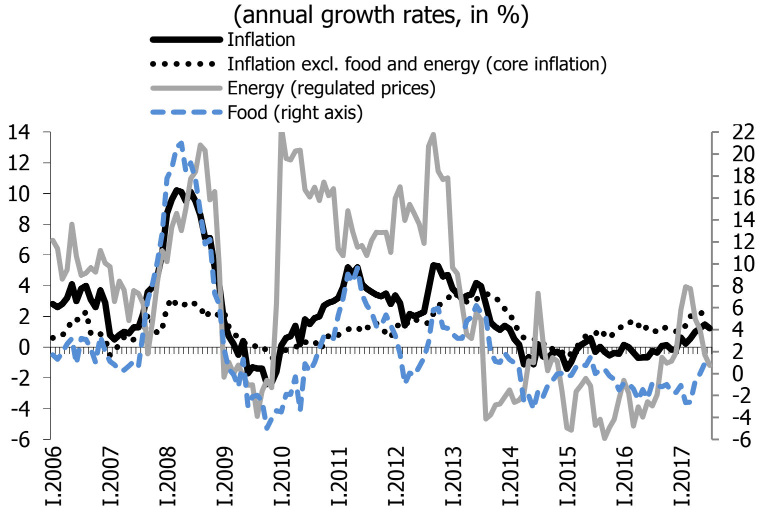

Source: SSO and NBRM.

**After the growth in the previous four months, in July 2017 the domestic consumer prices registered a monthly decrease of 0.6%[6]...**

...driven by lower food prices, as well as by the further monthly decrease in the energy prices. In July, there was a slowdown in the growth of core inflation, which also contributed to the change in the monthly trend of prices.

**Inflation and volatility of food and energy**

(annual growth rates, in %)




Source: State statistical office and NBRM calculations.

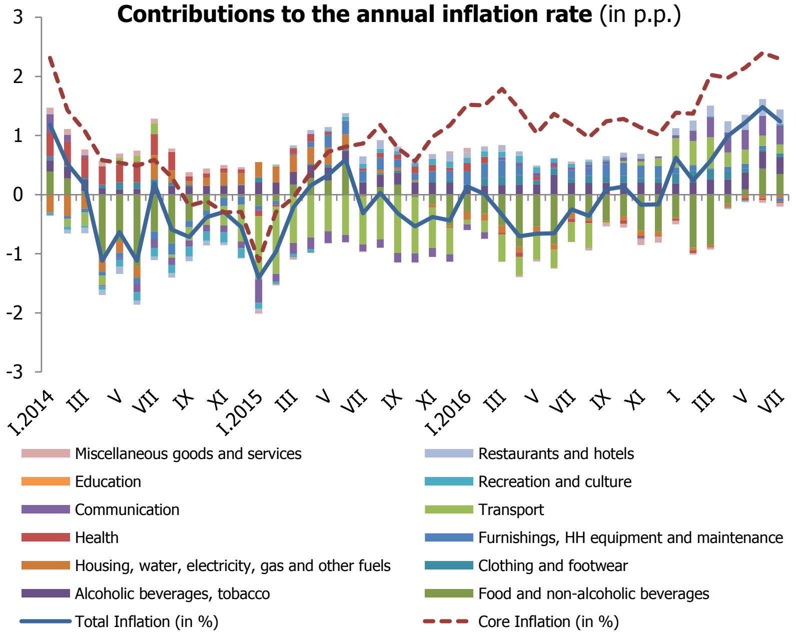
**The annual inflation rate in July amounted to 1.2%** (versus 1.5% in June), which is within the expected movement for July.

Observed by price category, the upward deviation is present in food prices.

On the other hand, with the energy component, the deviation is in the opposite direction (decline instead of the expected growth), while the realized core inflation rate is in line with the forecast.

**Analyzed cumulatively, the realized inflation rate in the first seven months is slightly lower than expected according to the April forecast.**

[6] Observed by group of products, the vegetables registered the highest negative contribution to the monthly fall in July.



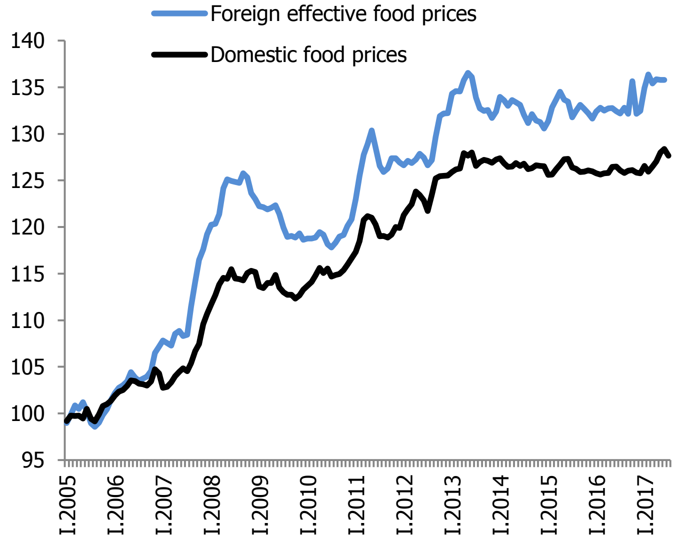

Source: SSO and NBRM.

**In July, core inflation equaled 0.1% on a monthly basis and 2.3% on an annual basis.**

Observing the structure of core inflation, the annual growth is due to the upward movement in prices of most categories within the core inflation, with the highest contribution of the prices of communications, tobacco[7], and "restaurants and hotels" category.

**Foreign effective food prices* and domestic food prices**

(indices, 2005 =100)




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

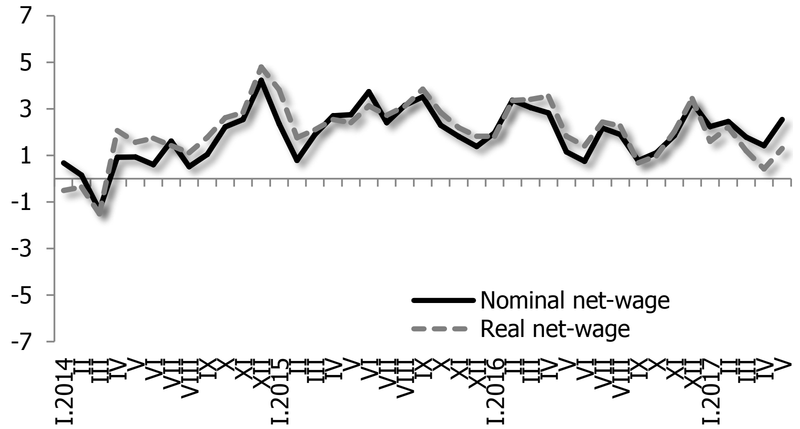
**The expected price movement of external input assumptions in the inflation forecast for the whole of 2017 has been revised in different directions.**

Thus, the latest oil and corn price estimates for 2017 indicate lower growth compared to the expectations in the April cycle projections, while the wheat price is expected to register faster growth.

**Amid relatively small deviation of the actual to forecasted inflation, and at the same time divergently revised external assumptions, it is currently assessed that the risks to inflation forecast for 2017 are balanced.** Namely, despite the downward revision of part of the external assumptions, the great uncertainty around the forecasted movement and the volatility of world prices of primary commodities, above all oil prices, impose a need for vigilance.

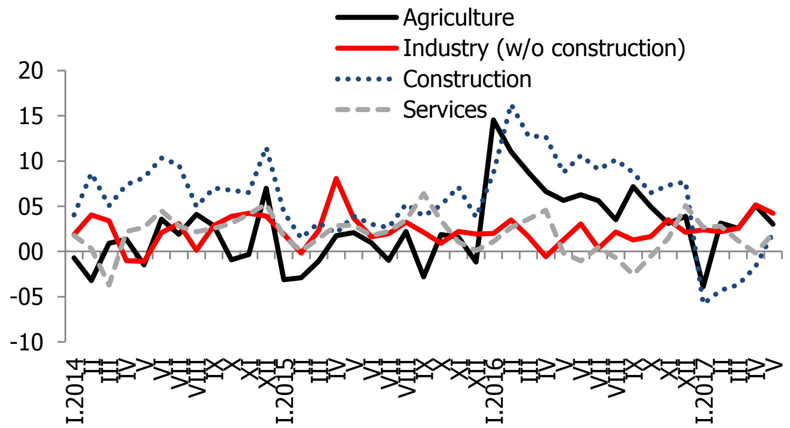
[7] The annual growth of tobacco prices in July is a combination of the increase in the price of a certain type of cigarettes in April and June 2017. In July 2017, the cigarette excise increased (from 1 July 2017 to 1 July 2023 the excise duty will increase by 0.20 denars/piece each year) which did not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

**Average net-wage**
(annual changes, in %)




Source: SSO.

**Average monthly net wage paid by sectors**
(nominal annual changes, in %)




Source: SSO.

**In May 2017, the average net wage registered a nominal annual growth of 2.5%,** which is a growth acceleration of 1.1 percentage point, compared to the previous month.

Upward movement of wages was registered in most of the activities, with highest growth recorded in "mining and quarrying", "professional, scientific and technical activities" and "processing industry", and wages in trade, agriculture and construction also registered an increase. On the other hand, in May, lower wages were paid only in "real estate activities" and "electricity, gas, steam and air-conditioning".

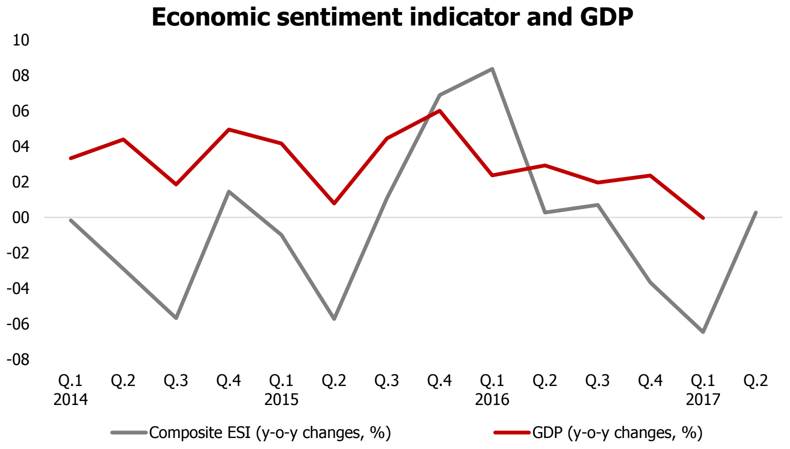
Amid increase in the consumer prices in May, the **real wages increased by 1.3%.**

In the first two months of the second quarter, the net salary recorded nominal and real annual growth of 2% and 0.9%, respectively. Such performances in the net salaries in the period are somewhat lower than the expected movements for the second quarter within the April forecast (2.9% and 1.3%, respectively).

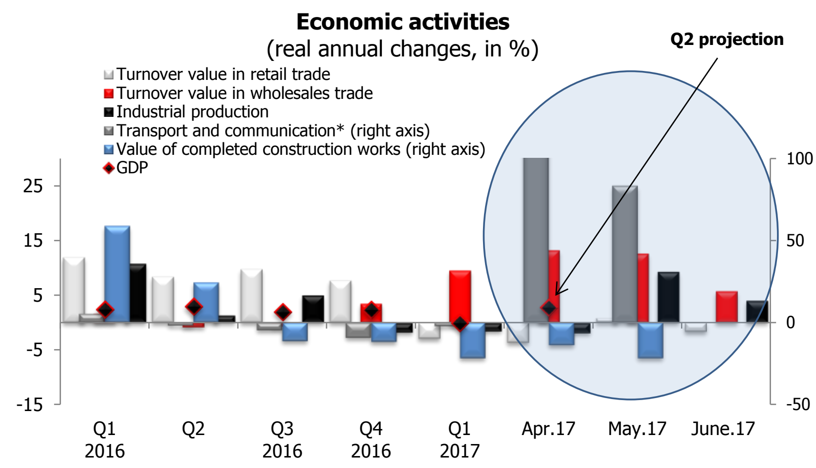
**The available data on the key macroeconomic indicators on the supply side indicate an improvement of the situation of the economy in the second quarter. The results obtained from the surveys that measure the perceptions of economic agents for the situation in the economy are in the same direction[8].**

After the fall in the first quarter, the **industrial output** grew in the second quarter of the year. This increase was mostly due to the increase in the production in the processing industry, while the increase in the production in mining and in the energy sector made positive, but more moderate contribution.

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




Source: State statistical office and European commission.




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

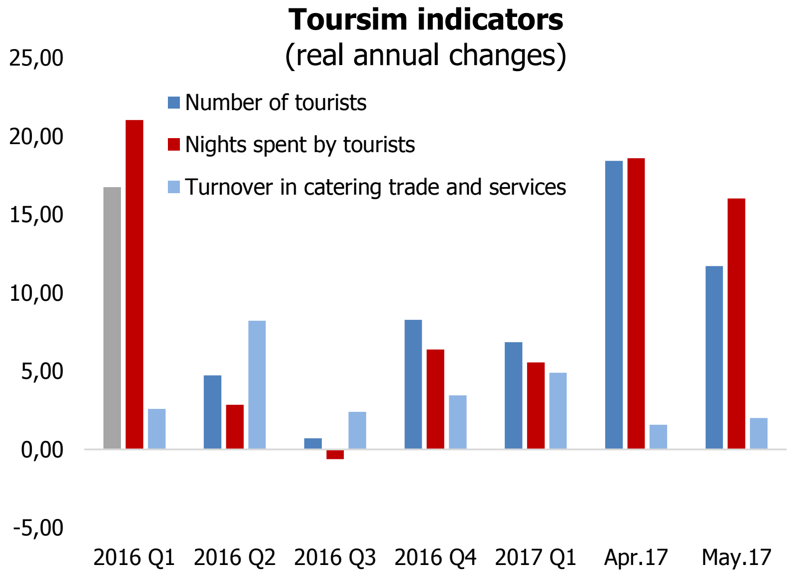
Within the processing industry in the second quarter, there is a growth concentration in part of the activities where foreign export facilities are present (production of machines and appliances and production of motor vehicles, trailers and semi-trailers), and solid positive performances have also been registered in the production of other non-metallic mineral products. The production of beverages, tobacco products, fabricated metal products, pharmaceutical products and textile, whose production registered a decline in the first quarter, made a moderate positive contribution to the industrial output growth in this quarter. Clothing production still declines, but with more moderate intensity compared to the first quarter.

**The turnover in the total trade** continued to grow in the second quarter, at a moderately faster pace compared to the first quarter. Structurally speaking, the growth of the trade turnover stems from the wholesale trade, while retail trade continued to decline, registering significant deceleration in the decline. The trade in motor vehicles also registers a decrease, at a faster pace compared to the first quarter.

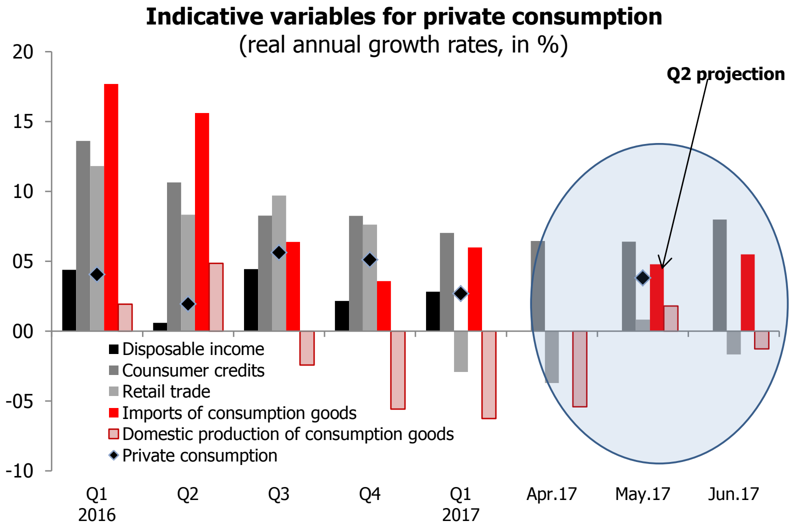
The unfavorable movements in **construction**, which began in the second half of 2016, continued in the period from April to May, but at a somewhat more moderate pace. The fall in this period is mainly explained by the drop in the value of the completed construction works in the area of the high-rise buildings, and the civil engineering also registers a decline.

On the other hand, within the **catering services**, the available data (the number of tourists, the number of overnight stays, the turnover value) show activity growth in this segment in the second quarter.

Regarding the **rail traffic** in the period April-May, there is a decrease in the number of carried passengers and an increase in the transported goods on an annual basis.




Source: SSO and NBRM calculations.




Source: SSO and NBRM calculations.

**The aggregate demand indicators mainly indicate growth of economic activity in the second quarter of 2017.**

High-frequency data on **private consumption** point to favorable developments for the second quarter of 2017...

...amid positive performances in the main disposable income components (wages, pensions, net private transfers, social government transfers), as well as amid solid growth of household lending.

At the same time, the import of consumer goods also increased, while the decline in retail trade and domestic production of consumer goods slowed down compared to the previous quarter.

Short-term indicators of **investment activity** provide divergent directions regarding the movement of gross capital formation in the second quarter of 2017...

...amid rise in the import of investment products and government capital investments...

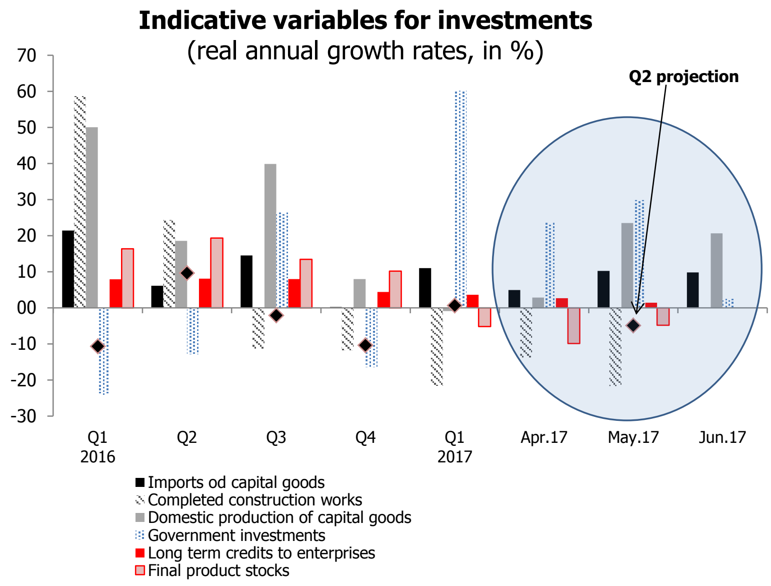
....as well as amid nominal growth of long-term lending to companies, although there is a significant slowdown compared to the last quarter.

Also, compared to the fall of the previous quarter, the domestic production of capital goods increased in the second quarter.

On the other hand, analyzing short-term indicators of investments, there was a decline in construction, inflows of foreign direct investment, as well as in the inventories of manufactured goods in the industry.

In the second quarter of 2017, the nominal data on **foreign trade** show narrowing of the trade deficit...

... given higher nominal growth in the export than in the import of goods.



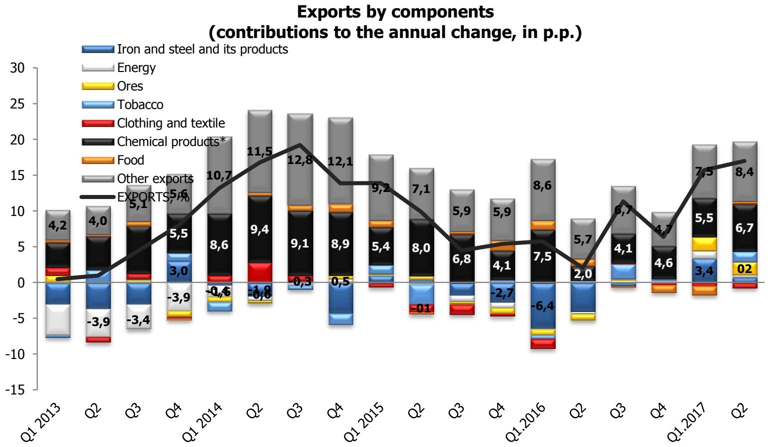

Source: SSO and NBRM calculations.

Budget data in the second quarter of 2017 indicate growth of the **public consumption**…

...amid higher wage expenses for the employees in the public sector and increased health care transfers.

In the second quarter of 2017, the intensified growth of exports compared to imports led to **decrease in the foreign trade deficit of 10.2% on an annual basis**.

**Export** of goods in the second quarter registered a high annual growth of 17%, primarily boosted by the good performance of the new export-oriented facilities, but favorable developments have also been registered in part of the traditional sectors. The positive contribution of the export of ores and tobacco was particularly pronounced.

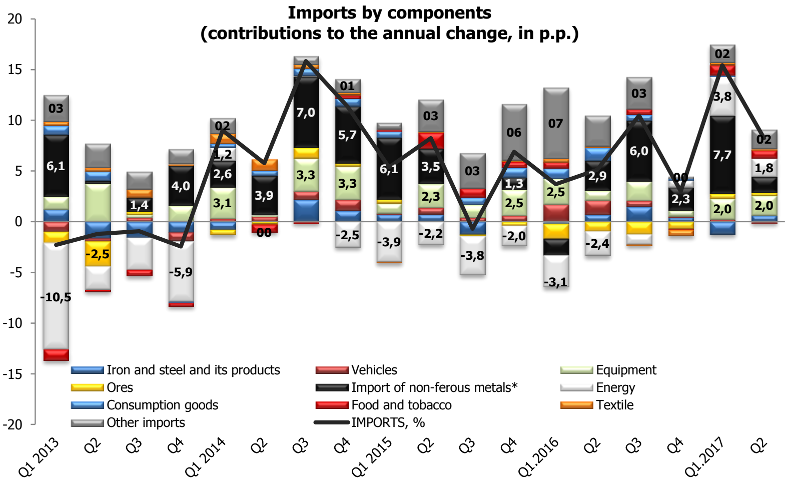



Source: NBRM.

Compared with the April forecast, the realized export in the second quarter was higher than the expectations. Significant upward deviations were registered in the export of the new production facilities, as well as in the export of ores and tobacco...

...while exports of iron and steel and clothing and textile were weaker compared to the expectations according to the April forecast.

**Import** of goods in the second quarter increased by 8.2% on annual basis, as a result of the increase in the import of equipment and machinery, the energy import and the import of raw materials of part of the new industrial facilities.

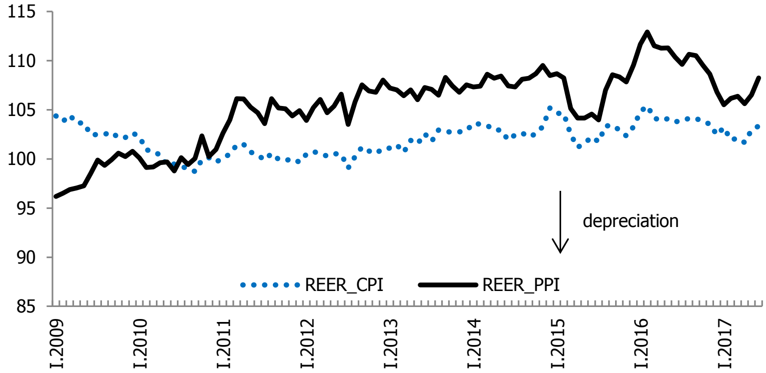



Source: NBRM.

*Imports of goods in the second quarter were moderately higher than expected according to the April forecast.* Considering the individual categories, upward deviations occur in the import of equipment and machinery, vehicles, energy and iron and steel. On the other hand, the import of part of the new export-oriented facilities and the import of consumer goods is weaker than forecasted.

**The performances of the foreign trade components indicate a trade deficit that is slightly lower than expected for the second quarter of 2017, according to the April forecast.**

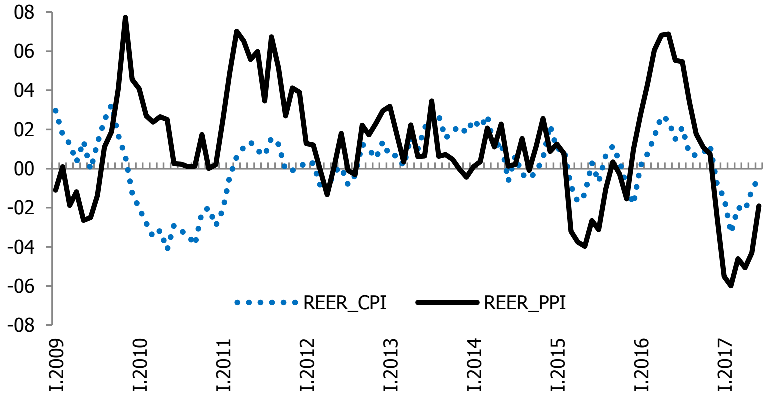
**REER**
*(2010=100)*




Source: NBRM.

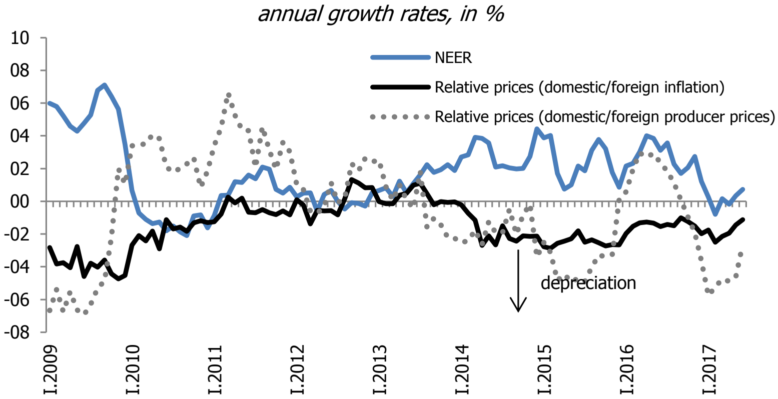
**Price competitiveness indicators of the domestic economy indicate favorable developments during the second quarter of 2017.** In June 2017, the REER index deflated by consumer prices depreciated by 0.4% on an annual basis and the REER index deflated by producer prices depreciated by 1.9%.

**REER**
*annual changes, in %*



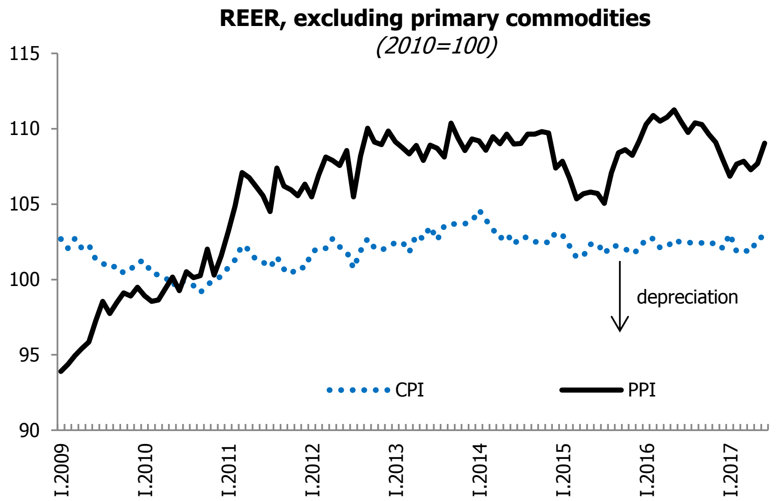

Source: NBRM.

**NEER and relative prices**
*annual growth rates, in %*



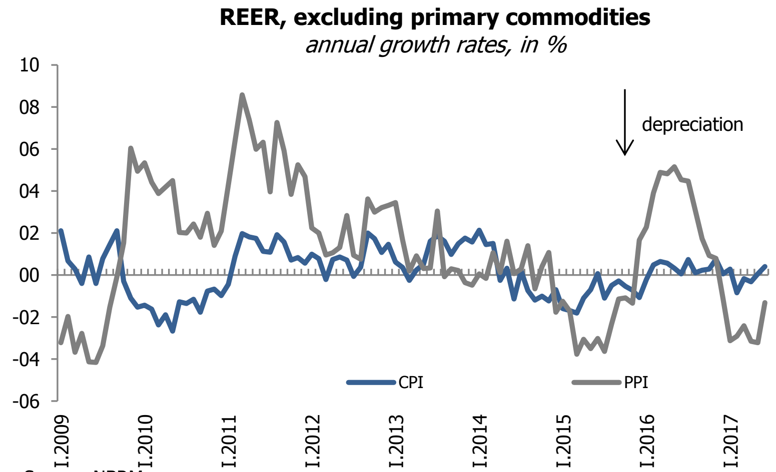

Source: NBRM.

These developments are mostly due to favorable changes in relative prices, and the relative prices of industrial products decreased by 2.6%, while the relative cost of living by 1.1%. The NEER also acted in the opposite direction, but more moderately, registering appreciation of 0.7% annually, mostly as a result of the appreciation of the Russian ruble, given the depreciation of the Turkish lira and the British pound.

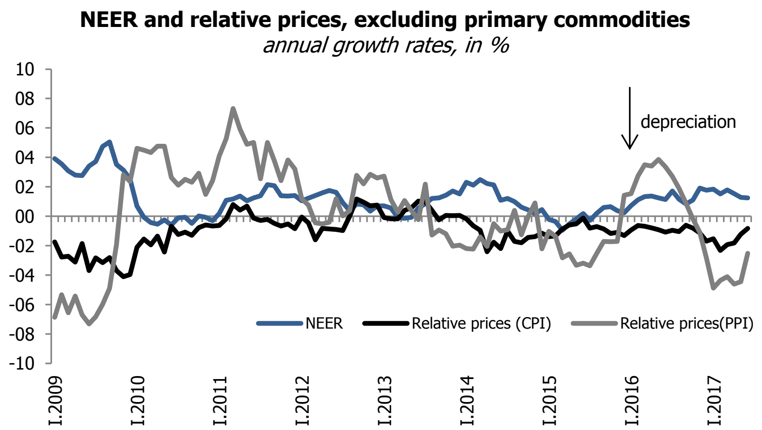



Source: NBRM.

**In June 2017, the analysis of REER indices, as measured using weights based on the foreign trade without primary commodities[9], indicates divergent movements.** The REER deflated by consumer prices registered slight appreciation of 0.4%, while the REER deflated by producer prices depreciated by 1.3%.



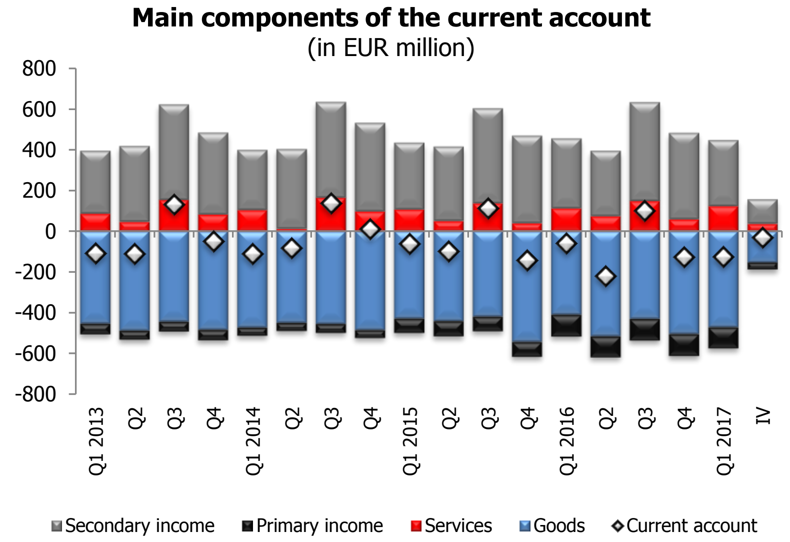

Source: NBRM.




Source: NBRM.

On an annual basis, the relative consumer prices and the relative producer prices decreased by 0.8% and 2.5%, respectively, while the NEER registered annual appreciation of 1.2%.

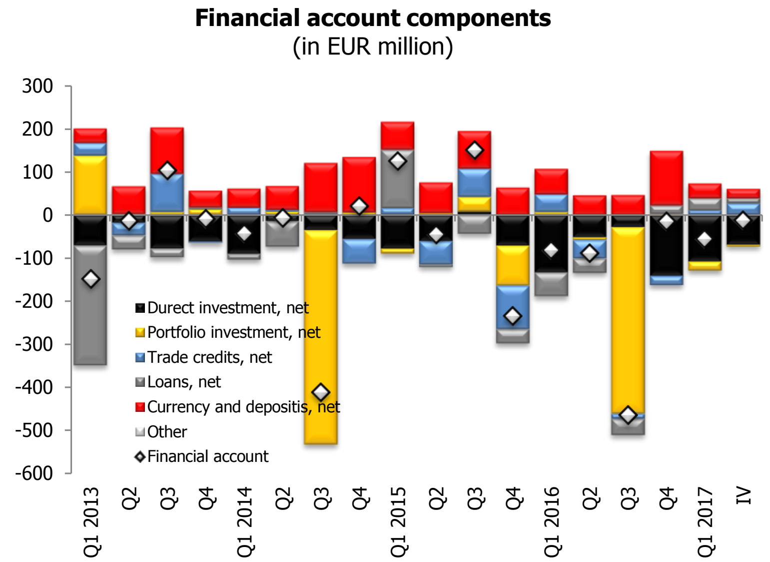
[9] Primary commodities not included in the calculation are: oil and oil derivatives, iron and steel, ores and imported raw materials for the new industrial facilities in the free economic zones.




Source: NBRM.

**In April and May 2017, the balance of payments current account registered a deficit of Euro 69.5 million (0.7% of GDP),** indicating a likelihood of lower deficit in the second quarter compared to the expectations with the April forecast.

Analyzing individual categories, positive deviations are registered in the balance of goods, primary and secondary income, while the surplus in services is moderately lower than expected with the April forecast.




Source: NBRM.

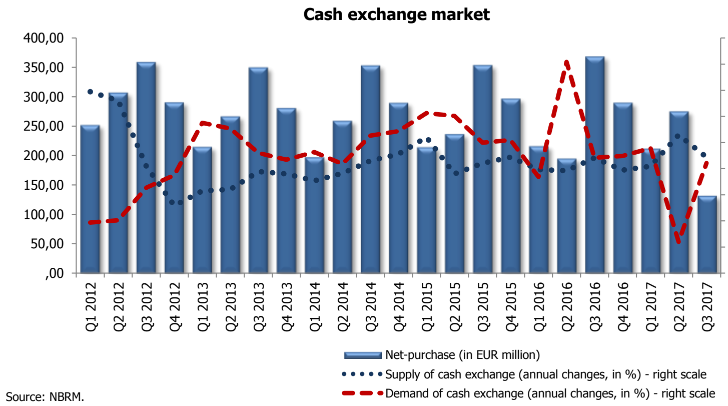
**During April and May, the financial account registered net inflows of Euro 36.3 million (or 0.4% of GDP)**, which is higher than the expectations for the second quarter according to the April forecast[10].

Significant positive deviations in April and May relative to the April forecast are registered in currency and deposits (realized net outflows that are lower than expected) and trade credits. The performances in foreign direct investments and portfolio investments are within the expectations with the forecast, while the performances in long-term loans in April and May are weaker, i.e. despite the expected net inflows, net outflows were realized, primarily as a result of the lower withdrawals by other sectors.

**In July 2017, the supply of and demand for foreign currency on the currency exchange market registered no major changes, and the performances in this segment so far are within the expectations.**

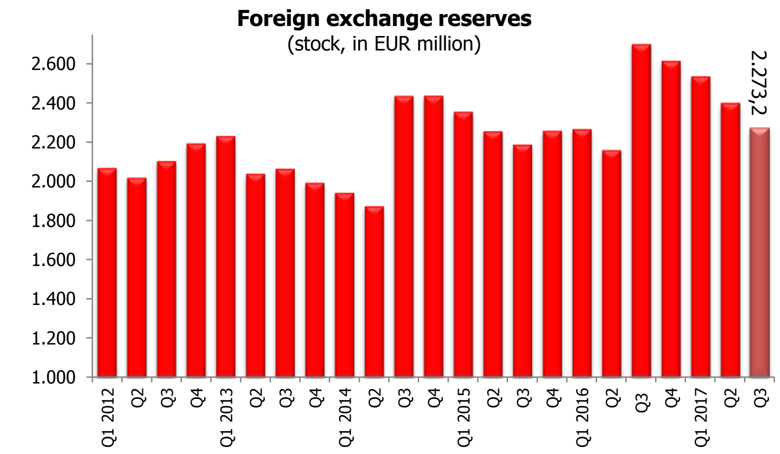
The net purchase on the currency exchange market in July 2017 totaled Euro 132 million, which is a moderate

[10] 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.



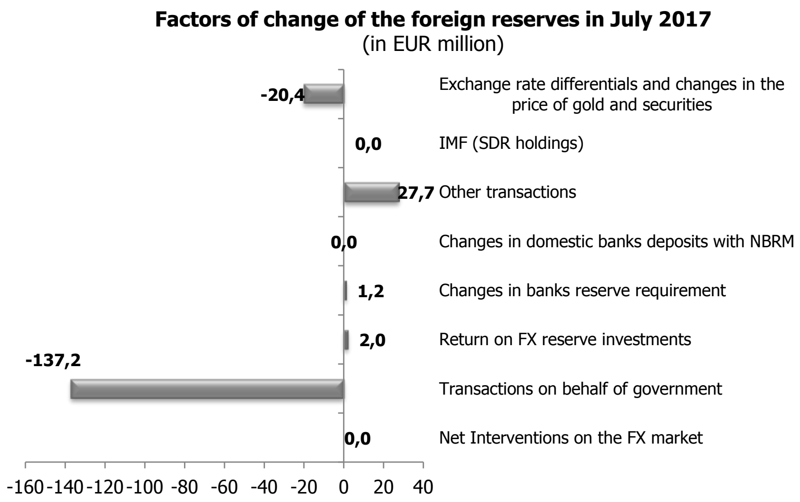

Source: NBRM.

increase of 5% on annual basis. These developments are the result of the higher increase in the supply of foreign currency (4.4%) than the growth in the demand for foreign currency (2.1%).

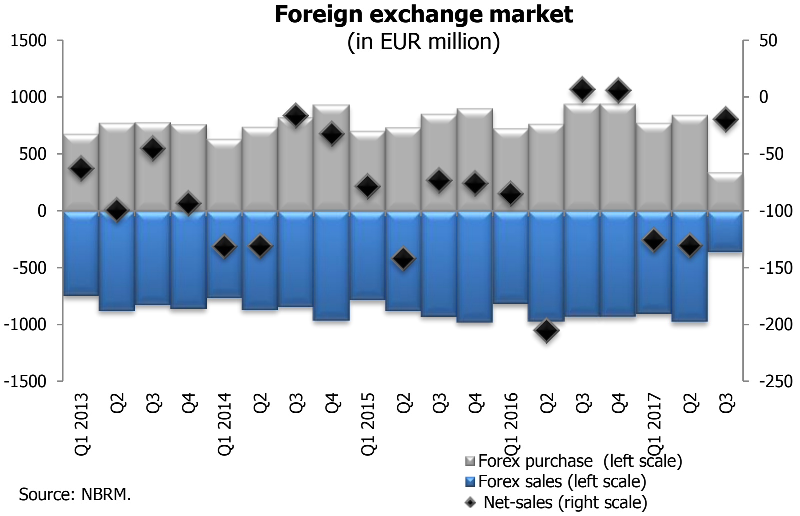



Source: NBRM.

**As of 31 July 2017, the gross foreign reserves stood at Euro 2,273.3 million,** which is a decrease of Euro 126.6 million compared to the end of the second quarter of 2017. The decrease in foreign reserves is mostly due to the transactions for the account of the Government, as a result of the regular servicing of the due external debt. Additionally, the category of currency changes and the change in the price of gold also had a negative impact.

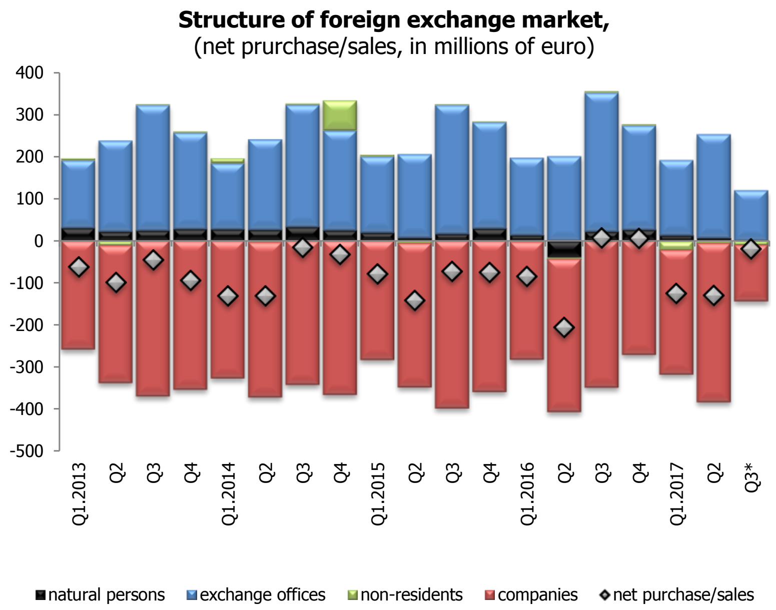



Source: NBRM.



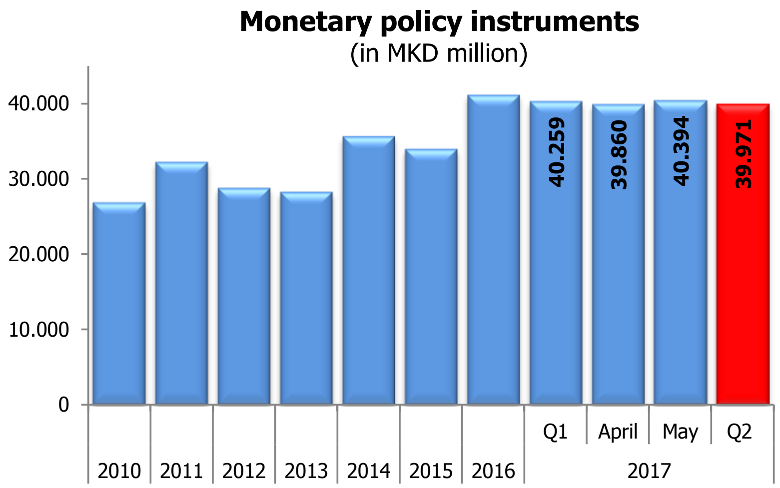

Source: NBRM.

In July 2017, the foreign exchange market of banks reported a net sale of foreign exchange of Euro 19.3 million, which is by Euro 40.2 million lower compared to the same month of the previous year, when a net purchase of Euro 21 million was realized. This annual change is due to the higher increase in the demand for foreign currency than the supply.

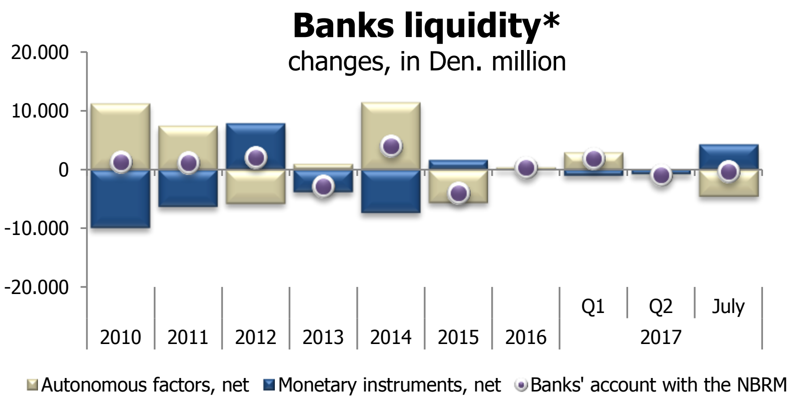



Source: NBRM

Sector-by-sector analysis shows that these changes mainly arise from the higher net sales in companies, as well as the realized net sales in non-residents (in July 2016, non-residents realized net purchase). In July, the realized net purchase in natural persons and exchange offices registered no significant change on an annual basis.




Source: NBRM.




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

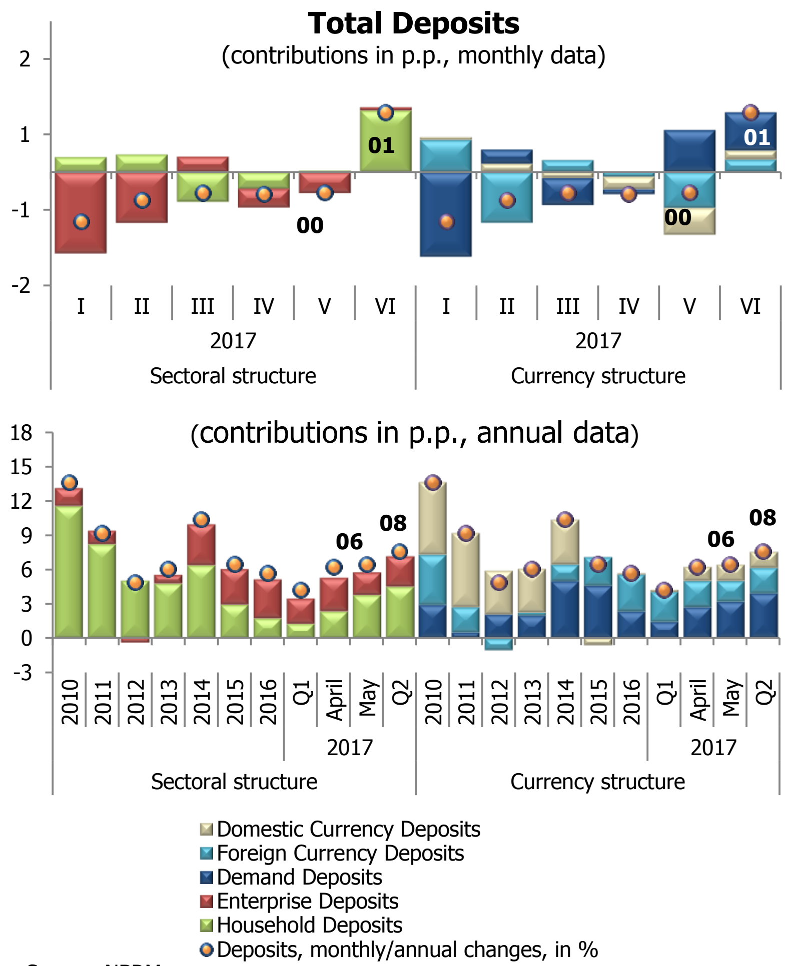
**The situation regarding the monetary instruments at the end of June is insignificantly lower, both in comparison with the previous month, and compared to the end of the first quarter. These performances are opposite to the expectations for a more substantial liquidity creation through the monetary instruments in the second quarter of 2017, according to the April forecast.**

From the balance sheet perspective, the net foreign assets of the NBRM in June registers a decrease, for the third consecutive month. This performance is in line with the expectations for the second quarter of the year, according to the April forecast. Total government deposits also recorded a decrease in the analyzed period. Thus, their situation is lower compared to the end of the first quarter of the year, which is also in line with the expectations, according to the April forecast.

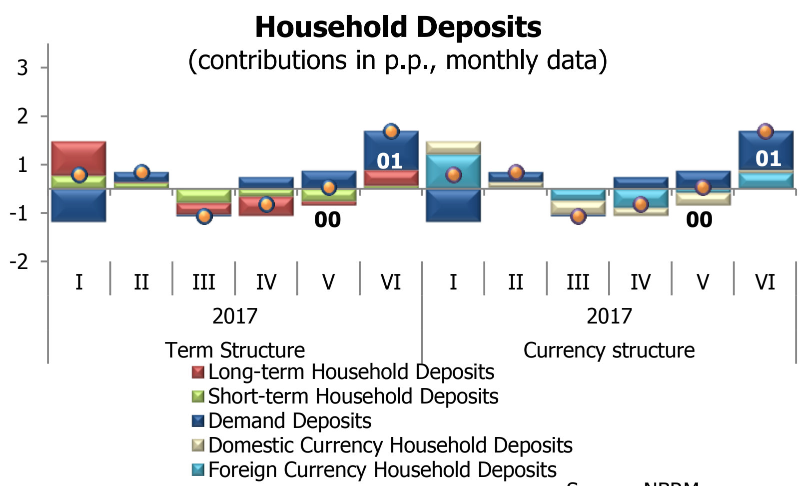
In contrast to the previous two months, the reserve money in June grew on a monthly basis. The growth was mostly due to the increase in the currency in circulation and to a lesser extent, to the banks' reserves with the NBRM. Compared to the end of the first quarter, the reserve money was higher, but the growth was lower than expected with the April forecasts, mostly due to the lower level of banks' reserves with the NBRM.

**According to operational liquidity data, in July, the liquidity of the banking system registered a slight monthly decline.** Amid a significant decrease in the liquidity influenced by the autonomous factors (currency in circulation and government transactions), the NBRM reduced the supply of CB bills in July[11], and additional liquidity in the system was created as a result of the reduced interest of banks in deposit facility.

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




Source: NBRM



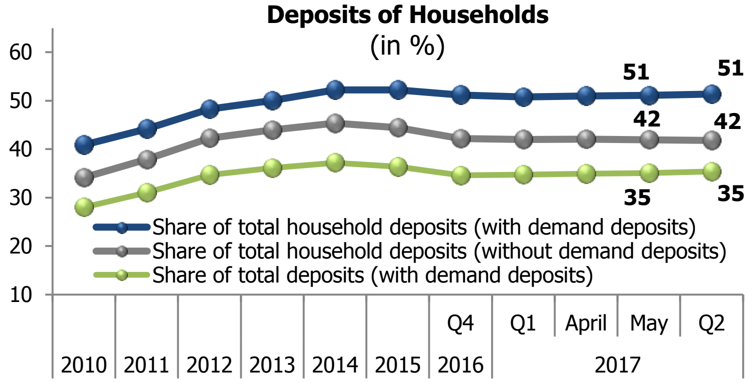

Source: NBRM

**In June 2017, total deposits increased on a monthly basis, despite the downward trend since the beginning of the year.** Analyzed by sectors, the monthly increase (of 0.8%) in June is almost entirely due to household deposits, which registered faster monthly growth for the first time since the beginning of the year. The growth of household savings corresponds to the budget payments based on denationalization bonds and subsidies. The corporate deposits in June registered a small monthly growth compared to the fall in the previous two months. In terms of currency structure, monthly increase was registered in both components, amid more significant growth in denar deposits.

**In June, the annual growth rate of total deposits equaled 7.6% (6.4% in May), which is below the growth for the second quarter of 2017 (of 8.4%), as forecasted in April.** From the viewpoint of the currency structure, the annual growth of total deposits in June was mostly due to the growth of denar deposits. The share of denar deposits in total deposits in June amounted to 58.9% and registered a slight increase of 0.2 percentage points compared to the previous month.

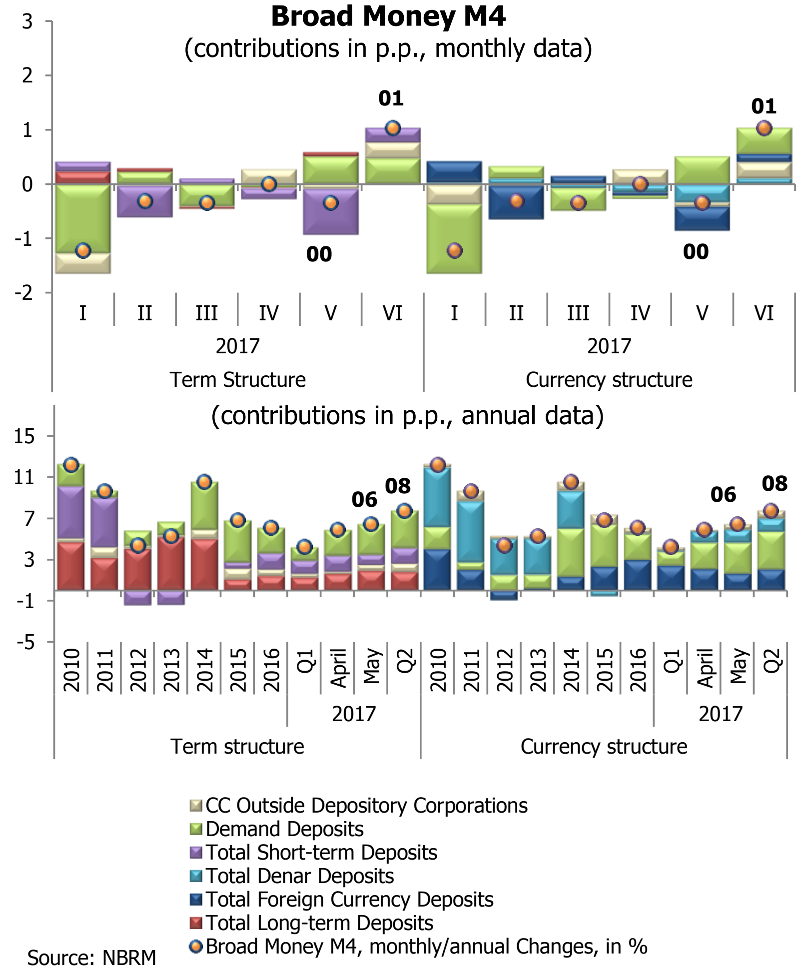
**Household deposits in June recorded a significant monthly increase.** Analyzing by currency, the monthly increase in household deposits (1.2%) arises from the higher growth of denar deposits, given moderate growth of foreign currency household deposits. As a result of these developments, in June, the share of denar deposits in total household deposits increased.

**Share of Denar Deposits of Households in Total Deposits of Households**
(in %)




Source: NBRM.

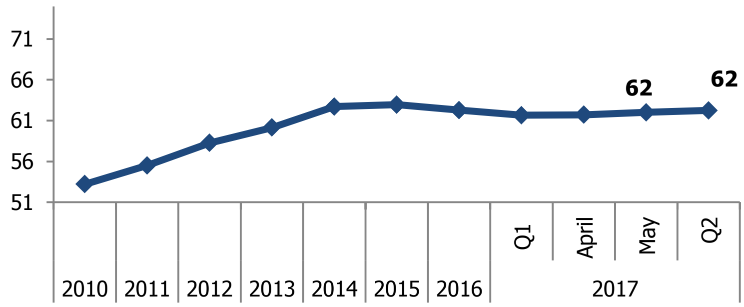
**Broad Money M4**
(contributions in p.p., monthly data)



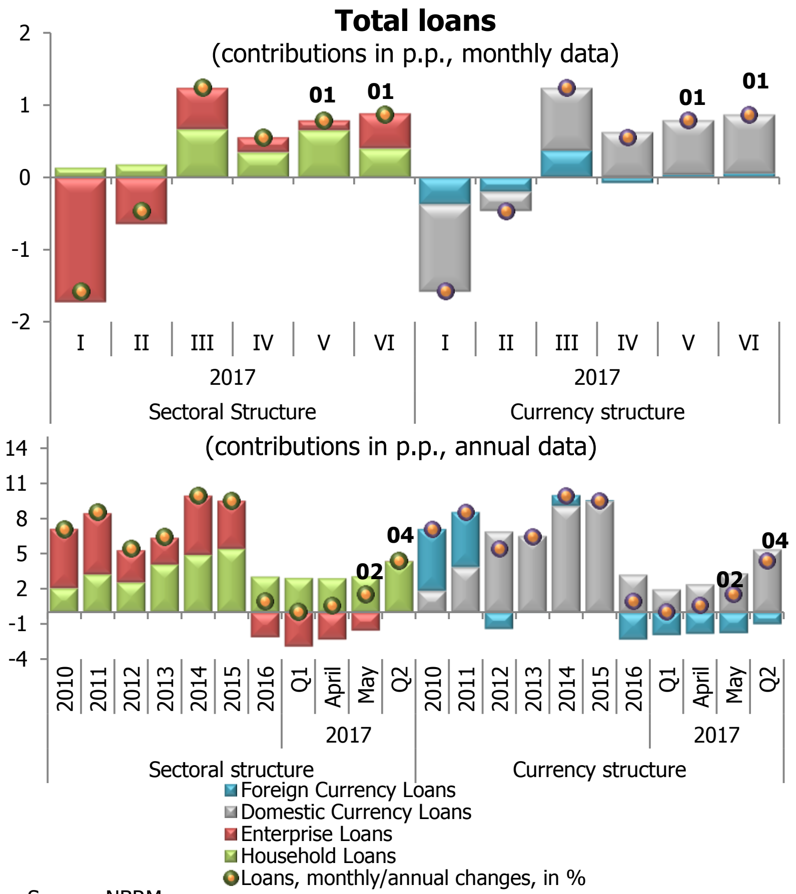

Source: NBRM

**During June, broad money M4 registered monthly growth, contrary to the decline registered in the previous month.** The monthly growth of the broadest money supply of 1.0% is primarily due to the growth of total deposits, but also to the currency in circulation. **On annual basis, the broad money has increased by 7.8%, which is below the forecasted growth of 8.0% for the second quarter of 2017.** The performances in June contributed to moderate increase in the share of denar deposits in the total money supply from 62.0% to 62.3% compared to the previous month.

**Share of Denar M4 in total M4**



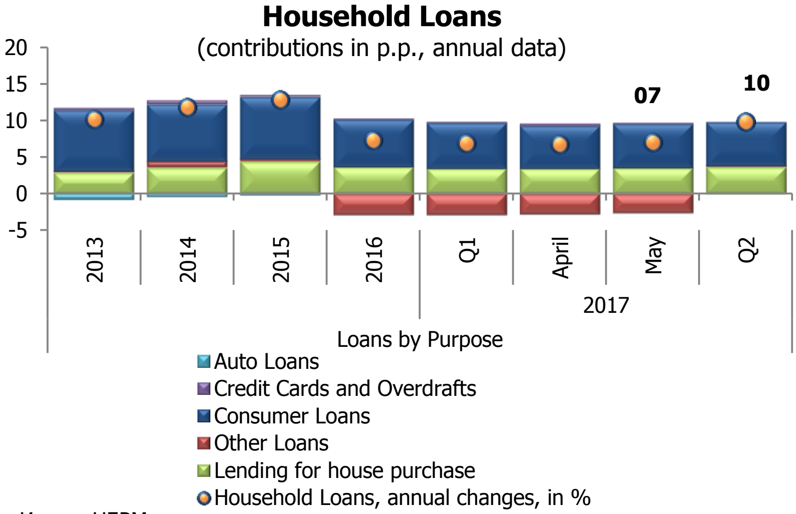

Source: NBRM.




Source: NBRM

**In June, total loans to the private sector registered a monthly growth, at a similar pace as in the previous month.** Analyzed by sector, the monthly increase in the total lending (of 0.9%) arises from the higher performances in both sectors (enterprises and households).

**On an annual basis, total loans in June grew by 4.4%, which is above the forecasted growth of 3.2% for the second quarter of 2017, according to the April forecast.** If we exclude the regulatory effect, the annual growth rate of total loans is 5.8% and is above the forecasted annual growth of 4.5% for the second quarter of 2017. Observing the currency, the annual growth of total loans in June 2017 stems from the growth of denar loans granted to households[12].

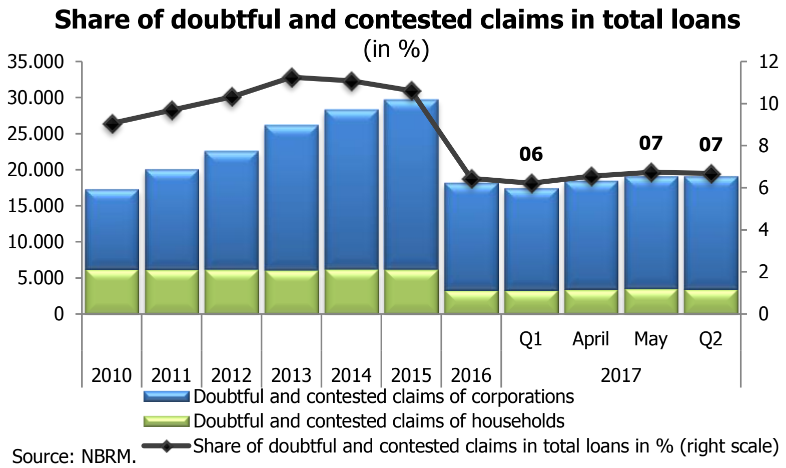



Извор: НБРМ

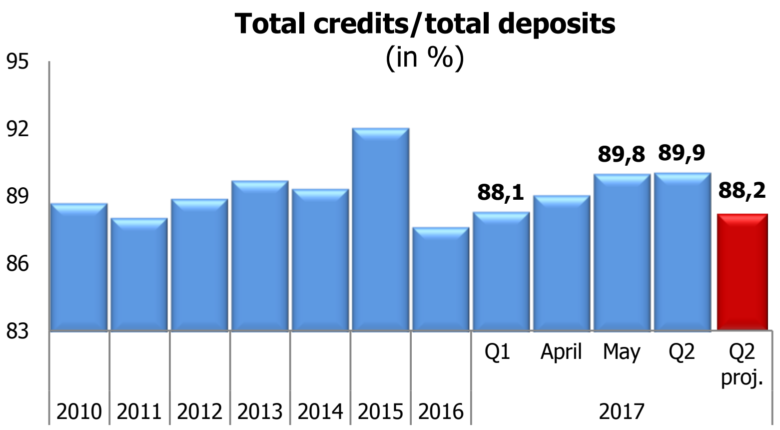
**In June, loans to households grew on an annual basis. On annual basis,** the growth of loans granted to households accelerated (from 7.0% in May to 9.8%), which is entirely derived from the base effect (effect of regulatory changes in June 2016).

**The share of doubtful and contested claims in total loans,** after the moderate growth in April and May (of 0.3 and 0.2 percentage points, respectively), remained stable in June (6.7%).

[12] Includes denar loans without FX clause, accrued interest and doubtful and contested claims.

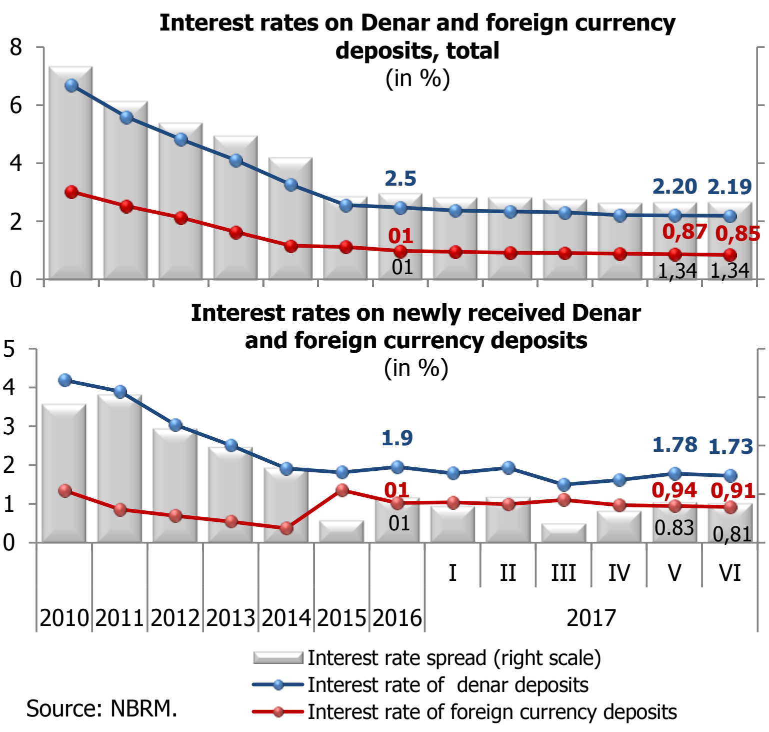



Source: NBRM.




Source: NBRM.

**Utilization of the deposit potential for lending to the private sector** at the end of June amounted to 89.9% and is almost at the same level as in the previous month. June performance is higher compared to the expectations for the second quarter of 2017, according to the April forecast[13].




Source: NBRM.

**In June, the interest rates on total deposits** registered a slight downward movement compared to the previous month, which was more pronounced with foreign currency deposits. As a result of these developments, the interest rate spread between the interest rates on denar and foreign currency deposits remained relatively stable. For **newly accepted total deposits,** the interest spread between denar and foreign currency deposits in June narrowed compared to the previous month as a result of the relatively lower interest rate on newly accepted denar deposits relative to the moderate downward movement in the interest rate on newly accepted foreign currency deposits. However, regarding the interest rates on the newly accepted deposits, it should have in mind that they characterize with variable movements[14].

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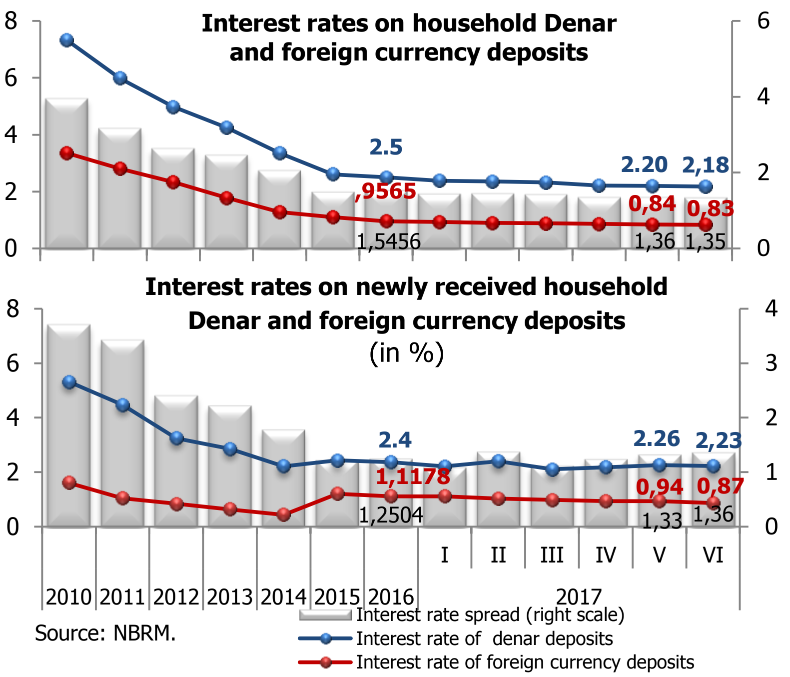
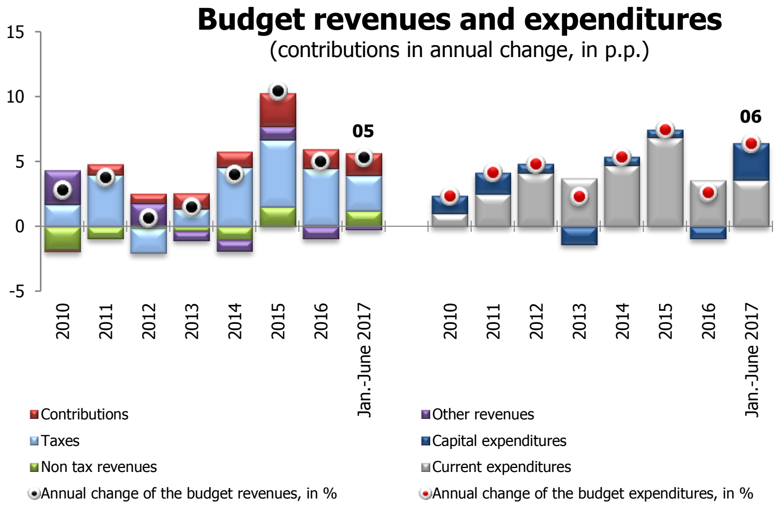
[13] Excluding the effect of regulatory write-off, the ratio of loans and deposits at the end of June is 95.5%.

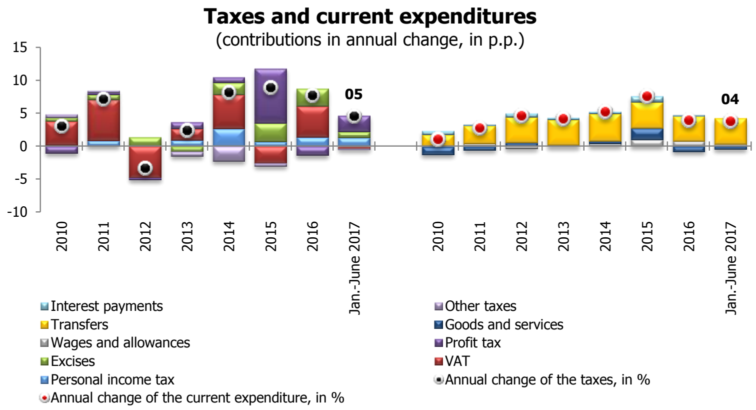
[14] Volatility of interest rate on newly accepted deposits results from the fact that they have been driven by the volume of newly accepted deposits (which can vary from month to month) and their interest rate.

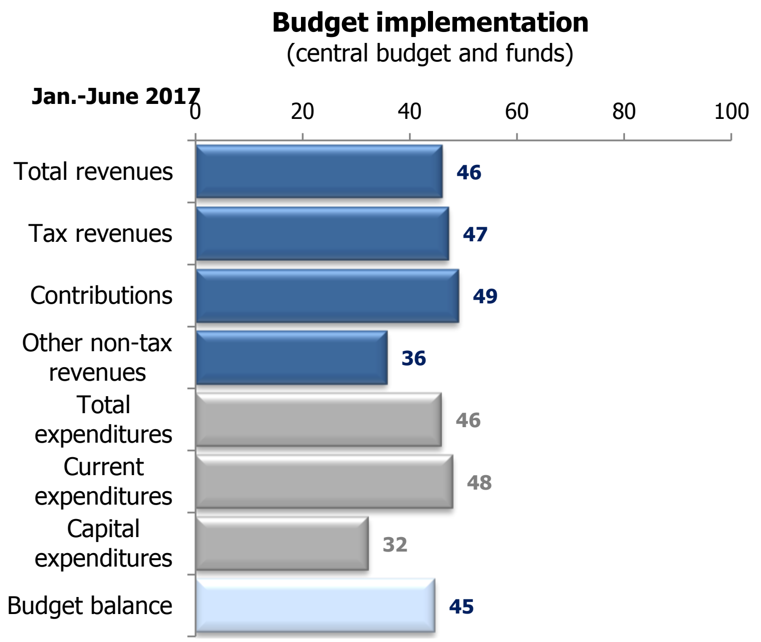



Source: NBRM.

**Interest rates on household deposits** in June moderately shifted downwards compared to the previous month, whereby the interest rate spread between denar and foreign currency interest rates remained relatively stable. Interest spread of **new household deposits** has slightly widened as a result of the moderate decrease in the interest rate on denar deposits compared to the decrease in the interest rate on foreign currency deposits.




Source: Ministry of Finance and NBRM's calculations.

In the period January-June 2017, the budget revenues in the Budget of the Republic of Macedonia (central budget and budgets of funds) increased by 5.3% compared to the same period last year. The improved performance arises from the higher realization of taxes, contributions and non-tax revenues, while other revenues made a small negative contribution to the annual growth.

Tax revenues in the period January-June 2017 increased by 4.6% on an annual basis, which is largely due to the higher performances in the income from the profit tax and the personal income tax, while the revenues from VAT made an insignificant negative contribution.

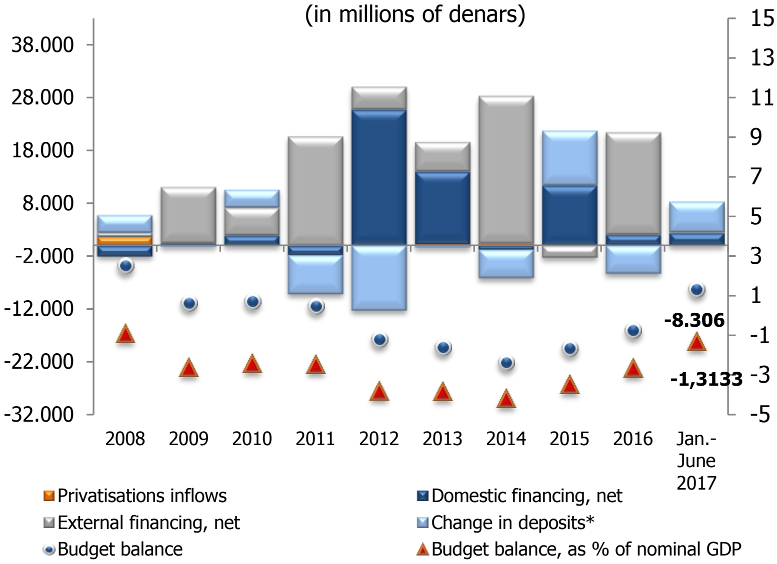
In the period January-June 2017, the budget expenditures increased by 6.4% on an annual basis, which almost equally arises from current expenditures and capital expenses.

In January-June 2017, the realized budget revenues constituted 46% of the revenues projected for 2017, according to the Budget. Analyzed by individual categories of budget revenues, higher performance was registered in contributions and taxes (realization of 49.1% and 47.2%, respectively), while the realization of the category of other non-tax revenues accounted for 35.7%.

Observing budget expenditures, in the period January-June 2017, 45.9% of the planned expenditures for 2017 were realized, which is largely due to the realization of the current costs (48% of the annual plan), while the realization of the capital expenditures is lower and equals 32.2% of the annual plan.

In the period January-June 2017, the Budget of the Republic of Macedonia registered a deficit of Denar 8,306 million,

**Financing of the budget balance**
(in millions of denars)

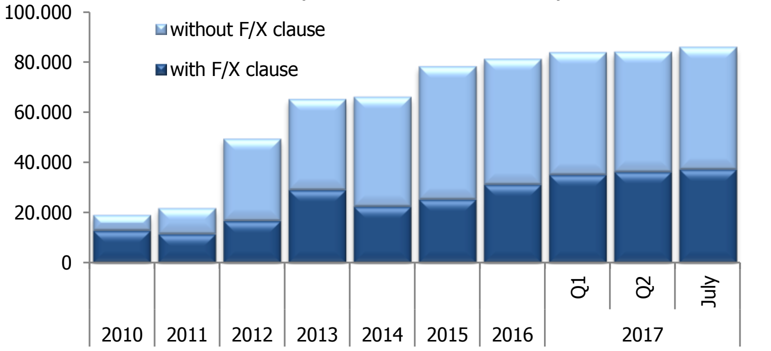



* Positive change- deposits withdrawal; negative change-deposits accumulation.
Source: MoF.

which is 1.3% of the nominal GDP[15]. The budget deficit in January-June 2017 accounts for 44.6% of that planned deficit for 2017 and

was financed by domestic sources, by withdrawing deposits from the government account with the National Bank and by net issue of new government securities.

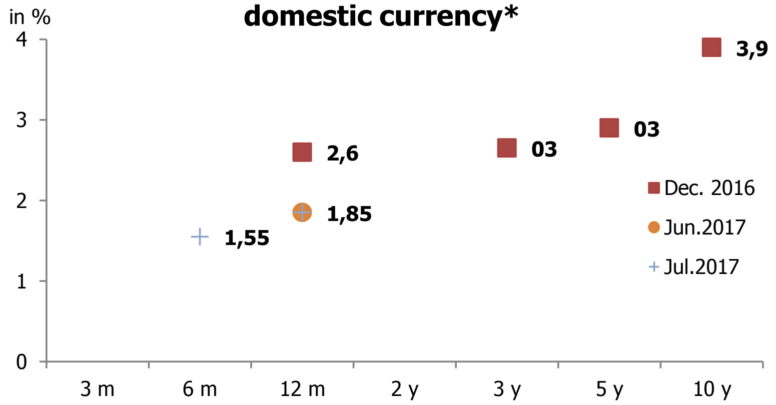
**Government securities**
(stocs, in millions of denars)




Source: NBRM.

The stock of the issued government securities on the domestic market at the end of July 2017 amounted to Denar 86,072 million. Compared to the previous quarter, the stock was higher by Denar 1,832 million, while in the period January - July 2017, government securities increased by Denar 4,702 million.

**Interest rates of government securities in domestic currency***

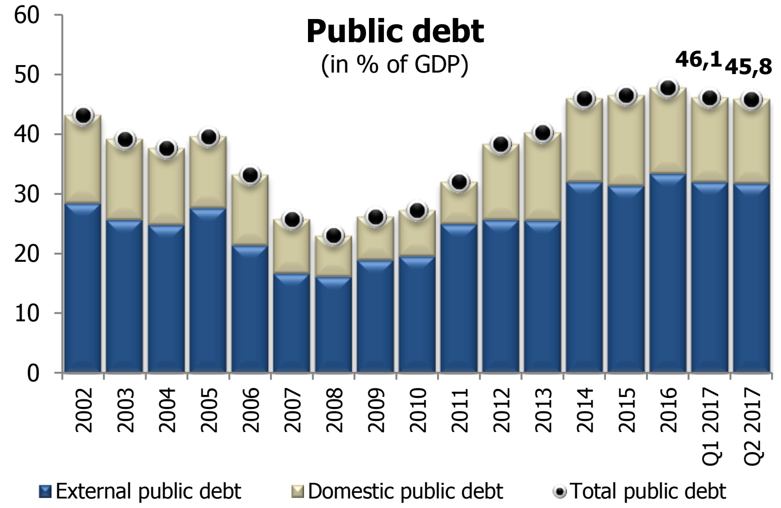



* interest rates for 3y and 5y government bonds are from auctions held in September 2015 and November 2014, respectively.
Source: Ministry of finance.

The interest rates on the issued government securities in July[16] 2017 remained unchanged compared to the previous month.

Compared with the end of the previous year, in July, the interest rates on 12-month treasury bills were lower by 0.75 percentage points.

[15] The analysis uses the NBRM April forecasts for the nominal GDP for 2017.
[16] At the auctions of government securities in July, there was an offer of 6-month treasury bills without FX clause, 6-month treasury bills with FX clause, 12-month treasury bills without FX clause and 15-year government bonds with FX clause.




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

At the end of the second quarter of 2017, total public debt[17] equaled 45.8% of GDP[18], which is a decrease of 0.3 percentage points compared to the previous quarter. The change is mostly due to the decrease in the external debt (from 31.9% to 31.7% of GDP), amid moderate decline in the internal debt (from 14.2% to 14.1% of GDP). The total government debt remained unchanged, while the public enterprises debt was lower by 0.3 percentage points of GDP, compared to the previous quarter.

[17] 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.
[18] The analysis uses the NBRM April forecasts for the nominal GDP for 2017.

**Budget Revision of the Republic of Macedonia for 2017**

The Budget Revision for 2017, which was adopted on 6 August, reduced the total budget revenues and expenditures by Denar 2,867 million and Denar 2,907 million, respectively. Thus, the budget deficit for 2017 amounted to Denar 18,567 million or 2.9% of GDP and registered no significant change from the initially planned deficit for 2017 (Denar 18,607 million). The revision of revenues reflects the downward correction of both tax revenues and the correction of non-tax and capital revenues. The decrease in expenditures is mostly due to the lower amount of capital expenditures, while current expenditures moderately increased, amid redistribution of funds from cost of goods and services to cost of social transfers. Changes have also been made in the sources of financing of the budget needs, amid an increase in the amount of debt financing (from both external and domestic sources), whereby the Revision envisages one part of the secured funds to be retained as a deposit on the account with the National Bank of the Republic of Macedonia.

in MKD million

| | Budget 2017 | Revised Budget 2017 | Revised Budget 2017/Budget 2017; difference |
|---|---|---|---|
| ***TOTAL REVENUES*** | **187.612** | **184.745** | **-2.867** |
| **Tax revenues and contributions** | **160.746** | **159.497** | **-1.249** |
| Taxes | 108.867 | 106.755 | -2.112 |
| Contributions | 51.879 | 52.742 | 863 |
| **Non-tax revenues** | **17.516** | **16.321** | **-1.195** |
| **Capital revenues** | **2.613** | **1.941** | **-672** |
| **Foreign donations** | **6.737** | **6.986** | **249** |
| ***TOTAL EXPENDITURES*** | **206.219** | **203.312** | **-2.907** |
| **Current expenditures** | **179.265** | **179.901** | **636** |
| Wages and allowances | 26.771 | 26.613 | -158 |
| Goods and services | 19.630 | 17.627 | -2.003 |
| Transfers to local goverment | 17.117 | 17.054 | -63 |
| Subsidies and transfers | 14.812 | 15.597 | 785 |
| Social transfers | 92.720 | 94.796 | 2.076 |
| Interest payments | 8.214 | 8.214 | 0 |
| **Capital expenditures** | **26.954** | **23.411** | **-3.543** |
| ***Budget balance*** | **-18.607** | **-18.567** | **40** |
| *Budget balance, % of GDP* | *-2,9* | *-2,9* | 0,01 |
| **Financing** | **18.607** | **18.567** | **-40** |
| **Inflows** | **37.133** | **36.920** | **-213** |
| Revenues based on privatisation | 0 | 0 | |
| Foreign loans | 17.634 | 23.535 | 5.901 |
| Deposits | 1.665 | -7.421 | -9.086 |
| T-bills | 17.824 | 20.806 | 2.982 |
| Sale of shares | 10 | 0 | |
| **Outflows** | **18.526** | **18.353** | **-173** |
| Principal repayments | 18.526 | 18.353 | -173 |
| External debt | 9.232 | 9.057 | -175 |
| Domestic debt | 9.294 | 9.296 | 2 |

Source: Ministry of Finance of Republic of Macedonia.

## 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 on 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[19], 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.

[19] 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).

**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 0.75% to 0.5% and on seven-day deposit facility from 1.25% to 1% 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.

**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, untill 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 current negative interest rates prevailing 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 Bazel 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 core and additional capital, **but the new Decision changes the structure of the core capital, which is divided into regular core capital and additional core capital.** The regular core 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 core capital, includes instruments which, among other things, contain a clause for their transformation into instruments of the regular core capital or for their write-off on temporary or permanent basis (reduction of 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 regular core capital, core capital and own funds,** i.e. 4.5% for the regular core capital, 6% for the core capital and 8% for the own funds of the risk-weighted assets. Thus, the greatest importance is given to the regular core capital positions (shares, reserves, retained undistributed profit), as capital positions with the highest quality.

**January 2017**

- At the regular meeting of the NBRM's Operational Monetary Policy Committee, held on 10 January 2017, the 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 the regular meeting of the NBRM's Operational Monetary Policy Committee, held on 14 February 2017, the 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:
- The Decision on the Methodology for Identifying Systemically Important Banks, 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.
- The Decision on the Methodology for Determining the Rate of Countercyclical Capital Buffer for Exposure 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.
- The Decision on the Methodology for Determining the Maximum Distributable Amount, 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. core equity tier 1 capital.
- The Decision on the Methodology for Managing Leverage Risk, 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 the regular meeting of the NBRM's Operational Monetary Policy Committee, held on 14 March 2017, the Committee decided to increase the supply of CB bills from Denar 25,000 million to Denar 30,000 million.

**July 2017**

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