National Bank of the Republic of Macedonia

MONETARY POLICY AND RESEARCH DEPARTMENT

Recent Macroeconomic Indicators
Review of the Current Situation

October 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 (April–September 2017) and to make a comparison with the latest macroeconomic forecasts (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.

In the period since April, economic indicators continued to indicate a continuous increase in global economic activity, which led to increased optimism regarding the global growth forecasts. However, the negative risks surrounding the global growth in the next period are still present, and they particularly refer to the possible increased protectionism worldwide, the uncertainty around the possible effects of Brexit, the effects of the normalization of the monetary policy of the central banks in the developed countries, the possible financial market volatility, as well as the increased geopolitical risks. Regarding the performance of the economy of the euro area, after the annual growth of the real GDP of 2.3% in the second quarter, the high frequency data and the surveys on the economic sentiment of both economies and households indicate further solid growth in the third quarter, amid expectations for favorable developments in all sectors of the economy. The positive trends in the real economy are accompanied by further improvement of the labor market conditions. The unemployment rate continued to gradually decline, and reduced to 9.1% in the period July-August, compared to 9.2% in the second quarter. According to the latest data, the annual inflation rate in September remained at the level of August (of 1.5%). However, different movements were registered within the individual components, whereby food prices registered faster growth (of 1.9%), while energy and core inflation showed a minimal slowdown compared to the previous month, amounting to 3.9% and 1.1%, respectively. Considering the latest macroeconomic performances and forecasts, economic analysts expect that the ECB, in October, will make a decision to gradually reduce the purchase of assets during 2018, but to emphasize that it will maintain the policy of low interest rates even after the end of the quantitative easing program. Hence, in 2017 and 2018, **EURIBOR** is expected to follow a similar upward path as in the April forecasts, and will continue to be maintained in the negative zone throughout the entire forecast horizon.

Observed from a viewpoint of the individual quantitative external environment indicators of the Macedonian economy, the forecasts regarding the foreign effective demand in 2017 and 2018 have been revised upwards in comparison with the April expectations. In contrast, the **foreign effective inflation** has been corrected downwards throughout the entire forecast horizon. According to the new estimates for the **euro / US dollar exchange rate**, the US dollar is expected to register significantly lower value compared to the April forecasts, especially in 2017. **Regarding the prices of primary commodities on the world markets, the comparison with April generally indicates lower growth rates of prices in 2017, in contrast to 2018, when the revisions are mostly upward.** In 2017, the **world oil prices** are expected to register lower growth in comparison with the April estimate, while in 2018, oil price is now expected to be stable, in contrast to the April forecast for its decline. Regarding the **metal prices**, the latest estimations indicate lower growth rates of nickel and copper prices in 2017, with estimates for improvement of the global market situation in 2018, when these metals are expected to achieve significantly higher price growth than the April forecasts. Regarding the **world prices of the primary food products**, in 2017, the revisions are in different direction, with estimates for slightly higher growth of the wheat price and decline, instead of growth, in the corn price. On the other hand, in 2018, the prices of these food products are expected to be lower compared to April, which would result in lower import pressures on the domestic inflation. 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 forecast dynamics within the April forecasting round indicates certain deviations in the individual segments of the economy. According to the estimated **GDP** data, the economic activity registers a decline in the first half of the year, contrary to the expectations for growth according to the April forecast. Deviations are recorded in all expenditure components, and the highest contribution is made by gross capital formation where the decrease is significantly deeper than the expectations. The available high frequency data for the third quarter indicate divergent movements which reduces the accuracy of the assessment of the situation in the economy in the third quarter of the year. In summary, the downward deviation in the first half of the year indicates the need for a downward adjustment of the economic growth forecast for the entire 2017. When it comes to **changes in consumer prices**, in September, positive inflation rate was measured, which is minimally higher than forecasted. However, seen cumulatively, the inflation rate registered in the first nine months of the year is in line with the April forecast. In circumstances of performances within the forecast, the risks with regard to the inflation forecast for 2017 remain mainly associated with the uncertainty about the expected movement in prices of primary commodities.

Recent foreign reserves data as of the end of September (adjusted for the effects of price and exchange rate differentials and price changes of securities) indicate decrease in the foreign reserves in the third quarter. Observing 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], while the NBRM interventions on the foreign exchange market acted in the opposite direction. The latest available data on net purchase from currency exchange operations as of September point to somewhat better realization in private transfers. 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 August show growth of total deposits with banks (of 1.4%) on a monthly basis, which follows after the decrease in the previous month (of 0.1%). Analyzed by sector, the growth of deposits in August was mostly due to increased corporate deposits, amid simultaneous moderate growth of household deposits. Analyzing the currency structure, the increase in total deposits stems from denar deposits, which, in contrast to the previous month, in August made a positive contribution to the monthly growth of total deposits, and the contribution of foreign currency deposits is also positive and moderately higher compared to the previous month. On an annual basis, total deposits in August grew by 6.1%, which is below the forecasted growth of 7.9% for the third quarter of 2017, according to the April forecast. This deviation is mainly the result of the lower performance of total deposits in the second quarter, compared to the expectations with the April forecast. Analyzing the credit market, in August, total loans registered monthly growth of 0.2%, which was slightly lower compared to the growth in the previous month (of 0.3%). The monthly increase in the total lending is still entirely driven by the higher performances in households, amid small decline in corporate loans. On an annual basis, total loans in August grew by 5.1%, which is higher than forecasted for the third quarter (by 4.8%), which reflects the improved performance at the end of the second quarter.

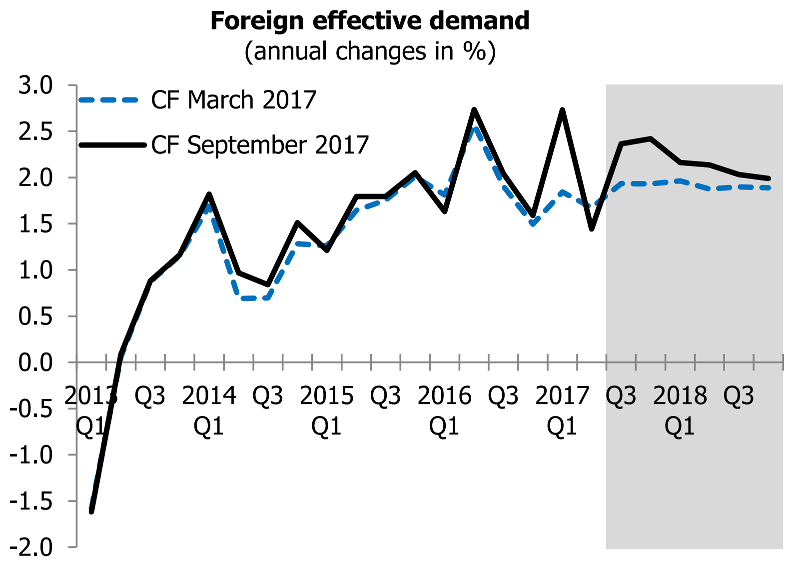
In the period January-August 2017, the Budget of the Republic of Macedonia registered a deficit of Denar 10,786 million, financed from domestic sources through withdrawal of deposits from the government account with the National Bank and with net issue of new government securities on the domestic market. The budget deficit constitutes 58.1% of the envisaged deficit in the Budget Revision for 2017.

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

The latest macroeconomic indicators and assessments indicate certain deviations compared to the forecast dynamics in individual segments in the economy, but the perceptions about the environment for conducting monetary policy and about the risks highlighted in the April forecasts are mainly unchanged. Foreign reserves (adjusted for price and exchange rate differentials and price changes of securities) decreased in the third quarter. However, foreign reserves adequacy indicators continue to hover in the safe zone. In terms of economic activity, the lower starting point, as a result of the downward deviation in the first half of the year, indicates a need for revision of the economic growth rate for the entire 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 2017. Within the monetary sector, the balance of total deposits and loans, as of August, gives indications of downward deviations from the forecast for the third quarter.

Selected economic indicators/1	2016					2017								
	Q1	Q2	Q3	Q4	2016	Q1	Apr.	May	Jun.	Q2	Jul.	Aug	Sep	Q3
I. Real sector indicators														
Gross domestic product (real growth rate, y-o-y) /2	**2.4**	**2.9**	**2.0**	**2.4**	**2.4**	**0.0**				**-1.8**				
Industrial production /3														
y-o-y	10.7	1.3	5.0	-1.8	3.4	-1.5	-1.9	9.2		3.7	-2.2	-5.3		
cumulative average	10.7	5.6	5.4	3.4	3.4	-1.5	-1.6	0.6		1.2	0.7	-0.1		
Inflation /4														
CPI Inflation (y-o-y) /5	-0.1	-0.7	-0.2	-0.1	-0.2	0.5	1.0	1.2	1.5	1.2	1.2	1.9	1.7	1.6
CPI Inflation (cumulative average)	-0.1	-0.4	-0.3	-0.2	-0.2	0.5	0.6	0.7	0.9	0.9	0.9	1.0	1.1	1.1
Core inflation (cumulative average)	1.6	1.4	1.3	1.3	1.3	1.6	1.7	1.8	1.9	1.9	1.9	2.1	2.1	2.1
Core inflation (y-o-y)	1.6	1.3	1.1	1.1	1.3	1.6	2.0	2.1	2.4	2.2	2.3	3.0	2.7	2.7
Labor force														
Unemployment rate	24.5	24.0	23.4	23.1	23.7	22.9				22.6				
II. Fiscal Indicators (Central Budget and Budgets of Funds)														
Total budget revenues	40,583	41,422	43,807	43,524	169,336	42,734	15,053	15,356	13,225	43,634	15,173			
Total budget expenditures	46,218	42,729	45,953	50,506	185,406	46,301	15,082	17,089	16,206	48,377	17,567			
Overall balance (cash)	-5,635	-1,307	-2,146	-6,982	-16,070	-3,567	-29	-1,733	-2,981	-4,743	-2,394			
Overall balance (in % of GDP)/1	-0.9	-0.2	-0.4	-1.1	-2.6	-0.6	0.0	-0.3	-0.5	-0.7	-0.4			
III. Financial indicators /6														
Broad money (M4), y-o-y growth rate	**6.2**	**2.5**	**4.0**	**6.1**	**6.1**	**4.2**	**5.9**	**6.4**	**7.8**	**7.8**	**7.4**	**6.5**		
Total credits, y-o-y growth rate	**8.4**	**3.5**	**2.5**	**0.9**	**0.9**	**0.0**	**0.6**	**1.5**	**4.4**	**4.4**	**4.9**	**5.1**		
Total credits - households	13.0	8.8	7.3	7.0	7.0	6.6	6.5	6.7	9.5	9.5	9.8	10.0		
Total credits - enterprises	5.1	-0.5	-1.2	-3.8	-3.8	-5.2	-4.2	-2.8	0.0	0.0	0.8	1.0		
Total deposits (incl. demand deposits), y-o-y growth rate	**6.2**	**2.3**	**4.0**	**5.7**	**5.7**	**4.2**	**6.3**	**6.4**	**7.6**	**7.6**	**7.3**	**6.1**		
Total deposits - households	3.1	0.2	1.2	2.5	2.5	1.8	3.4	5.5	6.5	6.5	5.4	5.7		
Total deposits - enterprises	16.0	5.6	11.3	13.4	13.4	8.8	12.0	7.9	10.8	10.8	11.4	6.2		
Interest rates /7														
Interst rates of CBBills	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)	6.7	6.6	6.6	6.5	6.6	6.4	6.3	6.3	6.2	6.3	6.2	6.2		
f/x rates	5.6	5.5	5.4	5.2	5.4	5.1	5.0	5.0	5.0	5.0	4.9	4.9		
Deposit rates														
denar rates (aggregated, incl. denar and denar with f/x clause)	2.5	2.5	2.5	2.5	2.5	2.3	2.2	2.2	2.2	2.2	2.1	2.1		
f/x rates	1.1	1.1	1.0	1.0	1.0	0.9	0.9	0.9	0.8	0.9	0.8	0.8		
IV. External sector indicators														
Current account balance (millions of EUR)	**-48.2**	**-209.4**	**108.1**	**-115.5**	**-265.0**	**-125.7**	**-30.3**	**-48.3**	**-14.0**	**-92.6**				
Current account balance (% of GDP)	-0.5	-2.2	1.1	-1.2	-2.7	-1.2	-0.3	-0.5	-0.1	-0.9				
Trade balance (millions of EUR)/8	**-373.2**	**-501.5**	**-391.4**	**-511.3**	**-1777.4**	**-421.8**	**-152.9**	**-178.1**	**-101.2**	**-432.2**	**-133.7**	**-149.2**		
Trade balance (% og GDP)	-3.8	-5.1	-4.0	-5.2	-18.0	-4.1	-1.5	-1.7	-1.0	-4.2	-1.3	-1.5		
import (millions of EUR)	-1356.6	-1557.7	-1540.0	-1652.4	-6106.7	-1559.7	-550.9	-609.1	-534.2	-1694.1	-546.7	-528.3		
export (millions of EUR)	983.3	1056.2	1148.6	1141.1	4329.3	1137.9	398.0	430.9	433.0	1261.9	413.0	379.1		
rate of growth of import (y-o-y)	3.3	4.9	10.2	3.0	5.3	15.0	4.1	14.7	7.4	8.8	5.8	3.7		
rate of growth of export (y-o-y)	5.3	1.4	10.5	6.4	5.9	15.7	8.0	21.2	30.3	19.5	2.2	7.2		
Foreign Direct Investment (millions of EUR)	**129.3**	**41.4**	**20.1**	**126.1**	**316.9**	**111.5**	**31.6**	**16.1**	**-62.5**	**-14.8**				
External debt														
Gross external debt (in milllions of EUR)	6813.1	6861.2	7488.7	7216.6	7216.6	7791.4				7781.3				
public sector	3279.1	3282.8	3890.9	3445.3	3445.3	3819.9				3740.9				
public sector/GDP (in %)	33.7	33.8	40.0	35.4	34.9	37.2				36.4				
private sector	3534.0	3578.4	3597.8	3771.2	3771.2	3971.6				4040.4				
Gross external debt/GDP (in %)	70.1	70.6	77.0	74.2	73.5	75.8				75.7				
Gross official reserves (millions of EUR)/9							**2,496.0**	**2,448.5**	**2,399.9**		**2,273.3**	**2,275**	**2,271**	

/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.



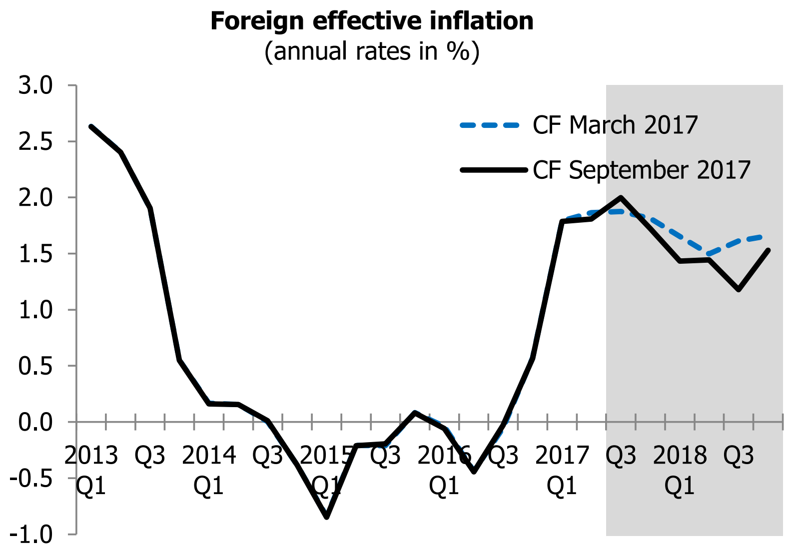
Source: "Consensus Forecast" and NBRM calculations.

Compared with the April round of forecasts, the foreign effective demand in 2017 has been revised upward...

...whereby its growth is expected to amount to 2.2%, which is by 0.4 percentage points higher than the April forecast...

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

Foreign demand has been slightly revised upwards for 2018, whereby the growth is expected to amount to 2.1% (1.9% in April).



Source: "Consensus Forecast" and NBRM calculations.

The expectations about the foreign effective inflation for 2017 have been revised downwards...

...so that an inflation rate of 1.8%, versus 1.9% in April is expected...

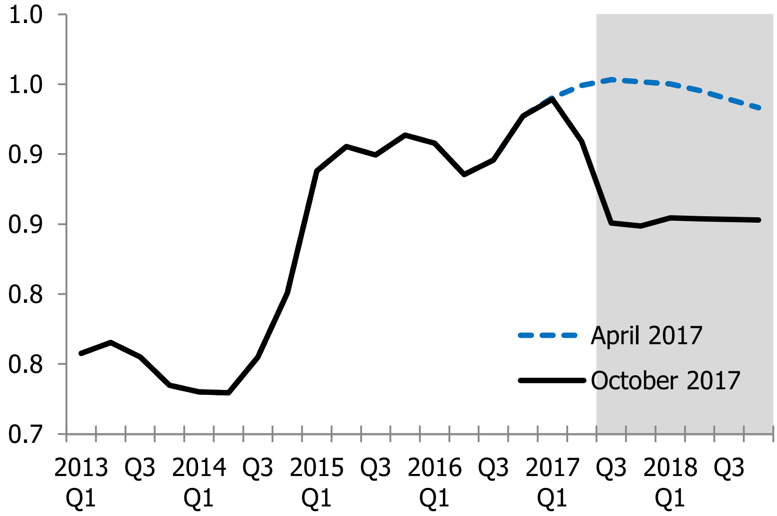
...amid expectations for slower price growth in Germany.

Downward revision was made in 2018 as well, when it is expected that the foreign inflation will equal 1.4% (1.6% in April)...

...largely as a result of the expectations for lower price growth in Serbia[2].

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

EUR/USD exchange rate



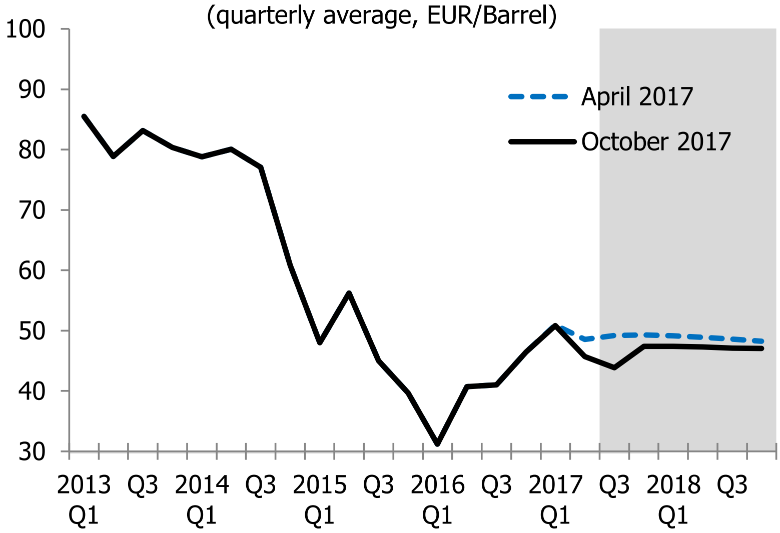
Source: "Consensus Forecast" and NBRM calculations.

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...

...whereby depreciation of the value of the US dollar against the euro is expected for 2017, despite previous expectations for its significant appreciation, while for 2018, a significantly greater depreciation is expected compared to the April forecasts...

...which is largely due to the reduced political risks and more favorable economic performance than expected in the euro area, contrary to the further internal political uncertainty and external political tensions of the United States[3].

Brent oil
(quarterly average, EUR/Barrel)



Source: IMF, World Bank and NBRM calculations.

The latest estimates for oil price for 2017 made an upward revision of prices denominated in US dollars, while prices denominated in euros were revised downwards compared to forecasted in April...

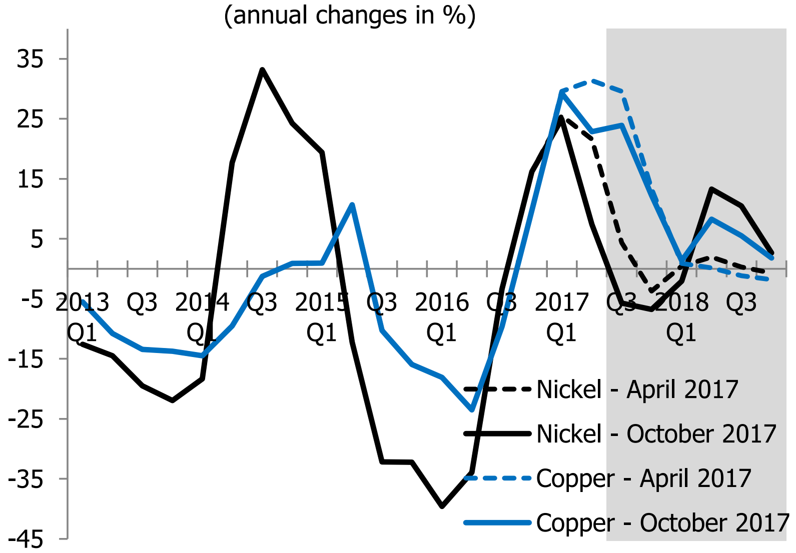
...which is the result of the exchange rate effect, i.e. the expectations for depreciation of the US dollar against the euro.

On the other hand, upward correction for 2018 was made...

...now expecting similar price level of oil as in 2017, in contrast to the previously forecasted slight fall in prices in April.

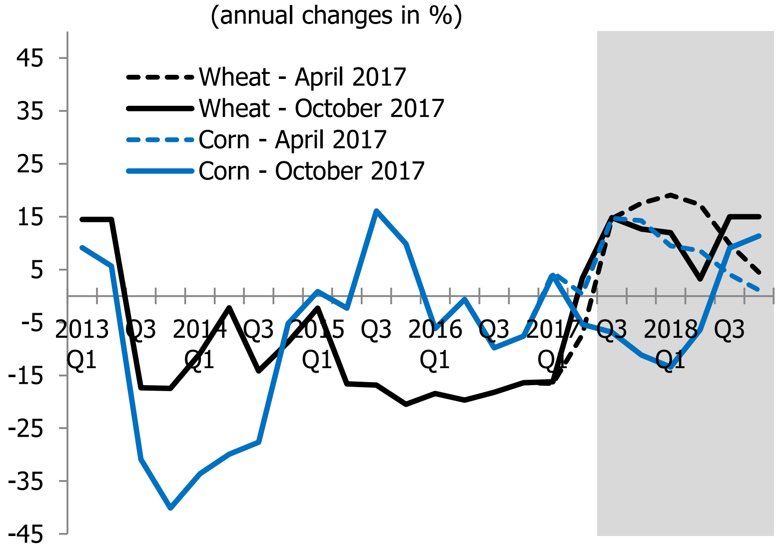
[3] Tense political relations between the United States and North Korea.

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



Source: IMF, World Bank and NBRM calculations.

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



Source: IMF, World Bank and NBRM calculations.

In 2017, metal prices denominated in US dollars have been revised upwards, while prices denominated in euros have been revised downwards compared to forecasted in April...

...which is due to changes in the exchange rate, i.e. the expectations for depreciation of the US dollar against the euro.

Forecasts of metal prices for 2018 have been considerably revised upwards...

...now expecting their solid growth, contrary to expectations for price stabilization in the April forecasts.

The expectations for the stock exchange prices of wheat[4] for 2017 have been revised upwards, while the expectations for the price of corn have been considerably revised downwards...

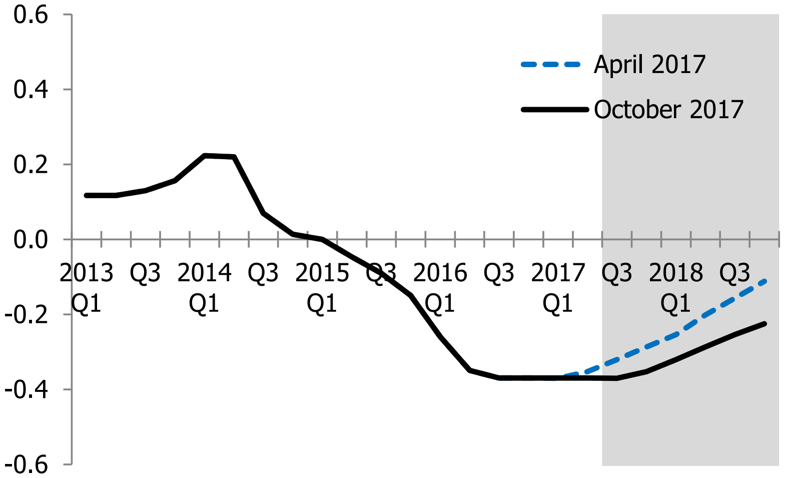
...and now, there are expectations for slightly faster growth of the price of wheat and a decline, rather than increase, in the price of corn...

...which is largely the result of the expectations for a reduced level of wheat production in Australia and the expectations for an increased level of corn production in the United States.

For 2018, the prices of food products have been revised downwards, now expecting slower growth of the price of wheat and a minimal decline in the price of corn.

[4] 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 in the comparison of the two forecasts, the series of data released by the World Bank is used.

1-month Euribor
(quarterly average, in %)



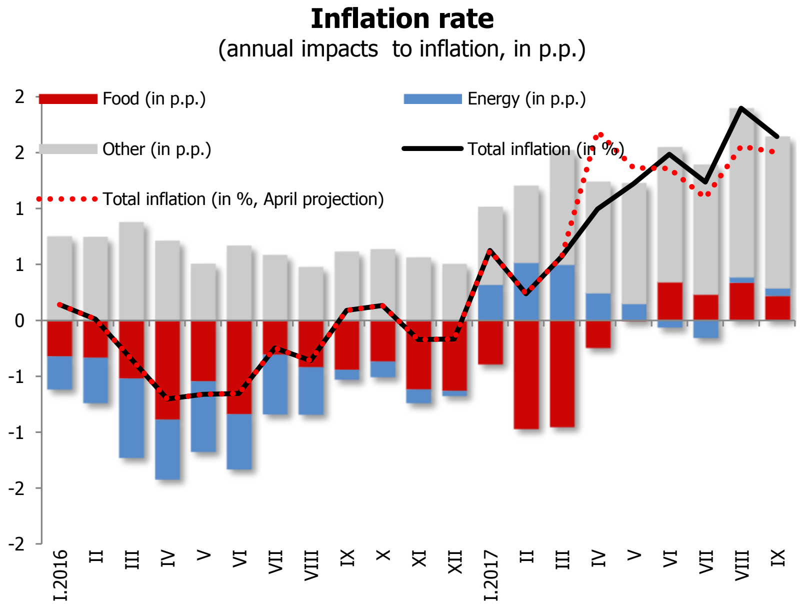
Source: "Consensus Forecast" and NBRM calculations.

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

...whereby similar average level of -0.37% (-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, downward revision of the average one-month Euribor to -0.27%, versus the forecasted -0.18% in April was made...

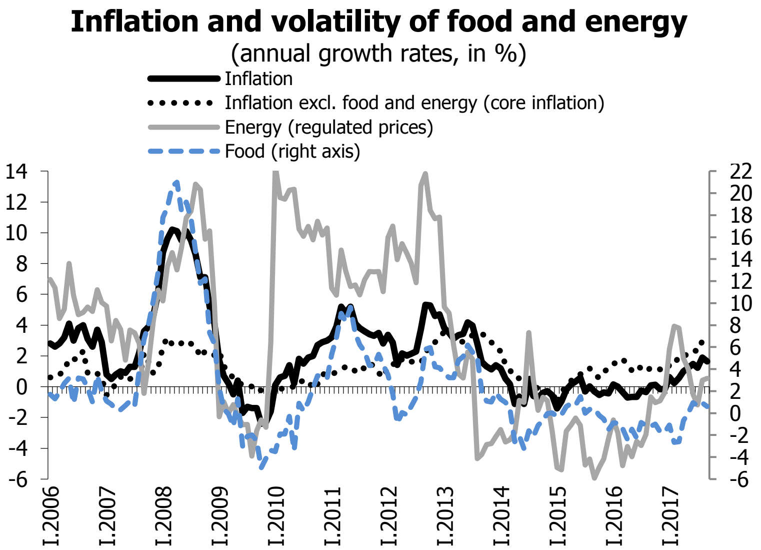
...amid expectations for gradual reduction in the volume of quantitative easing by the ECB after December 2017, but maintaining the current stimulating interest rate policy.



Source: SSO and NBRM.

In September 2017, domestic consumer prices registered no changes on a monthly basis[5] (versus the monthly increase of 0.4% in August)...

...as a result of the lower core inflation rate (for the first time since the beginning of the year), in conditions of unchanged food prices and growth of energy prices.



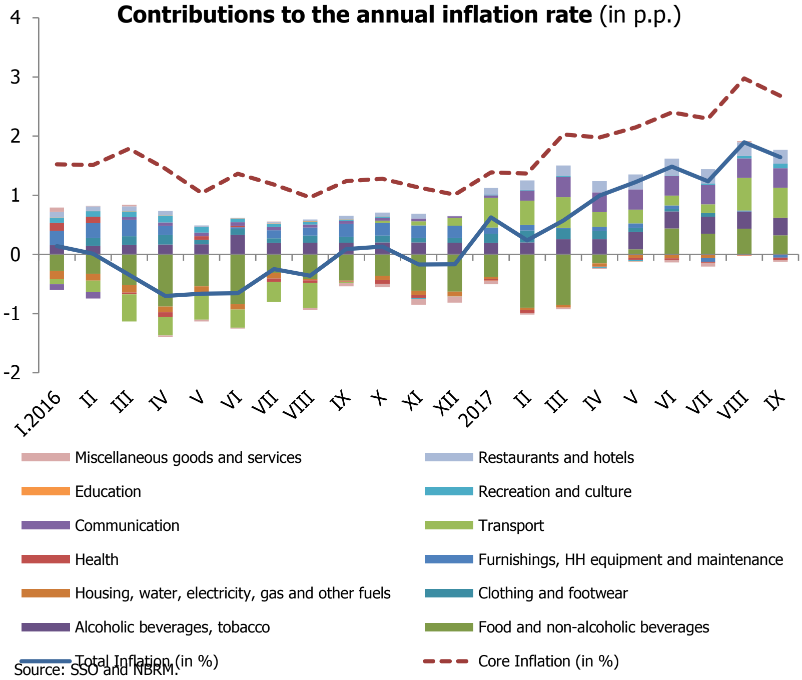
Source: State statistical office and NBRM calculations.

The annual inflation rate in September amounted to 1.7% (versus 1.9% in August), which is minimally higher than the expected movement for September, compared to the April round of forecasts.

Observed by price category, the upward deviation is present in food prices and core inflation, while in energy, the deviation is downward.

Analyzed cumulatively, the inflation rate registered in the first nine months is in line with the April forecast.

[5] Observed by group of products, the fruits and large part of the services (catering services, "electrical personal hygiene appliances and other appliances, personal hygiene products" category, hospital service and air transport) registered the highest negative contribution in September, while the prices of gas, liquid fuels, information equipment and transport prices acted in the opposite direction.



Source: SSO and NBRM.

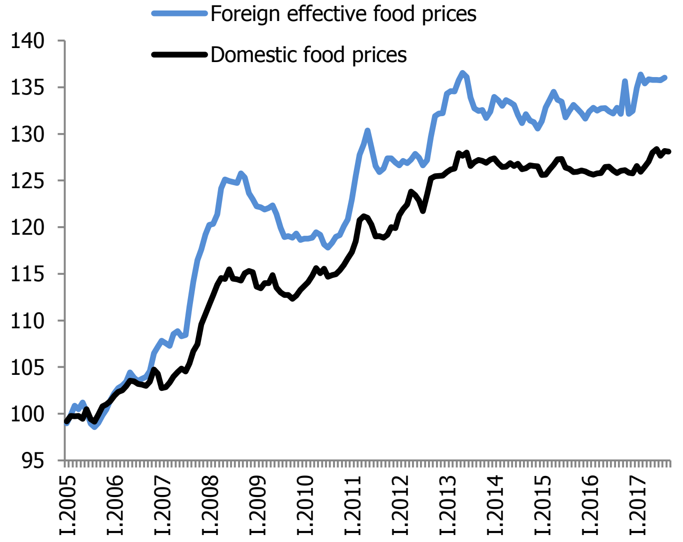
For the first time since the beginning of the year, core inflation decreased in September, whereby the fall amounted to 0.3% on a monthly basis (growth of 0.6% in August), which led to a slowdown in the annual growth of 2.7% (3% in August).

This monthly movement is the result of the decline or the slower growth in most categories within core inflation.

Regarding the structure of core inflation, the September annual growth is dominated by the same categories as last month, i.e. the growth is driven by the prices of air transport, tobacco[6], communications and catering services.

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.

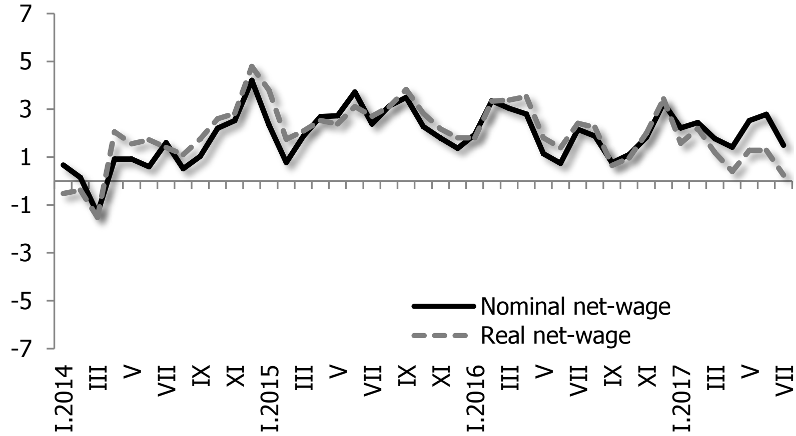
Input assumptions related to the movements of the external prices in 2017 have been revised downwards.

Thus, the latest oil and wheat price estimates for 2017 indicate lower growth compared to the expectations in the April round of forecasts, while the corn price is expected to register a decline rather than increase with the April round of forecasts.

Given that the performances in domestic prices as of September are in line with the forecast, the risks with regard to the inflation forecast for 2017 remain mainly associated with the uncertainty about the expected movement in prices of primary commodities.

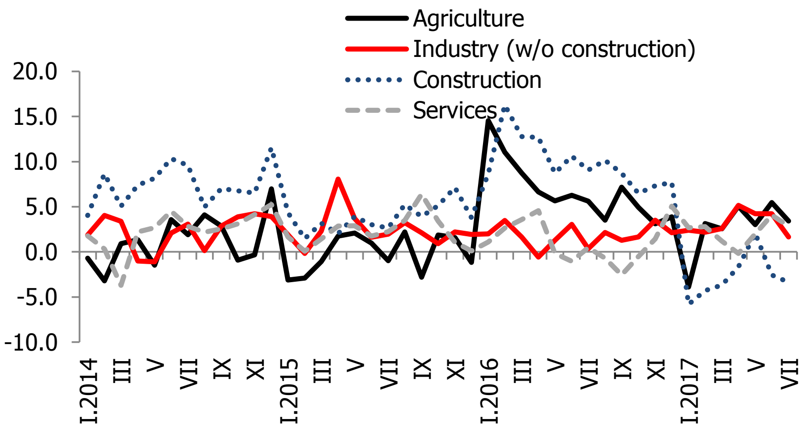
[6] The annual growth of tobacco prices in September is a combination of the increase in the price of a certain type of cigarettes in April and June 2017. In July 2017, the cigarette excise increased (from 1 July 2017 to 1 July 2023 the excise duty will increase by 0.20 denars/piece each year) which 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 July 2017, the average net wage registered a nominal annual growth of 1.5%,which is a deceleration in the growth of 1.3 percentage points compared to the growth last month. The highest contribution to the deceleration in the growth of the nominal net wages was made by several activities where in July, there was a fall in wages: construction, electricity, gas, steam and air-conditioning, water supply, water waste removal, waste management and environment and in health and social work.

Upward movement in wages was registered in most activities, with highest growth in professional, scientific and technical activities, mining and quarrying and information and communication.

Amid increase in the consumer prices in July, the **real wages increased by 0.3%.**

The realization in net wages at the beginning of the third quarter of the year is lower than expected for the quarter in the April forecast.

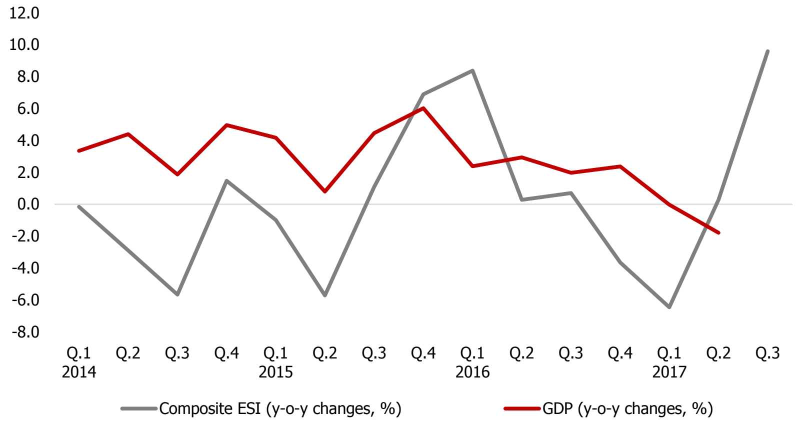
The available high frequency data on the shifts on the supply and demand side during the third quarter indicate divergent movements.

The results obtained from the surveys that measure the perceptions of economic agents for the situation in the economy[7] show a significant strengthening of the economic agents' confidence in the third quarter.

In the period July-August, the **industrial output** registered a decrease, amid lower production in the manufacturing industry and mining and increase in production in the energy sector.

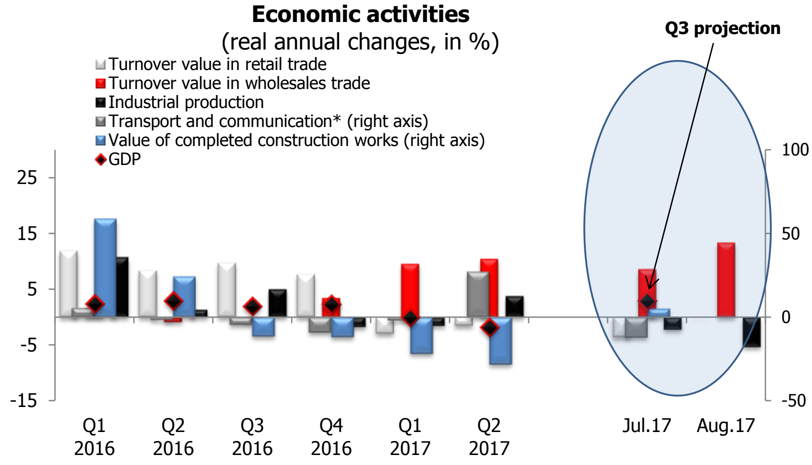
[7] It refers to the surveys conducted by the European Commission to measure the economic confidence of entities in an economy. The composite indicator of economic confidence is obtained as a weighted average from the confidence indicators for consumers and confidence indicators for individual economic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

Economic sentiment indicator and GDP



Source: State statistical office and European commission.

Economic activities
(real annual changes, in %)



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

Considering the individual activities within the manufacturing industry, decline in production was registered in most activities, while the highest negative contribution accounts for clothing and metal production. The unfavorable movements were somewhat mitigated by the growth recorded in production of beverages, textile, basic pharmaceutical products, electrical equipment and in production of non-metallic minerals.

In July, there are also unfavorable movements in the **rail traffic**.

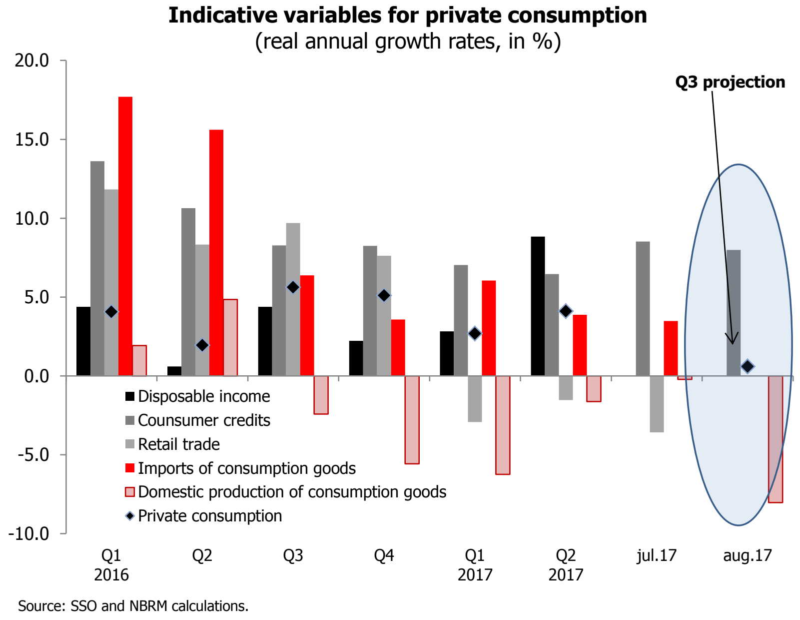
On the other hand, data on other economic sectors indicate a potential improvement of the situation. Thus, after the seven-month fall, at the beginning of the third quarter, **construction** registers an increase which is mainly explained by the increase in the high-rise buildings, but at the same time the civil engineering also registers an increase.

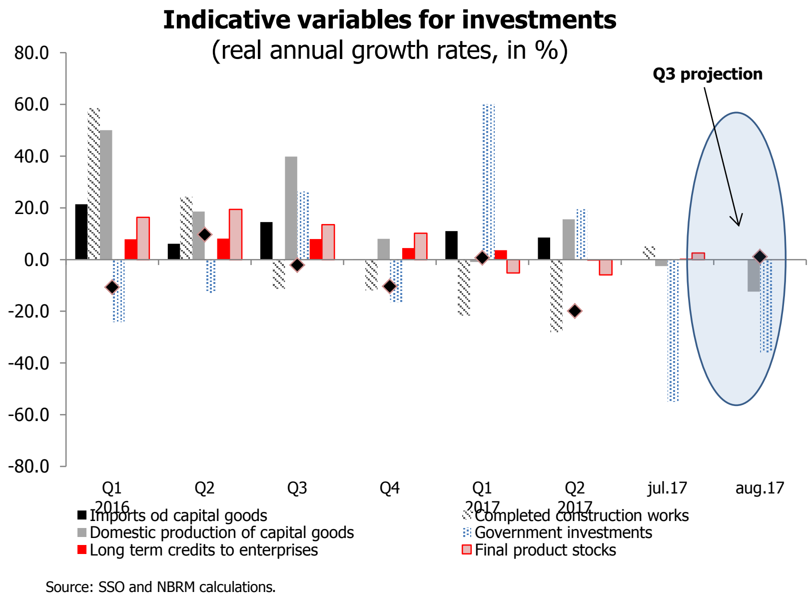
In the period July-August, the growth in the **total trade** continued, mainly as a reflection of the growth of the turnover in wholesale trade. Improvement has also been registered in retail trade, where, despite the negative movement seen cumulatively for the first two months of the quarter, in August, the turnover value registered an increase.

The growing number of tourists, overnight stays and turnover in the catering services in July indicates continuation of the favorable movements in this sector during the third quarter.

The performance of high frequency data on the **aggregate demand** side in July and August also indicate divergent movements.

Indicators of the movements in **private consumption** are mainly favorable, in





conditions of growth in household lending and favorable movements in part of the disposable income components (pensions and social transfers from the Government).

On the other hand, cumulatively in the first two months of the quarter, the turnover value in retail trade declined, while domestic production of consumer goods also registered a decline.

The movements in the available short-term indicators of **investment activity** in the third quarter are in divergent directions...

...amid lower government capital investments and domestic production of capital goods...

...and stagnation of the import of investment products in July.

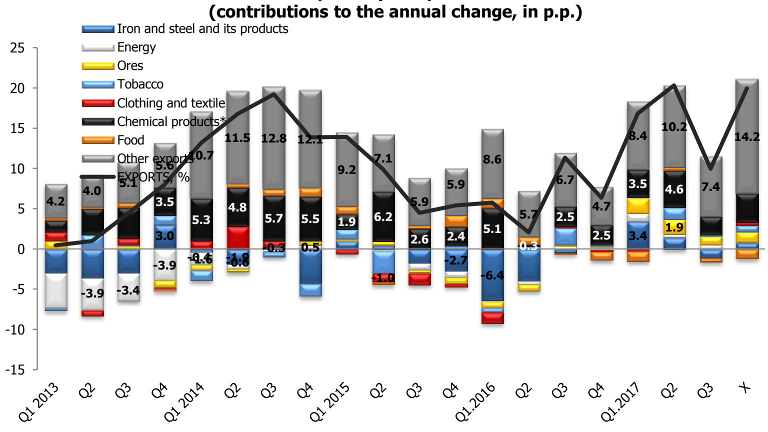
On the other hand, after several months of decline, construction activity increased in July, and the long-term lending to the corporate sector[8] also grew (although at a significantly slower pace).

The data on **foreign trade** show widening of the trade deficit in the first two months of the third quarter of 2017, amid a simultaneous nominal growth of both export and import of goods.

According to the July and August fiscal budget data, **public consumption** registers a decline, amid a decrease in the expenditures on salaries in the public sector, lower expenditures on goods and services and health care transfers[9].

[8] It refers to the average performance for July and August.
[9] Most of these assets relate to expenditures on goods and services.

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



Source: NBRM.

In July and August 2017, the foreign trade deficit increased by 5.4% on an annual basis, amid a slightly more intensive increase in the import than the export component.

In July and August, the **export** of goods registered an increase of 4.6%, primarily as a result of the increase in the export from the new export-oriented industrial facilities, as well as the export of ore and energy. On the other hand, the export from the traditional sectors (metal processing industry, clothing and textile and tobacco) registered a moderate decrease.

Compared with the April forecast, the export in July and August is lower than expected for the third quarter, primarily as a result of the lower export from one important industrial facility, as well as the small downward deviations in the export of iron and steel, clothing and food...

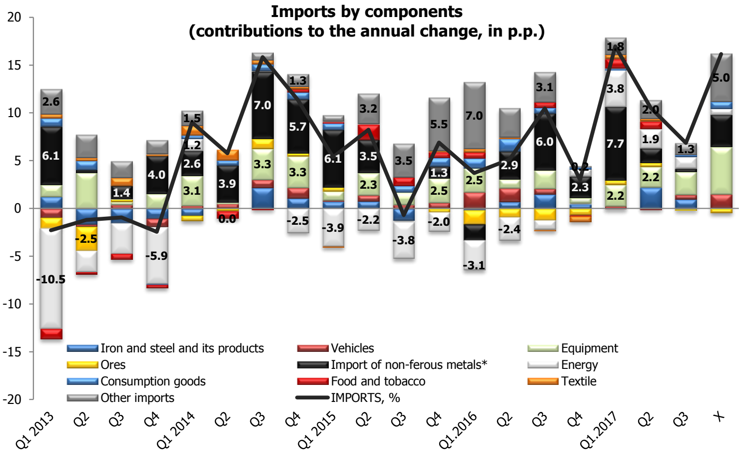
.... with positive deviations in the new export facilities.

Import of goods in July and August 2017 increased by 4.8% on an annual basis, reflecting the increase in the import in most components.

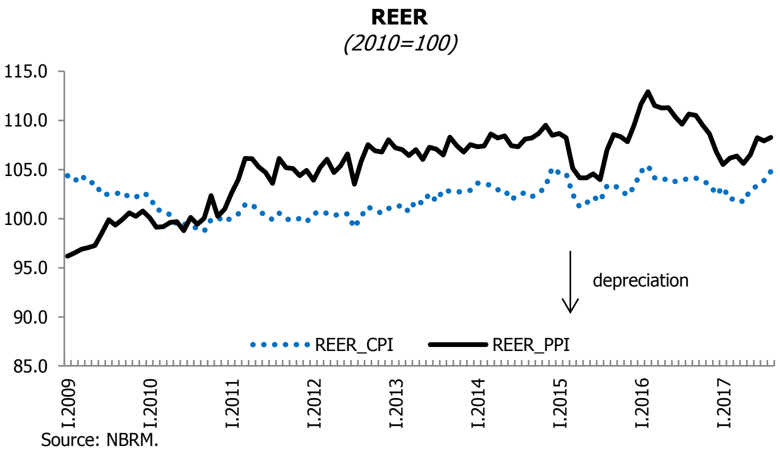
Imports of goods in July and August 2017 were lower than expected for the third quarter with the April forecast, amid downward deviations in one important industrial facility, as well as energy imports. Other components are within the April forecast.

The performances of the foreign trade components indicate a likelihood the trade deficit to be as forecasted for the third quarter of 2017, according to the April forecast.

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

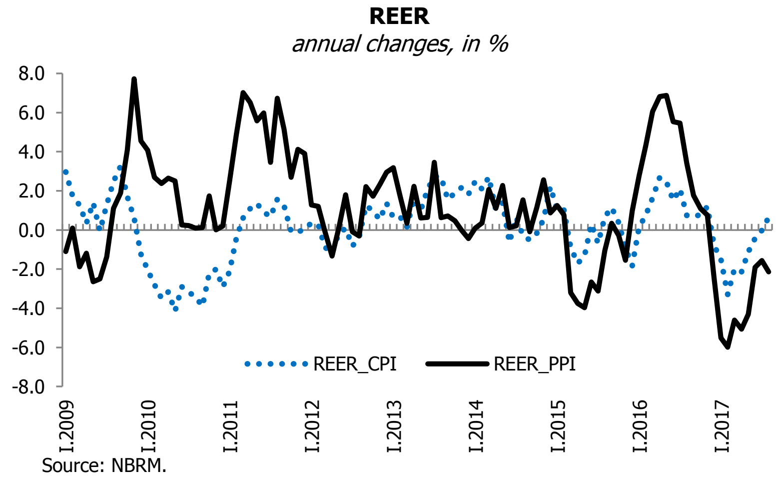


Source: NBRM.

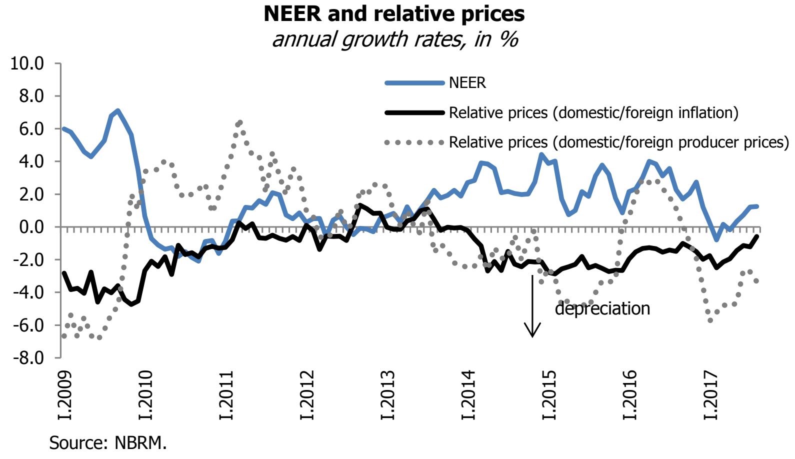


Source: NBRM.

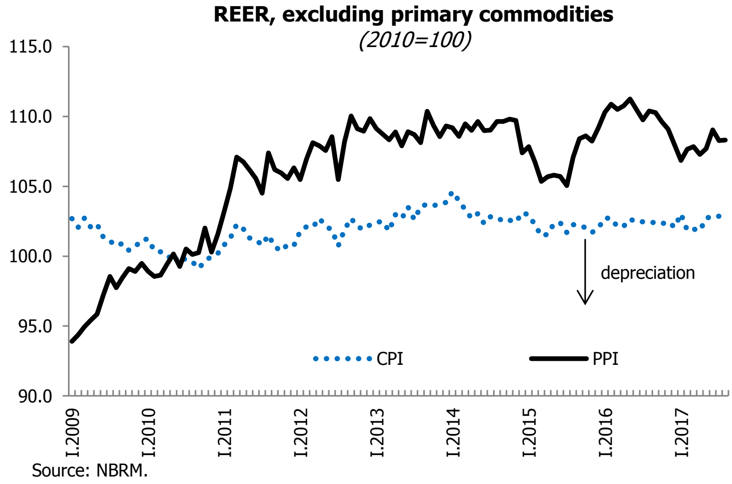
In August 2017, **price competitiveness indicators of the domestic economy registered divergent movements. Namely,** the REER index deflated by consumer prices registered a moderate appreciation of 0.7%, while the REER index deflated by producer prices depreciated by 2.1%.



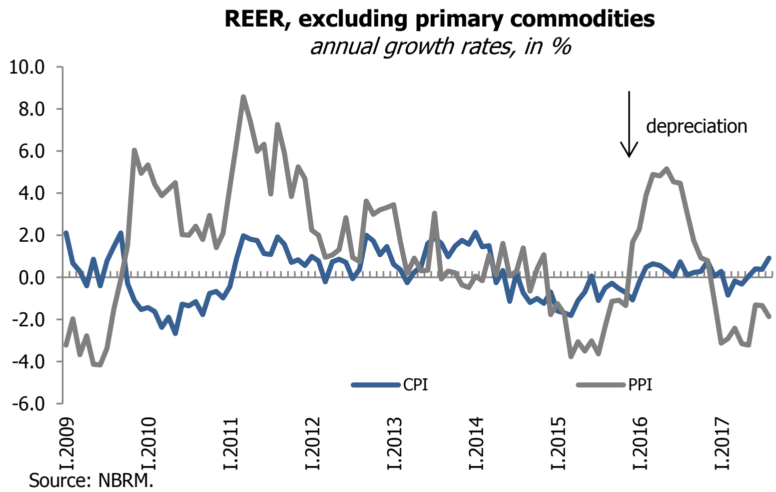
Source: NBRM.



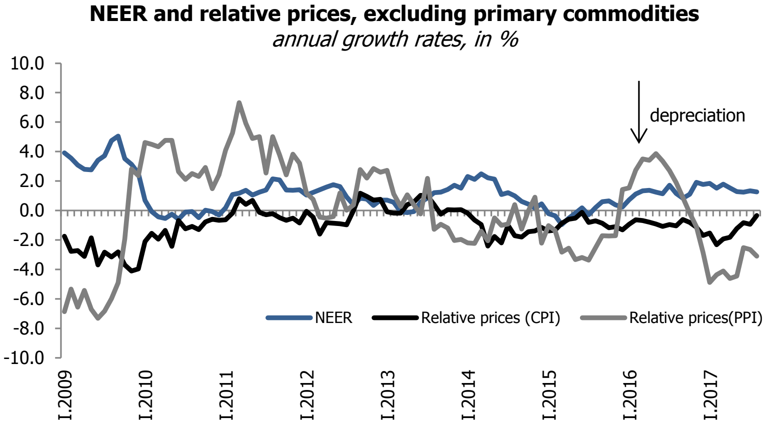
These developments are due to favorable movements in relative prices, and the relative prices of industrial products decreased by 3.3%, while the relative cost of living registered a moderate decrease of 0.6%. The NEER acted in the opposite direction, recording a moderate appreciation of 1.2% on an annual basis, mostly as a result of the depreciation of the Turkish lira, the Ukrainian hryvnia, the US dollar and the Swiss franc.



In August 2017, the analysis of **REER indices, as measured using weights based on the foreign trade without primary commodities**[10], 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 1.9%.



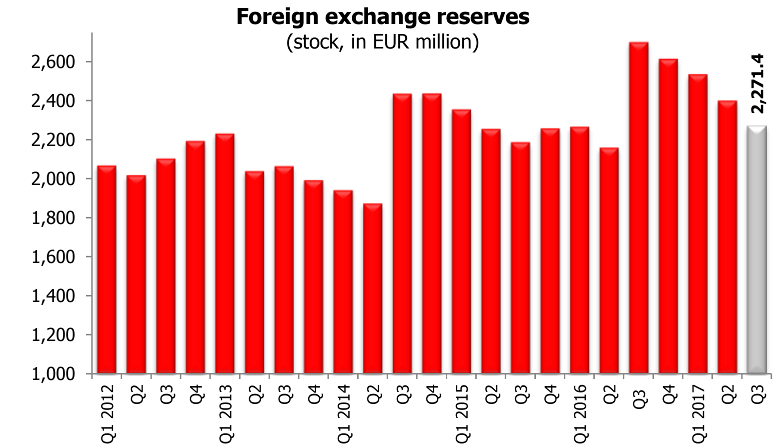
[10] Primary commodities not included in the calculation are: oil and oil derivatives, iron and steel, ores and imported raw materials for the new industrial facilities in the free economic zones.



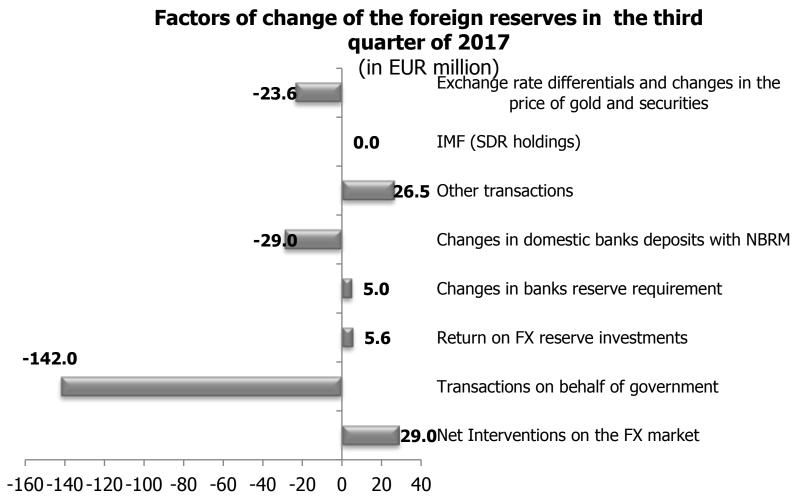
Source: NBRM.

On an annual basis, the relative consumer prices and the relative producer prices decreased by 0.3% and 3.1%, respectively. The NEER has appreciated by 1.3% on an annual basis.

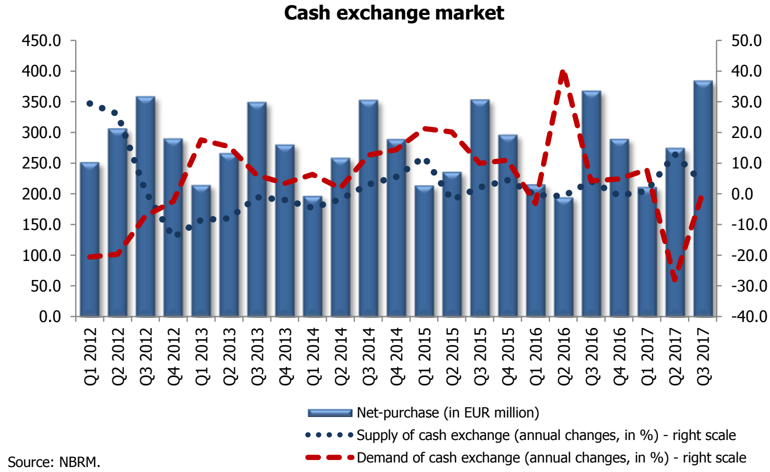
As of 30 September 2017, the gross foreign reserves stood at Euro 2,271.4 million, which is a decrease of Euro 128.6 million compared to the end of the second quarter of 2017. The decrease in foreign reserves mostly arises from the transactions for the account of the Government and to a lesser extent, from the fall in the foreign currency deposits of the domestic banks with the NBRM and from the currency changes and the changes in the price of gold. On the other hand, the NBRM interventions in the direction of purchase on the foreign exchange market had positive influence, as well as the Other category.



Source: NBRM.



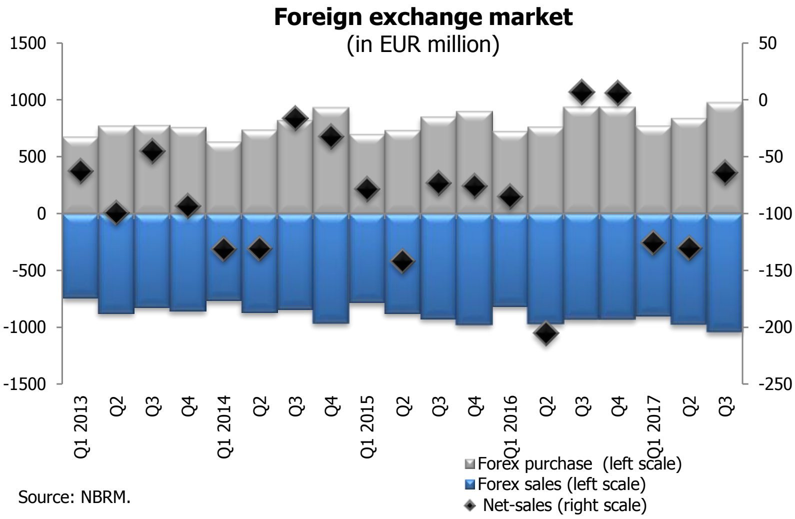
Source: NBRM.



Source: NBRM.

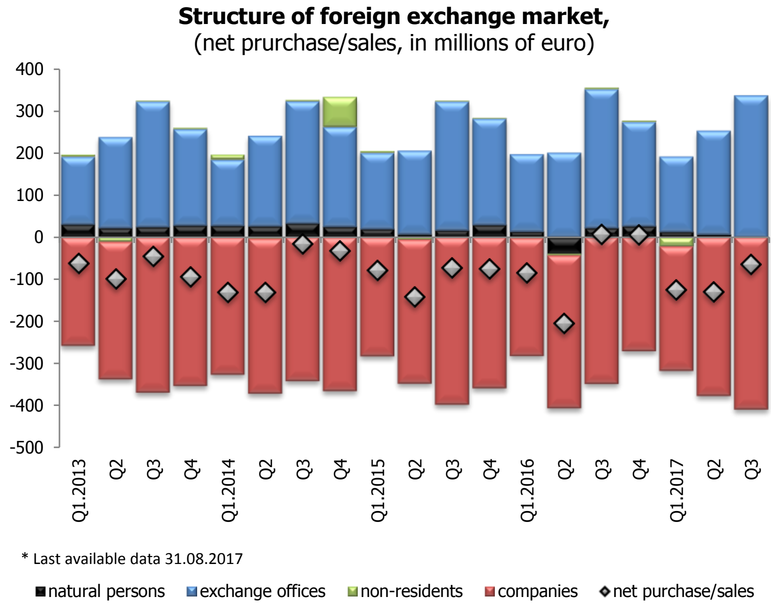
Recent data on currency exchange operations as of September 2017 indicate faster annual increase in the supply of relative to the demand for foreign currency.

The net purchase on the currency exchange market registered within 1 July 2017 – 30 September 2017 period equaled Euro 384.5 million, which is annual increase of 4.4%.



Source: NBRM.

In the third quarter of 2017, the foreign exchange market of banks reported a net sale of foreign currency of Euro 63.8 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.



* Last available data 31.08.2017

Source: NBRM

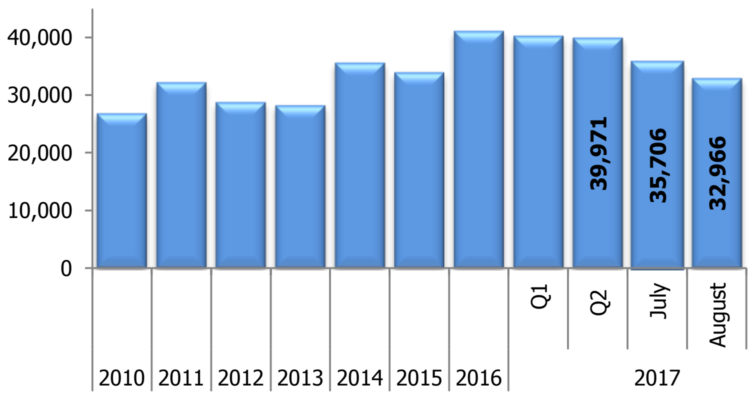
Sector-by-sector analysis shows that these changes arise from the higher net sales in companies and the sales in non-residents (as opposed to the small last year's net purchase).

The situation regarding the monetary instruments in August decreased on a monthly basis and is lower compared to the end of the second quarter[11]. Such performances are contrary to the forecasted growth of the monetary instruments and liquidity withdrawal from the banking system in the third quarter of the year, according to the April forecast.

The net foreign assets of the NBRM, after the fall in July, moderately increased in August. With the performance in August, the net foreign assets of the NBRM are lower compared to the end of June, whereby the decrease is larger than forecasted for the third quarter with the April forecasts. Total government deposits (after the monthly decline in July) in August registered growth. Their balance is lower compared to the end of June, whereby the decrease is with a smaller intensity compared to the expectations for the third quarter, according to the April forecast.

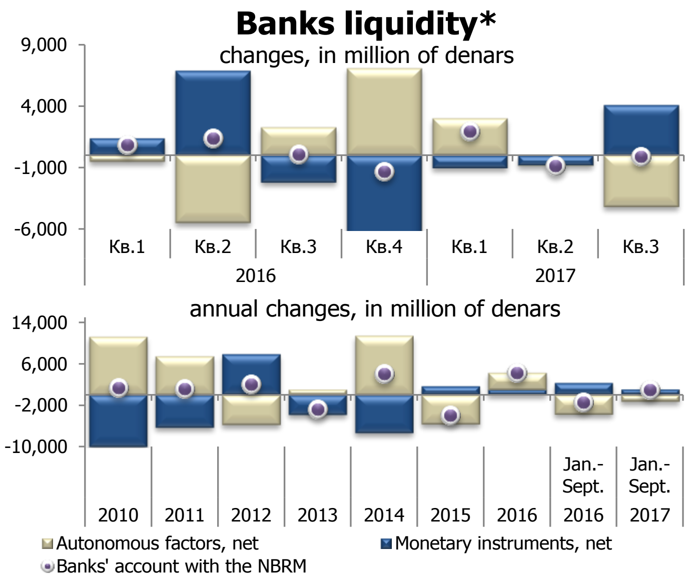
The reserve money increased also in August (for the third consecutive month). The increase in August fully arises from the growth of total liquid assets of banks, unlike the previous month, when the growth of the reserve money was affected by the increase in currency in circulation. Compared to the end of the second quarter, the balance of the reserve money is higher, whereby the growth is in line with the expected dynamics for the third quarter.

Monetary policy instruments
(in MKD million)

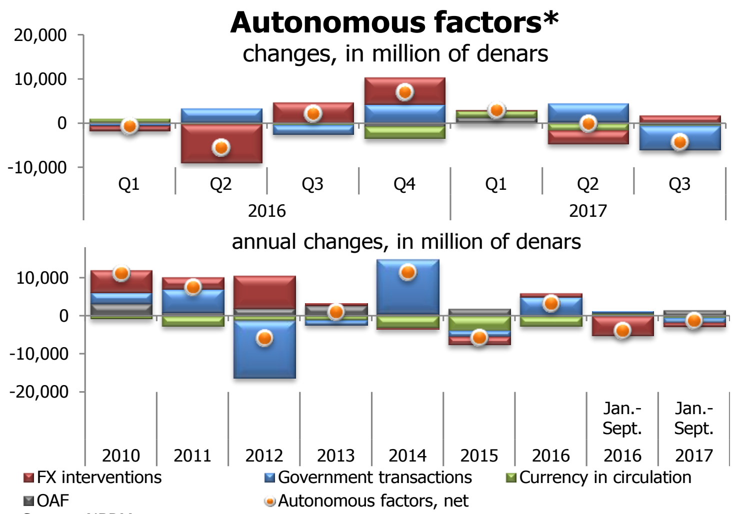


Source: NBRM.

[11] The NBRM reduced the supply of CB bills also in August (for the second consecutive month). Banks' interest in CB bills was within the offered amount (Denar 25,000 million), whereby liquid assets were emitted in the banking system through CB bills in the amount of Denar 2,361 million. Viewed from the balance sheet perspective, the decrease in the situation regarding the monetary instruments in August was also affected by the maturity of the foreign currency deposits (in equivalent of Euro 29.9 million), while the net effect of the deposits with the NBRM was in the opposite direction (Denar 1,315 million), with further banks' interest to place the excess liquid assets in deposits with the NBRM.

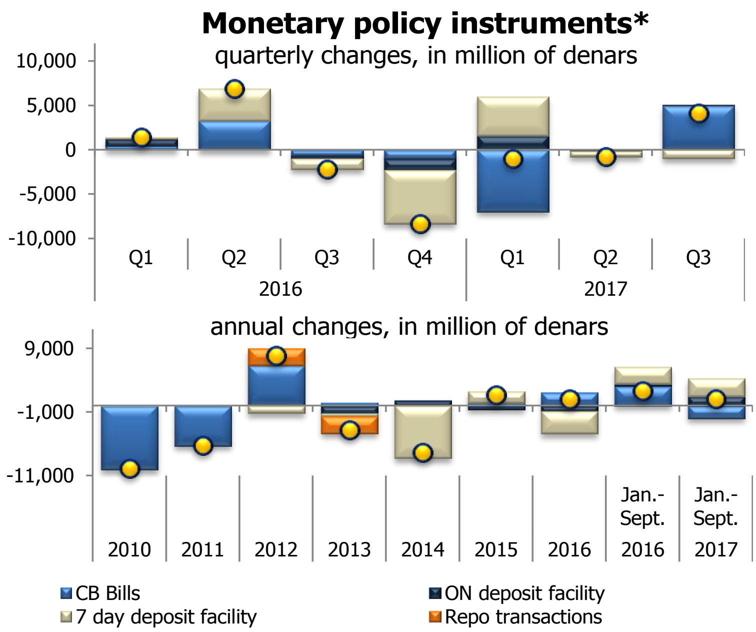


Source: NBRM
* positive change: liquidity creation, negative change: liquidity withdrawal

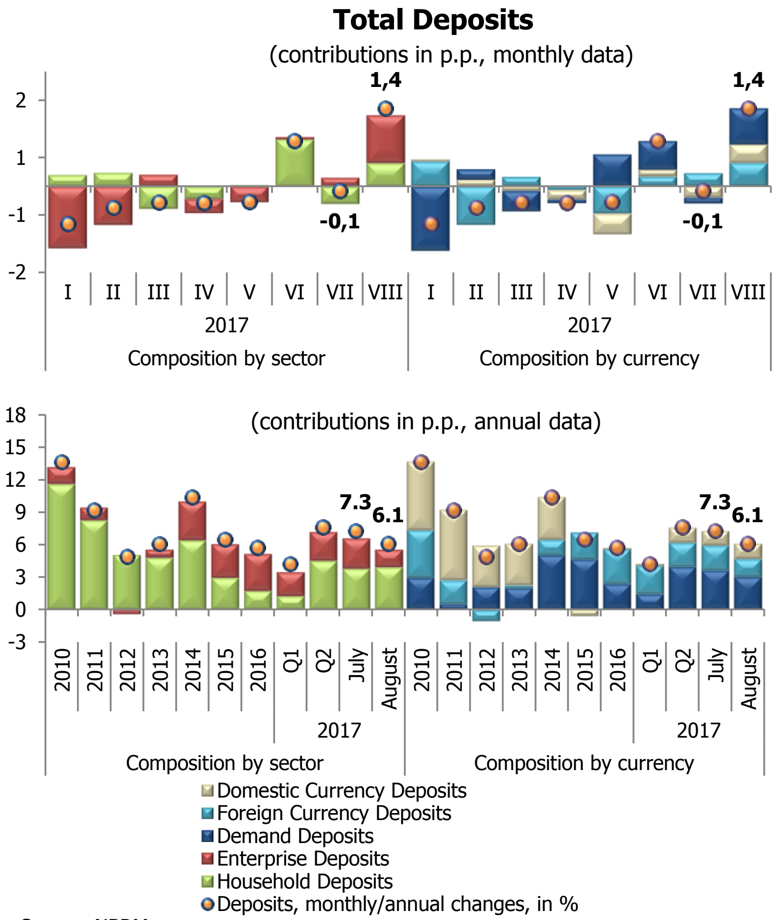


Source: NBRM
* positive change: liquidity creation, negative change: liquidity withdrawal

According to operational liquidity data, in September, the liquidity of the banking system registered a moderate decrease on a monthly basis. The fall in liquidity almost 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. Autonomous factors also reduced the banks' liquidity, but their effect was small. Denar government deposits registered an increase, thereby reducing liquidity, while currency in circulation and the NBRM foreign exchange interventions increased the liquidity in the banking system.



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

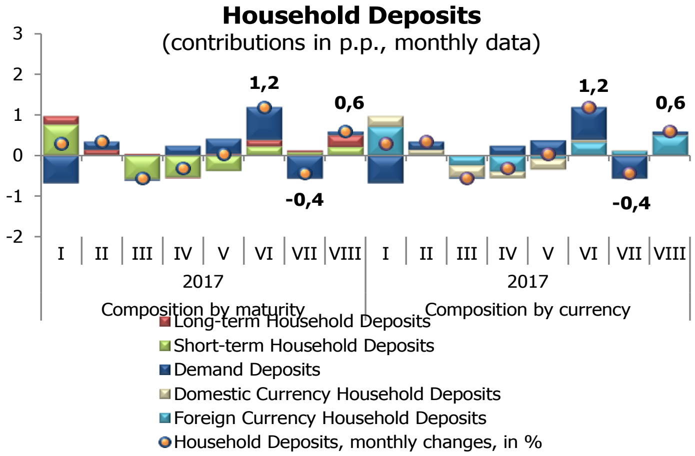


Source: NBRM.

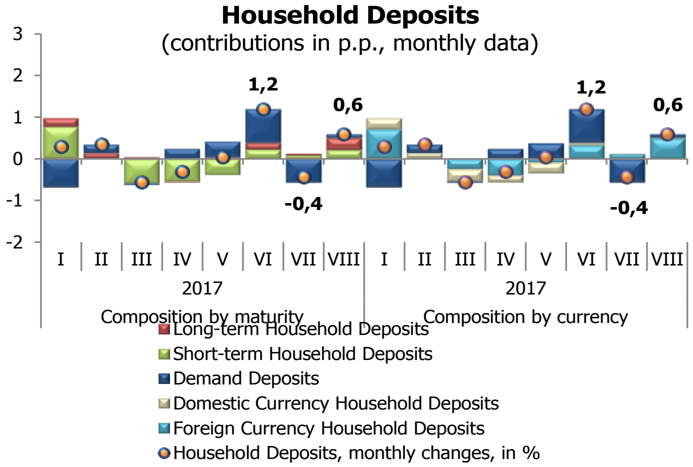
In August 2017, total deposits in the banking sector registered solid growth on a monthly basis, despite the decrease in the previous month. Analyzed by sector, the monthly increase (of 1.4%) in August was mostly due to corporate deposits, amid simultaneous growth of household deposits. Analyzing the currency structure, denar deposits in August, in contrast to the previous month, made a positive contribution to the monthly growth of total deposits, and the contribution of foreign currency deposits was also positive and moderately higher.

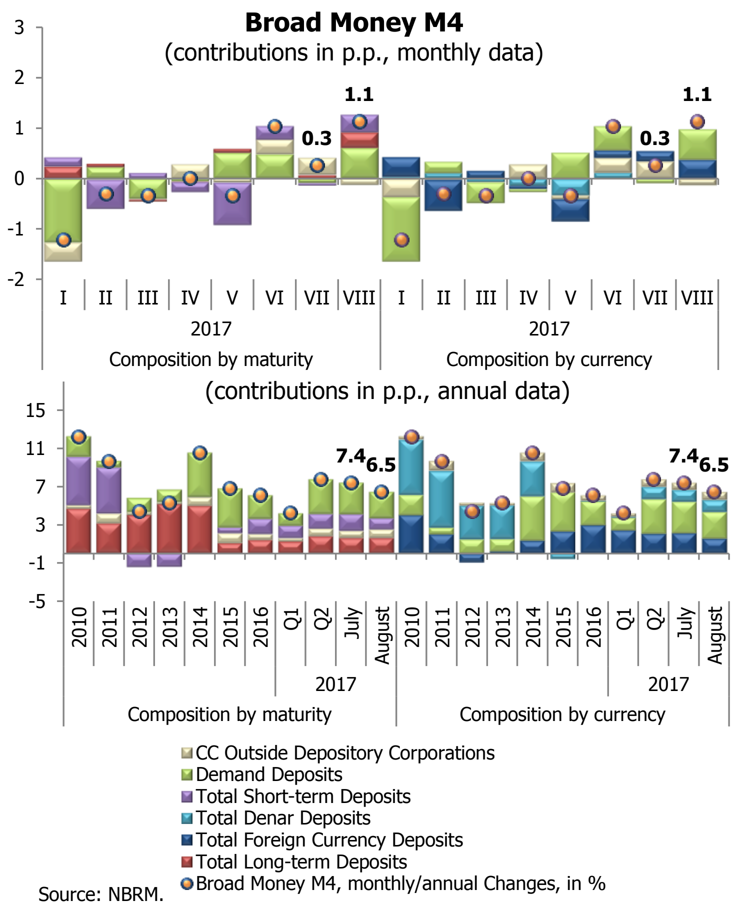
As of August, total deposit performance is in line with the forecast.

In August, the annual growth rate of total deposits equaled 6.1% (7.3% in July), which is below the growth for the third quarter of 2017 (of 7.9%) as forecasted in April. This deviation is mainly the result of the lower performance of total deposits in the second quarter, compared to the expectations with the April forecast. On an annual basis, the growth rate of total deposits slowed down in August (for the second consecutive month), whereby the slowdown mostly reflects the pace of growth of foreign currency deposits and corporate deposits. The performances in August contributed to slight increase in the share of denar deposits in total deposits (from 58.6% to 58.8%).



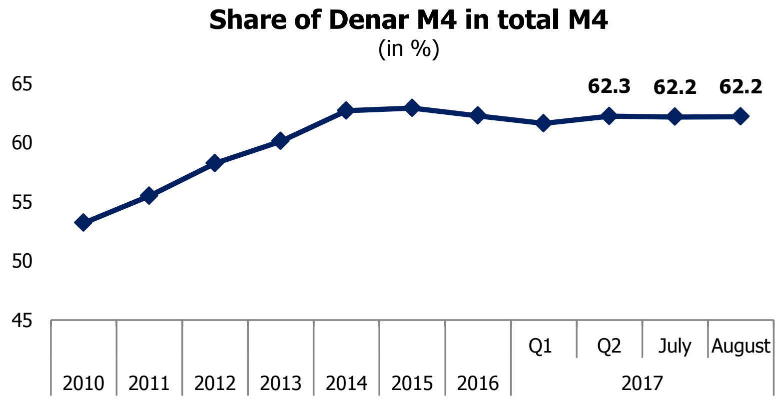
In August, household deposits increased on a monthly basis, despite their decrease in the previous month. Analyzing by currency, the monthly increase in household deposits (of 0.6%) is mostly due to the more intensive growth of foreign currency deposits, but moderate positive contribution to the monthly growth was also made by denar deposits, despite their fall in the previous month. As a result of these developments, in August, the share of denar deposits (with demand deposits) in total household deposits decreased from 51.0% to 50.8%.



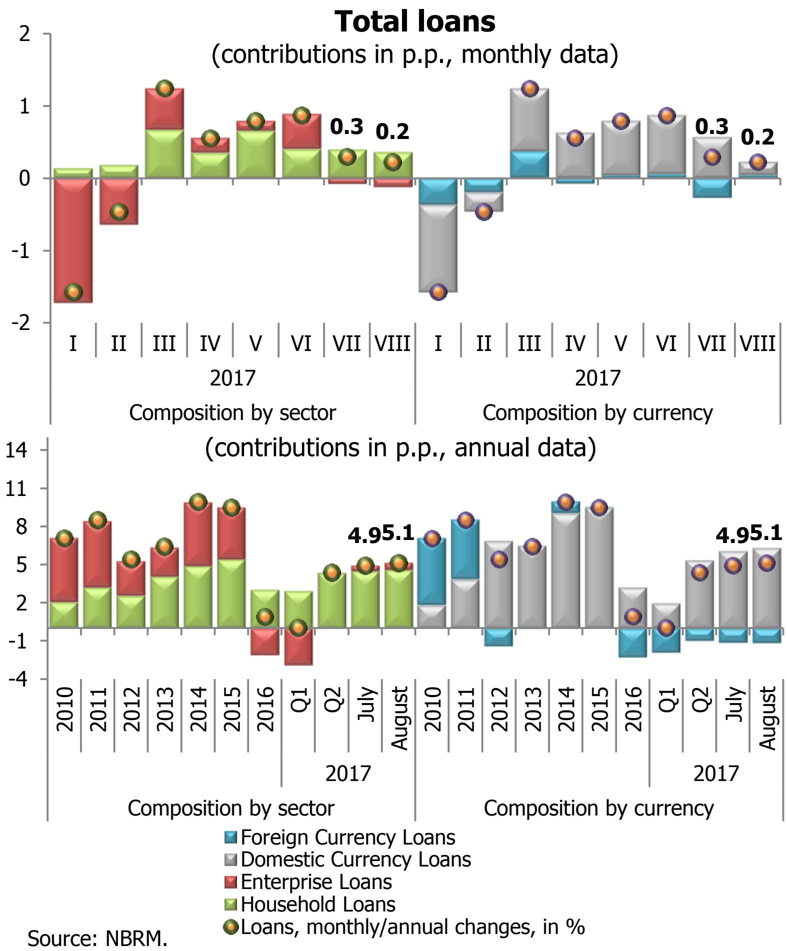


Source: NBRM.

During August, broad money M4 continued to increase, at a faster pace compared to the previous month. The monthly growth of the broadest money supply of 1.1% is fully 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 6.5% (7.4% in July), which is below the forecasted growth of 7.9% for the third quarter of 2017.** On an annual basis, the growth rate of the broad money slowed down in August, whereby the slowdown mostly reflects the pace of growth of foreign currency deposits and to a lesser extent of demand deposits. With the performances in August, the share of the denar share in the total money supply remained at the level of the previous month.



Source: NBRM.



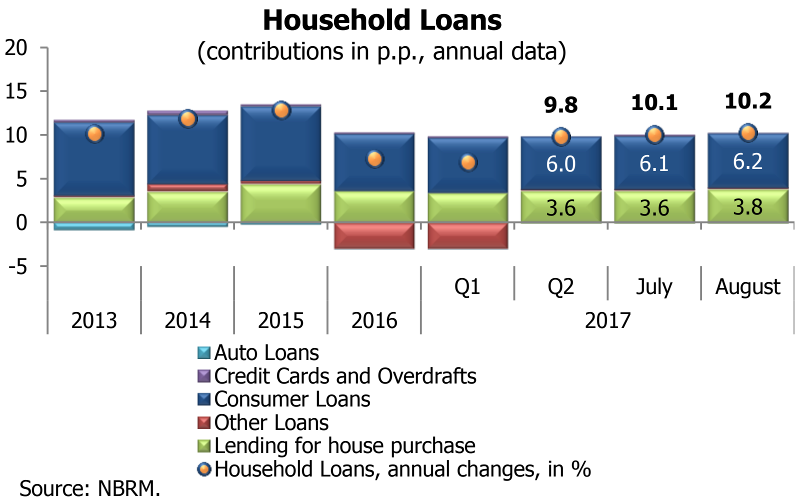
Source: NBRM.

In August, total loans to the private sector continued to grow, with a slightly lower intensity compared to the previous month. Analyzed by sector, the monthly increase in the total lending (of 0.2%) fully arises from the performances in households, while corporate loans register a decline for the second consecutive month.

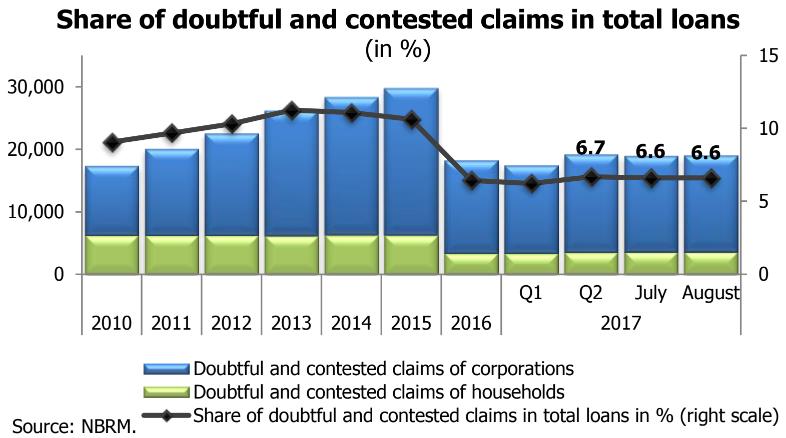
As of August, total loan performance is weaker than forecasted.

On an annual basis, total loans in August grew by 5.1%, which is higher than forecasted (growth of 4.8%) for the third quarter of 2017, as a result of the improved performance at the end of the second quarter. Observing the currency, the annual growth of total loans also in August 2017 stems from the growth of denar loans, amid continued annual decline in foreign currency loans.

Loans to households in August continued to moderately increase on an annual basis, whereby housing and consumer loans still make the dominant contribution to the growth.

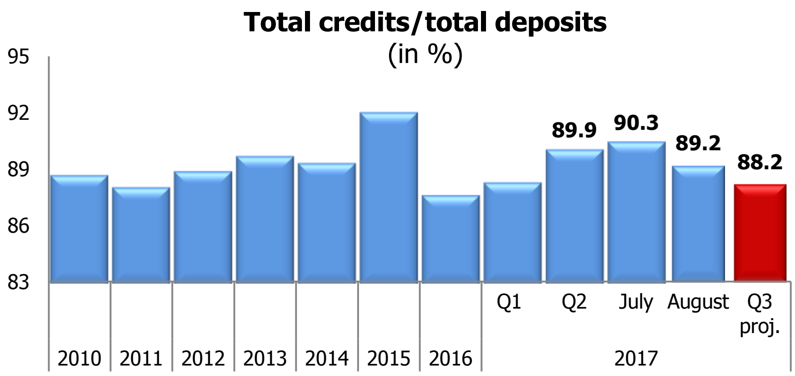


Source: NBRM.



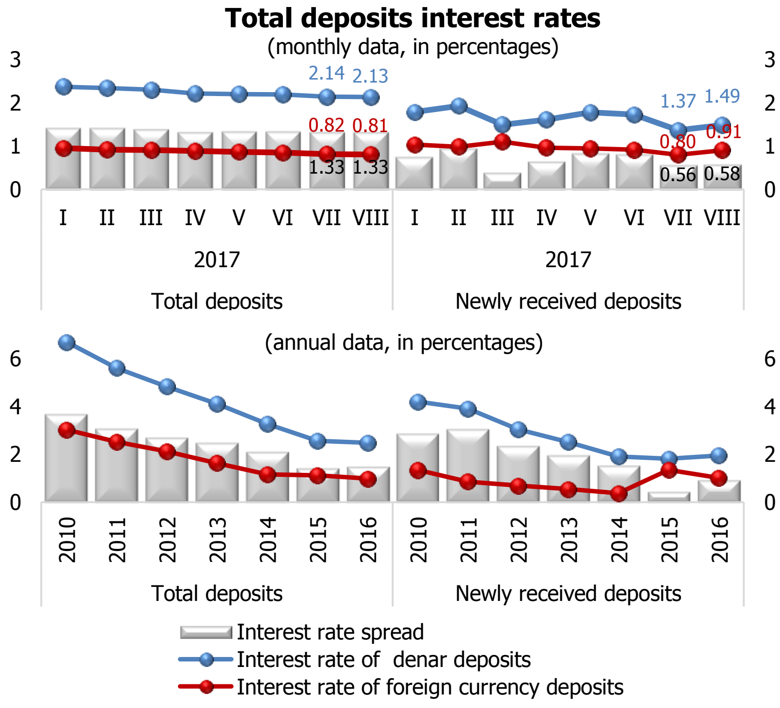
Source: NBRM.

In August, the **share of doubtful and contested claims in total loans** registered no changes and remained at the level of 6.6% as in the previous month.

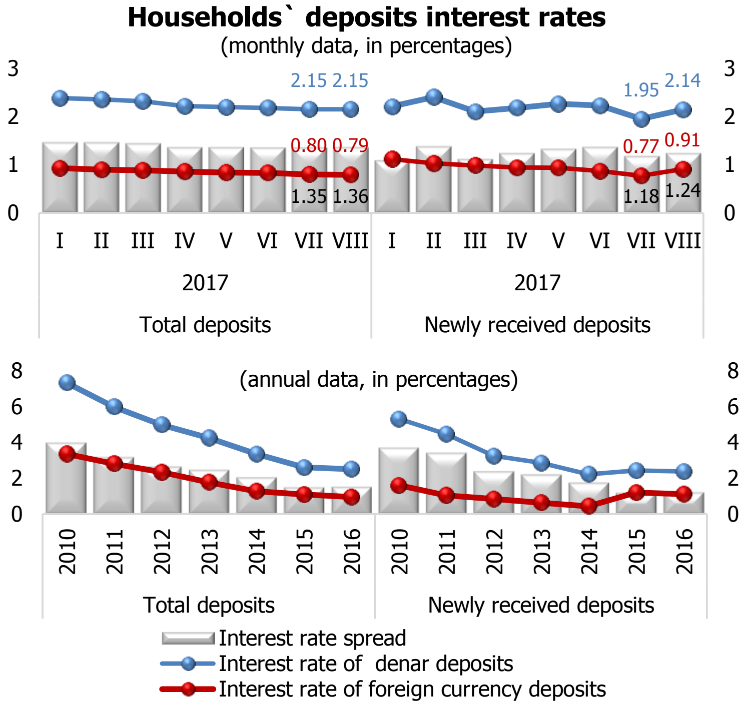


Source: NBRM.

Utilization of the deposit potential for lending to the private sector in August decreased on a monthly basis, from 90.3% to 89.2%. August performance is higher compared to the expectations for the third quarter of 2017, according to the April forecast.

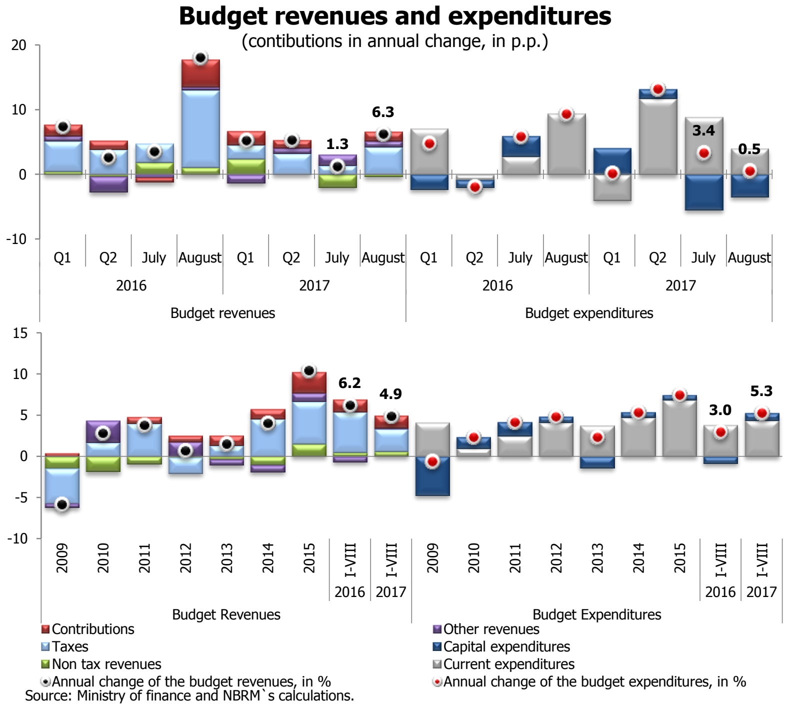


In August, the interest rates on total deposits registered no significant change compared to the previous month, whereby the interest rate spread between the interest rates on denar and foreign currency deposits remained at the level of 1.3 percentage points. For **newly accepted total deposits**, the interest spread between denar and foreign currency deposits remained at a relatively stable level of 0.6 percentage points, given the small increase in the interest rates on newly accepted denar and foreign currency deposits. However, regarding the interest rates on the newly accepted deposits, it should have in mind that they characterize with variable movements[12].



In August, the **interest rates on household deposits** registered no changes compared to the previous month, whereby the interest rate spread between denar and foreign currency interest rates remained at a relatively stable level of 1.4 percentage points. **New household deposits** registered a slight increase in the interest rates on newly accepted denar and foreign currency deposits, whereby the interest rate spread remained at the level of 1.2 percentage points.

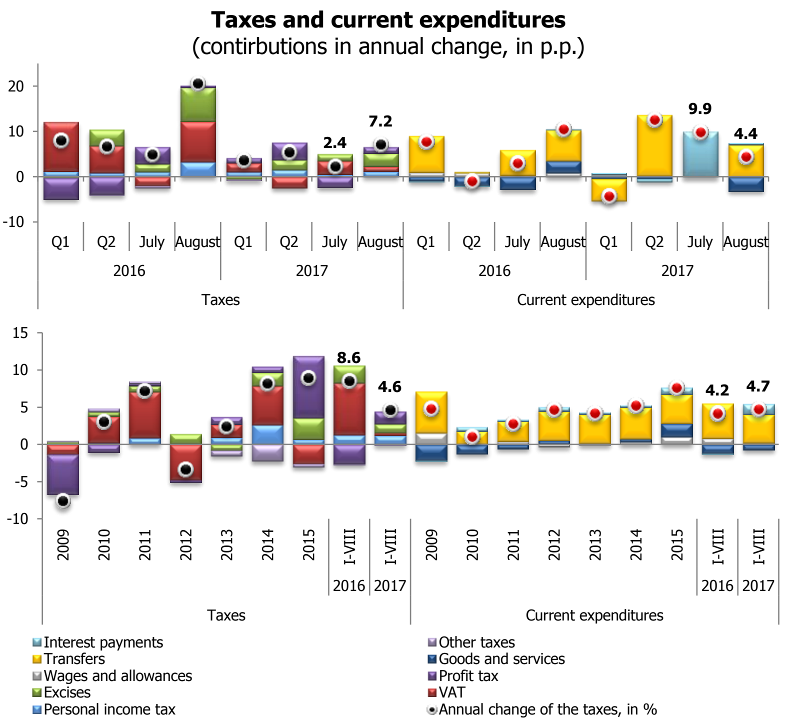
[12] Volatility of interest rate on newly accepted deposits results from the fact that they have been driven by the volume of newly accepted deposits (which can vary from month to month) and their interest rate.



Source: Ministry of finance and NBRM`s calculations.

In August, total revenues and total expenditures in the Budget of the Republic of Macedonia (central budget and budget of funds) grew by 6.3% and 0.5%, respectively, on an annual basis. The annual increase in budget revenues in August 2017 is mostly due to the inflows based on taxes, while the current expenditures make a positive contribution to the growth of budget expenditures, while the contribution of the capital expenditures is negative.

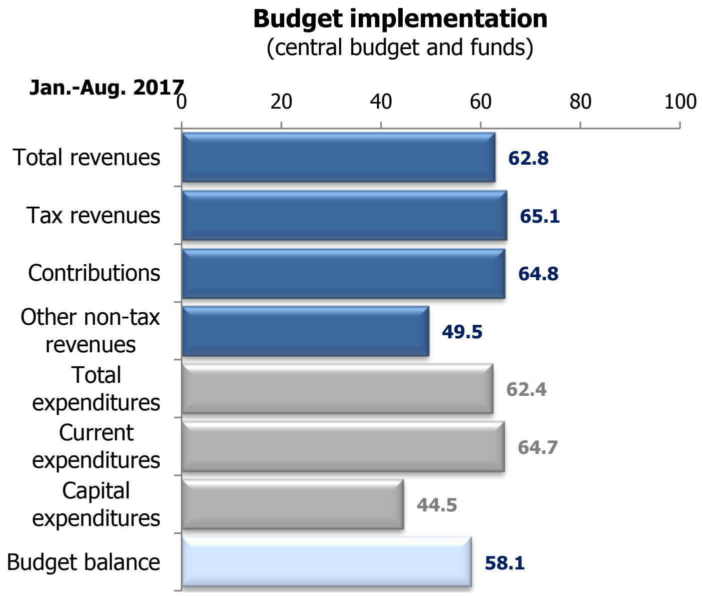
In the period January-August 2017, total budget revenues increased by 4.9% compared to the same period last year. The improved performance mostly arises from the higher realization in taxes and contributions, and to a lesser extent, from non-tax revenues. In the period January-August 2017, the budget expenditures increased by 5.3% on an annual basis, which is mostly due to the higher current expenditures, and to a lesser extent, to capital expenditures.



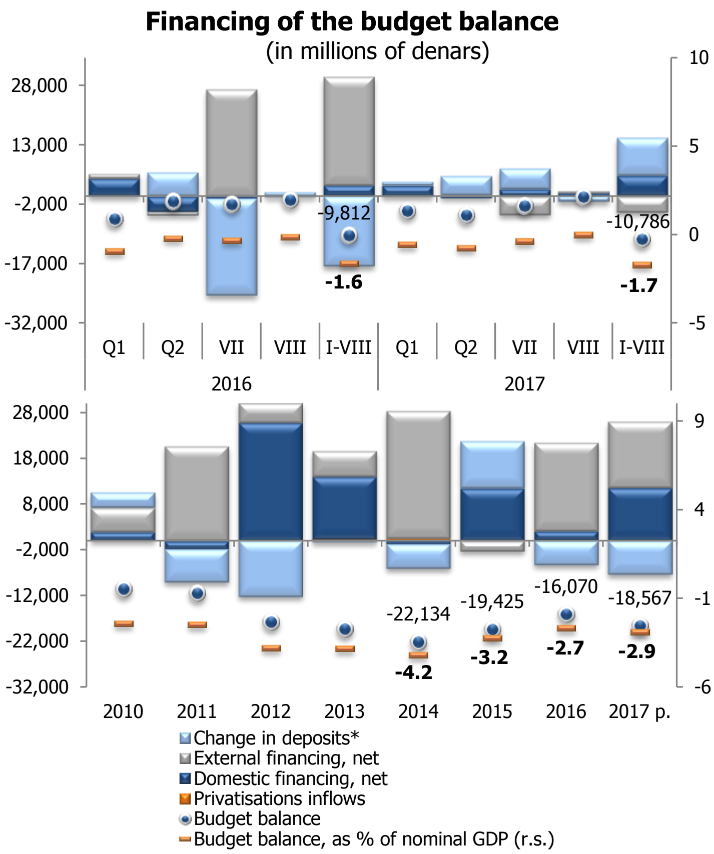
Source: Ministry of finance and NBRM`s calculations.

In August, the inflows of taxes in the Budget of the RM were higher by 7.2% on an annual basis, whereby excise duties make the dominant contribution to the growth. On the other hand, the current expenditures in August were higher by 4.4% on an annual basis, with dominant contribution of transfers.

In the period January-August 2017, the inflows of taxes grew by 4.6% on an annual basis, whereby analyzed by individual tax categories, the largest contribution to the annual growth was made by the income from the profit tax, inflows of personal income tax and inflows of excise duties. Regarding the current expenditures, the growth rate in the analyzed period equaled 4.7% on an annual basis, with dominant contribution of transfers.



Source: Ministry of Finance and NBRM's calculations.



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

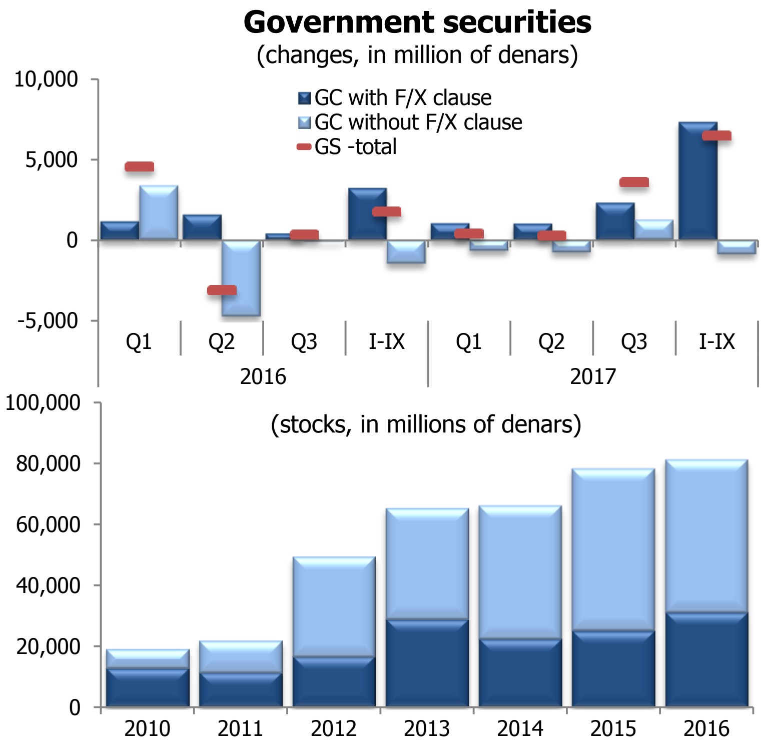
In the period January-August 2017, the realized budget revenues constituted 62.8% of the revenues projected for 2017, respectively, under the Budget Revision[13]. Analyzed by individual categories of budget revenues, higher performance was registered in taxes and contributions (realization of 65.1% and 64.8%, respectively), while the realization of the category of other non-tax revenues was lower and accounted for 49.5%.

Analyzing budget expenditures, in the period January-August 2017, 62.4% of the planned expenditures for 2017 were realized, which is mostly due to the realization of the current expenditures (64.7% of the annual plan), while the realization of the capital expenditures amounted to 44.5% of the annual plan.

In the period January-August 2017, the Budget of the Republic of Macedonia registered a deficit of Denar 10,786 million, which is 1.7% of the nominal GDP[14]. In the period January-August 2017, the realized budget deficit constituted 58.1% of the deficit projected for 2017, respectively, under the Budget Revision.

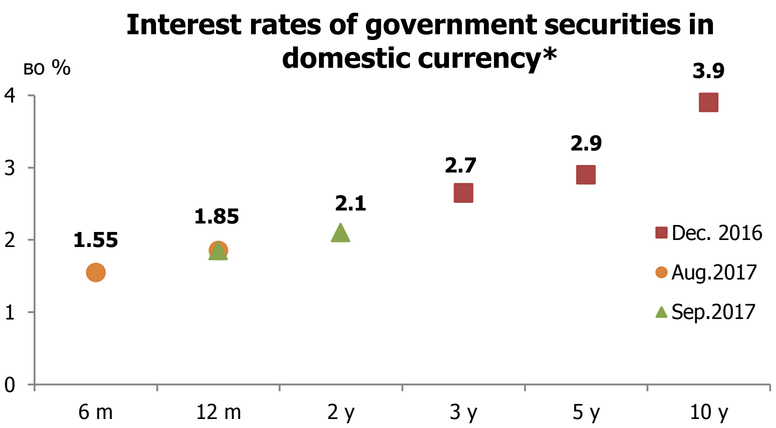
The deficit registered within January-August 2017 period was financed by domestic sources through the withdrawal of deposits from the government account with the National Bank and with the net issuance of new government securities on the domestic market.

[13] The comparison is made with the Budget Revision for 2017 of August 2017.
[14] The analysis uses the NBRM April forecasts for the nominal GDP for 2017.



Source: NBRM.

At the end of September 2017, the stock of issued government securities on the domestic market was Denar 87,848 million, which is higher by Denar 3,607 million, compared to the end of the second quarter. On a cumulative basis, for the period January-September 2017, government securities increased by Denar 6,477 million, constituting 56.3% of the amount projected for 2017[15].



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

Source: Ministry of Finance.

In September 2017, the interest rates on government securities remained unchanged compared to the previous month[16].

[15] The comparison is made with the annual plan with the Budget Revision for 2017 of August 2017.
[16] At the auctions of government securities in September, 12-month treasury bills without FX clause, 12-month treasury bills with FX clause and 2-year government bonds without FX clause were offered and executed.

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[17], 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 0.75% 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.

[17] 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.